New Zealand's new cartel regime
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A. Introduction

1. The Commerce (Cartels and Other Matters) Amendment Bill (the Bill) is currently awaiting its second reading in New Zealand's Parliament. The Bill, which has been some time in gestation and which has been the subject of vigorous debate, overhauls New Zealand's cartel rules.

2. Initially, and perhaps even now, the most controversial aspect of the Bill has been to make engaging in cartel conduct a potentially criminal offence. Individual offenders can go to jail for up to seven years. By introducing criminal sanctions, the Bill brings New Zealand into line with many of our major trading partners, notably Australia, the United States, Canada and the United Kingdom. Despite this – and in fact in some cases because of this – many stakeholders advocated strongly against introducing a criminal sanction.

3. Neither the Commerce Commission nor I took a position on whether or not cartel conduct should be criminalised. We do not regard such a position to be appropriate. That said, we have made submissions on the way the offence is drafted and in particular around the proposed honest belief defence to the criminal offence.

4. Allied to the introduction of the criminal offence, and the potential risk of over-deterrence, policy makers recognised that there was a need to redefine what cartel conduct is, and when such conduct will be deemed to be illegal per se. The inevitable consequence of a per se rule is that it will capture and prohibit some conduct which is in fact pro-competitive or competitively neutral.

5. The need to guard against these Type 1 errors was well summarised by the Minister in his first reading speech[1]:

> The Government believes that a competitive, innovative economy trading successfully with the world is the best way to build sustainable economic growth that creates jobs and grows incomes. Effective competition underpins the productivity of individual firms and the public sector, and as a result plays an important role in the overall economy. The Bill provides a vehicle to build a stronger, more competitive economy by encouraging pro-competitive collaboration and innovation, and deterring hard-core cartel conduct.

6. In this respect, New Zealand's price fixing prohibition, and the exemptions to mitigate the negative impacts of its per se nature, were seen as long overdue for an overhaul. In particular, the joint venture exemption to price fixing was seen as overly form based and restrictive, and therefore unable to deal with modern commercial arrangements.

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1 (24 July 2013) 682 NZPD 3868.

7. The new cartel prohibition broadly follows the OECD model for a cartel prohibition, and introduces new exemptions to define the scope of the per se rule. Specifically, the Bill includes a new substance based collaborative activity exemption. This exemption draws on approaches taken in other jurisdictions (in particular, the United States), although its final form is, to my knowledge, novel, unique and without comparator anywhere else in the world.

8. Also novel is the idea of a pre-arrangement clearance regime for collaborative activities. The regime is designed to be similar to our merger clearance regime. Policy makers have stated that the purpose of the clearance regime is to allow businesses to manage residual risk around the application of the cartel prohibition. Once again I am unaware of a comparator to this regime anywhere else in the world.

9. We will shortly release Draft Guidelines on the new cartel prohibition, the exemptions, and the clearance process. These will be available on our website. However, in this paper I will briefly outline the changes being made to the Act.

B. Current provisions of the Commerce Act

Prohibition on price fixing – per se illegality

10. Price fixing is illegal per se in New Zealand. This is because, as New Zealand's Court of Appeal, has recognised that '[c]artel conduct has a damaging impact upon society: it results in high prices, misallocation of resources, and corrodes the incentive for firms to innovate'.[2]

11. However, price fixing is currently prohibited in New Zealand in a rather circuitous fashion.

12. Section 27 of the Commerce Act sets out a general prohibition on anti-competitive arrangements. Specifically, section 27 prohibits provisions in contracts, arrangements or understandings (I use the term arrangement to cover all three) that have the purpose, effect or likely effect of substantially lessening competition in a market.

13. Section 30 of the Commerce Act then defines arrangements between competitors containing provisions that fix, control or maintain prices, to be price fixing arrangements. Such price fixing arrangements are deemed to substantially lessen competition in breach of section 27.

14. The result of this is that a person does not breach our price fixing section (section 30), but rather becomes liable because such an arrangement is deemed to breach our general prohibition on anti-competitive arrangements. The effect is that price fixing is per se illegal as it is in many other jurisdictions around the world.

15. However, as in other jurisdictions, it is recognised that such a per se rule will inevitably capture some conduct which is in fact pro-competitive or competitively neutral. Indeed, that is the policy trade off associated with a per se rule. As a result, the impost of the per se rule is lessened to some extent by a series of exemptions in

[2] *Commerce Commission v Visy Board Pty Ltd* [2012] NZCA 383, at [32].

the Act, and by the ability for parties to apply for authorisations of price fixing arrangements.

Current exemptions in the Commerce Act

16. The Commerce Act currently contains three limited exemptions to the per se price fixing rule. These are in place to mitigate the potential for the per se rule to over-reach, ie, they are intended to mitigate the incidence of Type 1 errors. The three exemptions cover:

16.1 certain joint ventures;

16.2 recommended pricing by industry associations; and

16.3 joint buying and promotion arrangements.

Joint venture exemption

17. The Act contains a form-based joint venture exemption.

> **Joint venture pricing exempt from application of section 30**
>
> (1) For the purposes of this section—
>
> (a) joint venture means an activity in trade—
>
> (i) carried on by 2 or more persons, whether or not in partnership; or
>
> (ii) carried on by a body corporate for the purpose of enabling 2 or more persons to carry on that activity jointly by means of their joint control, or by means of their ownership of shares in the capital, of that body corporate or an interconnected body corporate:
>
> (b) ….
>
> (2) Nothing in section 30 applies to a provision of a contract or arrangement entered into, or an understanding arrived at for the purposes of a joint venture, to the extent that the provision relates to—
>
> (a) the joint supply by the parties to the joint venture, or the supply by the parties to the joint venture in proportion to their respective interests in the joint venture, of goods jointly produced by those parties in pursuance of the joint venture; or
>
> (b) the joint supply by the parties to the joint venture of services in pursuance of the joint venture, or the supply by the parties to the joint venture in proportion to their respective interests in the joint venture, of services in pursuance of, and made available as a result of, the joint venture; or
>
> (c) in the case of a joint venture carried on by a body corporate in terms of subsection (1)(a)(ii),—

(i) the supply by that body corporate of goods produced by it in pursuance of the joint venture; or

(ii) the supply by that body corporate of services in pursuance of the joint venture, not being services supplied on behalf of the body corporate by a person who is the owner of shares in the capital of the body corporate, or a body corporate that is interconnected with such a person.

18. As can be seen, the exemption is horribly complicated and prescriptive and is form rather than substance based.

19. Indeed, the main criticism levelled at the joint venture exemption is that it focuses on how an arrangement is structured, as opposed to its substance.[3] This means that pro-competitive or competitively neutral collaborations between competitors fall outside the exemption only because they do not meet certain structural requirements.

20. This structural approach has been argued to mean that the exemption is unable to cope with the way collaboration occurs in many sectors, and favours incorporated joint ventures over unincorporated joint ventures.

21. For these reasons, the exemption was not widely regarded as being an appropriate filter to apply to mitigate the impacts of the per se price fixing prohibition, and so in need of amendment.

Recommended pricing

22. The Commerce Act deems any recommendations made by associations of persons to its members to be an agreement between its members. As such, a pricing recommendation could fall foul of the per se price fixing rule.

23. The quirky exemption in section 32 provides a specific exemption for pricing recommendations made by an association with 50 members or more. However, the exact policy rationale is not easy to decipher. Indeed, policy makers have indicated that they believe there 'is little economic justification for this exemption' and noted that the OECD specifically recommended it be repealed.[4]

[3] See for example New Zealand Contractors Federation "Commerce Committee: Commerce (Cartels and other Matters) Amendment Bill) and Business New Zealand "The Commerce Select Committee "Commerce (Cartels and Other Matters) Amendment Bill".

[4] Ministry of Economic Development *Exposure draft bill – explanatory materials*, June 2011, at [59]. (Available at http://www.med.govt.nz/business/competition-policy/cartel-criminalisation/exposure-draft-bill-explanatory-material).

Joint buying and promotion agreements

24. The Act also contains an exemption for joint buying and promotion agreements.

> **Joint buying and promotion arrangements exempt from application of section 30**
>
> Nothing in section 30 applies to a provision of a contract, arrangement, or understanding that—
>
> (a) relates to the price for goods or services to be collectively acquired, whether directly or indirectly, by parties to the contract, arrangement, or understanding; or
>
> (b) provides for joint advertising of the price for the resupply of goods so acquired

25. While there is a robust policy rationale for such an exemption, there has been some confusion as to how in fact this exemption has applied in practice.[5]

Authorisations

26. Even if none of these exemptions apply, a price fixing arrangement may nevertheless be 'authorised' provided the arrangement generates benefits to the New Zealand public that outweigh the harm of the agreement. As with an exemption, the consequence of the Commission authorising an agreement is that it cannot be challenged by the Commission or any third party.[6]

C. New prohibition on cartel conduct

27. The Bill repeals the current prohibition on price fixing, and introduces a new per se prohibition on cartel provisions. The Bill also overhauls the exemptions to the per se cartel rule.

28. These changes are an attempt to clarify the scope of the prohibition and to allow market participants to identify for themselves what conduct is per se illegal and what conduct is not.[7] I outline these new exemptions in the next section of this paper.

New prohibition on cartel provisions

29. The new cartel prohibition is based on the OECD's definition of hard core cartel conduct. In 1998 the OECD defined hard core cartel behaviour in the *Recommendation concerning Effective Action against Hard Core Cartels* (1998

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5 See for example Franchise Association of New Zealand "Submission to the Commerce Select Committee", Mitre 10 "Submission to the Commerce Select Committee on the Commerce (Cartels and Other Matters) Amendment Bill" and New Zealand Retailers Association "Submission to the Commerce Select Committee, Commerce (Cartels and Other Matters) Amendment Bill.

6 An example of a price fixing arrangement that was authorised was a joint marketing arrangement between Shell, Todd and OMV to jointly sell gas from their jointly owned Pohokura gas field.

7 Regulatory impact statement, at [39] (available at http://www.med.govt.nz/business/competition-policy/pdf-docs-library/Cartel%20Criminalisation-RIS.pdf)

Recommendation) with the intention of capturing international consensus on anti-cartel enforcement.[8]

> A 'hard core cartel' is 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.

30. Consistent with international best practice, the Bill clarifies that along with price fixing, allocating markets, rigging bids, and restricting output are prohibited cartel conduct. However, it is fair to say that the changes in the prohibition itself are more in the nature of a renovation of the existing approach rather than a substantive change.

31. Section 30 of the Bill is as follows:

> **Prohibition on entering into or giving effect to cartel provision**
>
> (1) No person may, unless an exemption in section 31, 32, or 33 applies,—
>
> (a) enter into a contract or arrangement, or arrive at an understanding, that contains a cartel provision; or
>
> (b) give effect to a cartel provision.
>
> (2) See section 80 for liability to a pecuniary penalty, and section 82B for criminal liability, for contravention of this section.

32. Cartel provision has been defined in section 30A of the Bill[9]:

> **Meaning of cartel provision and related terms**
>
> (1) A cartel provision is a provision, contained in a contract, arrangement, or understanding, that has the purpose, effect, or likely effect of 1 or more of the following:
>
> (a) price fixing:
>
> (b) restricting output:
>
> (c) market allocating.

33. The Bill then further defines price fixing, restricting output and market allocating. Importantly, however, the three types of cartel provisions are not mutually exclusive and may overlap. For example, a provision may amount to both price fixing and market allocation.

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8 OECD, *Recommendations of the Council Concerning Effective Action Against Hard Core Cartels,* 25 March 1998.

9 The Bill as introduced included bid rigging as a type of cartel provision. The reference to bid rigging was removed by the Select Committee for reasons of 'simplicity and clarity'. The Committee explained that 'defining bid rigging as an additional and overlapping category would create uncertainty, and that prohibiting the other categories of cartel conduct (price fixing, restricting output, and market allocating) would adequately prevent anti-competitive bidding practices'.

34. Price fixing occurs when parties enter into or give effect to an arrangement fixing, controlling or maintaining:

    34.1 the price of goods or services that two or more of the parties to the arrangement supply or acquire in competition with each other; or

    34.2 any discount, allowance, rebate, or credit of goods or services that that two or more of the parties to the arrangement supply or acquire in competition with each other.

35. Output restrictions between competing sellers of goods or services occur where two or more of those competing suppliers arrange to prevent, restrict, or limit:

    35.1 their supply, production, or likely supply or production of those goods; or

    35.2 their supply, capacity, or likely supply or capacity to supply those services.[10]

36. Market allocating, or market sharing, between competing sellers of goods or services is defined to occur where two or more of those sellers arrange to allocate between themselves the particular customers to whom, or the particular geographic areas in which, each will supply their respective goods or services.[11] Market allocating, or market sharing, between competing buyers of goods or services occurs where two or more of those buyers arrange to allocate between themselves the particular suppliers from whom, or the particular geographic areas in which, each will acquire their goods or services.

Is the scope of the new prohibition any different to the current prohibition?

37. While the new prohibition includes specific reference to market allocation and capacity limitation as types of cartel conduct, we do not see the new prohibition as materially extending the scope of the current per se price fixing prohibition.

38. Rather, we see the new Bill as being more descriptive of the types of conduct we already consider are likely captured by the current price fixing prohibition. For example, we or other regulators have successfully proceeded against companies that were allocating customers,[12] or that were limiting capacity.[13]

39. That said there will be cases at the margin which may become easier for us to pursue with the newly formulated test.

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10 Output restrictions between competing buyers of goods or services occur where two or more competing buyers of goods or services arrange to prevent, restrict, or limit their acquisition or likely acquisition of those goods or services.

11 Under the Bill, market allocation does not only concern sales to final customers. The prohibition covers arrangements between suppliers to allocate sales to any persons, including distributors, resellers or final customers.

12 See *Commerce Commission v Visy Board (NZ) Limited* [2013] NZHC 2097; *Commerce Commission v Christchurch Transport Ltd* CP72/98 21 August 1998.

13 See, for example, *ACCC v The Tasmanian Salmon Growers Association Ltd* (2003) ATPR 41-954.

D. Refined exemptions to the per se prohibition on cartel prohibitions

40. As intimated above, the Bill contains three exemptions to the cartel prohibition. If an exemption applies, then the cartel provision is not unlawful unless it can be shown that the provision does not have the purpose, effect or likely effect of substantially lessening competition.

41. The three exemptions cover:

    41.1 vertical supply contracts;

    41.2 joint buying and promotion agreements; and, most significantly

    41.3 collaborative activities.

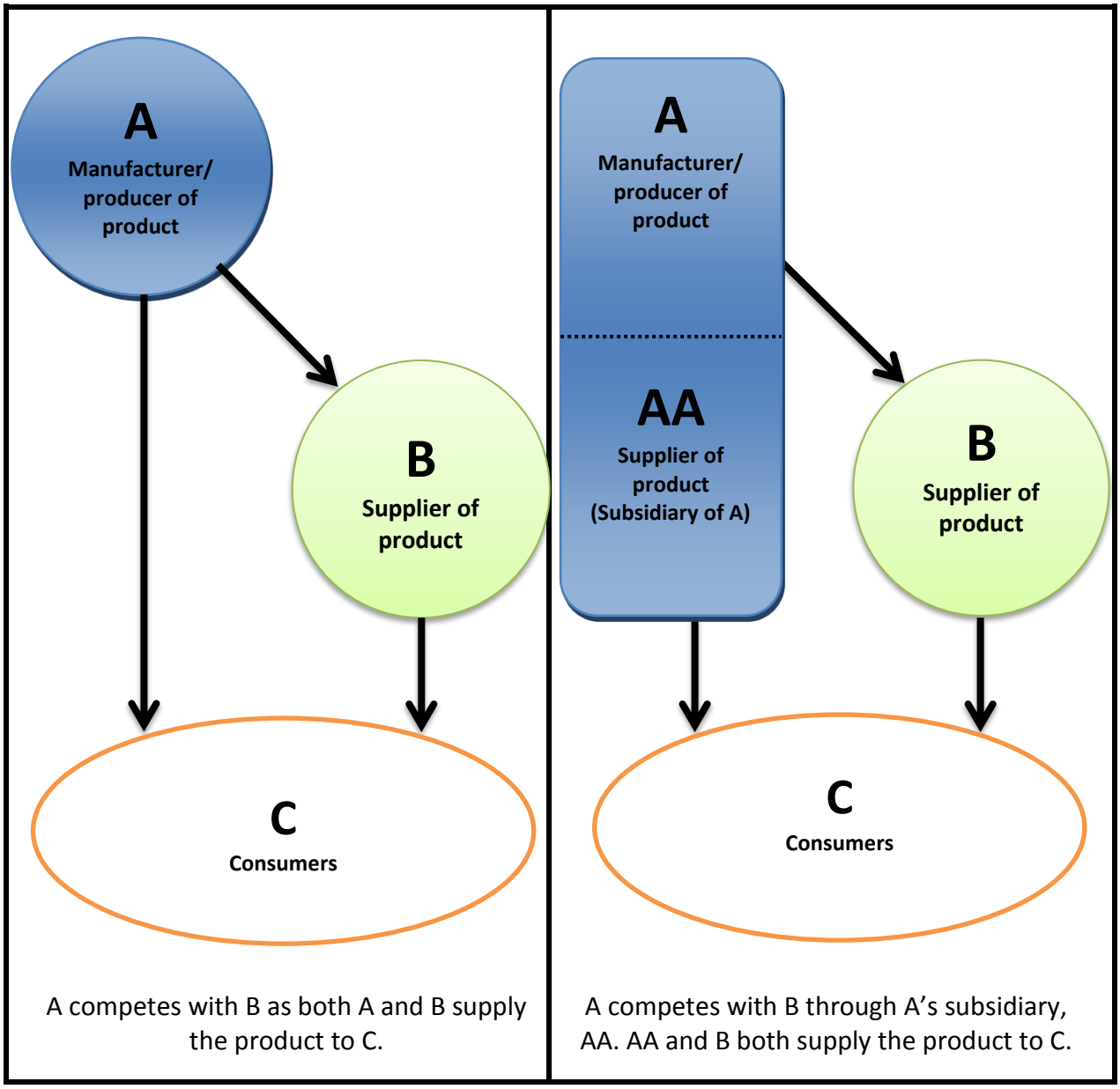
Vertical supply contracts

42. Because the Bill defines a competitor to include interconnected bodies corporate, the per se cartel prohibition may apply to vertical supply agreements.

43. This would occur where a supplier (or one of its interconnected bodies corporate) and a customer are competitors (or potential competitors). A common example where a supplier and a customer are competitors is where the supplier supplies goods both directly to end customers (eg, over the internet) and also supplies to distributors who then resupply those goods (eg, in a retail store).

44. Figure 1 below (which is reproduced from our draft guidelines) illustrates, more generally, situations in which a supplier and a customer may be in competition (which includes where the supplier supplies to customers via a subsidiary).

Figure 1: When a supplier and a customer will be competitors[14]



45. Policy makers recognised, however, that such vertical agreements 'are commonplace and are generally considered to enhance consumer welfare'.[15] Hence, the inclusion of a specific exemption intended to ensure that such beneficial arrangements are not captured by the per se rule.

46. As currently proposed, the vertical supply contract exemption applies where:

    46.1 a supplier or likely supplier of goods or services (A) and a customer or likely customer of that supplier (B), enter into a contract;[16]

    46.2 the cartel provision in the contract:

[14] In this example, both A and AA are party to the arrangement (Commerce Act 1986, s 30B). As a result, either or both may be subject to enforcement action.

[15] Exposure draft, [62]

[16] The exemption only applies to contracts; it does not extend to arrangements or understandings.

46.2.1 relates to the supply or likely supply of goods or services by A to B, or to the maximum price at which B may resupply the goods or services originally supplied by A to B; and

46.2.2 does not have the dominant purpose of lessening competition between A and B.

47. In relation to the first limb of that test, we consider that a provision will 'relate to' the supply of goods from A to B if it forms part of the contractual obligations giving rise to the supply. In contrast, a restriction will not be covered by the exemption if the restriction does not form part of – ie, is collateral to – the contractual obligations for the supply of goods from A to B.

48. The second requirement – that the provision not apply where the cartel provision has the dominant purpose of lessening competition between any two or more of the parties to the contract – also applies to the collaborative activity exemption. I will address our thinking around that below.

Joint buying and promotion agreements

49. The Bill also continues the current section 32 exemption for joint buying. The stated policy rationale is that:[17]

> … joint buying and promotion agreements can have beneficial effects if the savings achieved through joint buying are passed on to consumers. It can also promote competition by permitting small traders to combine their purchases and thereby to compete more effectively against larger competitors.

50. However, as I indicated earlier, the scope of the current exemption has caused some uncertainty. The new Bill seeks to resolve that uncertainty via a more fulsome explanation of when the exemption will apply.

51. An arrangement between buyers in relation to the price at which they acquire goods or services will not be price fixing provided that provision:

51.1 relates to the price of goods or services the competing buyers directly or indirectly collectively acquire;

51.2 provides for the competing buyers to collectively negotiate the price for goods or services which they then purchase individually; or

51.3 provides for an intermediary to take title to goods and resell or resupply them to one or more of the competing buyers.

Collaborative activities

52. The final – and most pivotal – exemption is the new exemption for collaborative activities. This exemption replaces the previous form based joint venture exemption which I explained above.

[17] Exposure draft [61].

53. The collaborative activity exemption is the centre piece of the Government's reforms in this area. In fact, speeches from the Minister focus more on this exemption than on the changes to the cartel prohibition. For example he has expressed the view that this exemption is intended to enable 'pro-competitive collaboration' and 'efficiency-enhancing activities', by ensuring such conduct falls outside the ambit of the per se rule.[18]

54. The exemption is 'principles based' and is designed to focus on substance rather than form. It is intended to be sufficiently broad to cover both joint ventures and ancillary restraints.[19] As such, while it draws from jurisprudence and thinking in other jurisdictions, it is novel.

55. The collaborative activity exemption effectively dis-applies the cartel prohibition if:

    55.1 the parties to the arrangement are involved in a collaborative activity; and

    55.2 the cartel provision is reasonably necessary for the purpose of the collaborative activity.

56. The Bill also enables a person to apply for clearance under this exemption. I explain how the clearance regime works in Section E of this paper.

57. In explaining the basis for the exemption, policy makers pointed to a number of advantages arising from a broad, principles based, exemption.[20]

    a. Unlike the joint venture exemption, there is no requirement that the activity be carried on jointly. This ensures that it applies to activities that enhance consumer welfare such as consortia bidding and syndicated loans. Both of these examples represent activities that are carried on in collaboration but may be structured so that parties have separate rights and obligations in respect of the activity.

    b. It would not require examination of what constitutes a joint venture. Having further considered the US position and a number of other jurisdictions, it appears to be extremely difficult to define a joint venture because legitimate collaborative activity can take a variety of forms, ranging from strategic alliances to resource pooling.

    c. Unlike the ancillary restraints defence, there is no confusion over its scope. In the US the term ancillary restraint is used in two slightly different ways. In one sense, an ancillary restraint is contrasted with a naked restraint. A naked restraint has no purpose other than stifling competition but an ancillary restraint is a component of a joint venture, in that it is necessary to achieve the collaborative objectives of the joint venture. In the second sense, ancillary restraint is applied to restraints that are collateral to the joint venture, such as restraints between the parents to the joint venture. The different interpretations raise uncertainty over whether an ancillary restraints defence is sufficiently broad to be capable of exempting joint ventures and there is a risk that courts could interpret the exemption too narrowly.

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18 Above n 1.
19 Exposure draft, at [46]-[47].
20 Exposure draft, at [49]

d. The exemption for collaborative activity is intended to make it clear that the Act encourages pro-competitive, innovative and efficiency enhancing activities.

What is a collaborative activity?

58. The Bill defines a collaborative activity to be an enterprise, venture, or other activity, in trade, that:

58.1 is carried on in co-operation by two or more persons; and

58.2 is not carried on for the dominant purpose of lessening competition between two or more of the parties.

59. We interpret the first of these requirements as meaning that the parties to the collaborative activity need to be working actively together towards the same common objective.

60. The second requirement that the collaborative activity not be carried out for the dominant purpose of lessening competition between the parties to the arrangement, has been described as reflecting:

> …the need to guard against the use of sham joint ventures or other sham collaborations to evade operation of the per se criminal and civil prohibitions against cartel conduct".[21]

61. Whether an arrangement has a dominant purpose of lessening competition between any two of the parties to the agreement will be an intensely factual enquiry in each case. We can, however, infer the dominant purpose of a collaborative activity from the conduct of any relevant person or from any other relevant circumstance.

62. Interestingly, the Minister of Commerce in his speech when introducing the Bill for its first reading described this requirement as answering the question: 'whether the collaborative activity has a legitimate collaborative purpose'. Looking to the words of the section, a 'legitimate' purpose (to use the Minister's words) is defined by exclusion; that is, as long as the dominant purpose of the collaboration is not to lessen competition, the purpose will be 'legitimate' in the Minister's language.

63. The important corollary of the fact that the test is framed in the negative, is that the section does not require the parties to show they have a pro-competitive purpose to benefit from the exemption. Rather, they only have to show they do not have a dominant anti-competitive one.

64. We expressed concern at the failure to include any reference to efficiencies or a pro-competitive purpose.[22] This is particularly the case as:

64.1 the section 30 cartel prohibition reflects a policy that cartels are so likely to damage competition that they should be condemned without further enquiry; and

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[21] Hampton L, Scott P *Guide to Competition Law*, Lexis Nexis 2013, at 196.

[22] As did other submitters. Russell McVeagh "Submission to the Commerce Committee, Commerce (Cartels and Other Matters) Amendment Bill"

64.2 the Minister has explained that the exemptions in sections 31 to 33 have been included in the Bill to mitigate any risk that section 30 may capture conduct which is in fact pro-competitive.

65. Yet there is no requirement or even reference to a pro-competitive and efficiency-enhancing rationale in the collaborative activity exemption. We have advocated, without success, for there to at least be a requirement that the courts and the Commission consider the pro-competitive purpose of the collaboration and any efficiency likely to be produced as a result of the collaboration, in determining whether a collaborative activity is carried on for the dominant purpose of lessening competition between any two or more of the parties.

66. All that said, in practical terms, evidence that the collaboration is 'output enhancing', ie, it allows something new to happen on the part of the parties that wouldn't occur without the collaboration, seems likely to be highly persuasive. For example, as the Federal Trade Commission and US Department of Justice's *Antitrust Guidelines for Collaborations Among Competitors* (the US Guidelines) state:

> ... a competitor collaboration may enable participants to offer goods or services that are cheaper, more valuable to consumers, or brought to market faster than would be possible absent the collaboration. A collaboration may allow its participants to better use existing assets, or may provide incentives for them to make output-enhancing investments that would not occur absent the collaboration.

67. Similarly, the Canadian Guidelines talk of 'legitimate collaborations' as distinct from naked restraints, and in the preface state that such collaborations:

> ...can permit firms to combine capabilities and resources so as to lower the costs of production, enhance product quality, and reduce the time required to bring new products to market.

68. But the negative test means that the absence of evidence that the collaboration is pro-competitive and efficiency-enhancing will not be fatal to a party's reliance on the exemption. As I have indicated however, practically speaking, failing to be able to explain how the collaboration will expand output or otherwise be pro-competitive may raise the stakes for the parties, as they will need to point us to other good evidence that they lack the proscribed purpose.[23]

Cartel provision must be reasonably necessary for the purpose of the collaborative activity

69. After deciding that the dominant purpose of the cartel provision is 'legitimate', the second part of the exemption requires one to consider the cartel provision's role in achieving the collaboration's legitimate purpose. Reasonably necessary provides the causal link between the cartel provision and the 'legitimate' purpose of the collaboration.

[23] There may well be certain situations where firms collaborate for reasons that are not directly related to improving their ability and incentive to compete, yet do not indicate a dominant purpose not to compete. For example, firms may collaborate to achieve some environmental environment, health and safety, or other social welfare purpose, which is unrelated to their individual or collective competitiveness.

70. The reasonably necessary language was directly 'borrowed' from the US Guidelines.[24] The US Guidelines talk about the agreement being reasonably related to the pro-competitive benefits of the collaboration. The Guidelines make the following points:

> An agreement may be "reasonably necessary" without being essential.[25]
>
> If the participants could achieve an equivalent or comparable efficiency-enhancing integration through practical, significantly less restrictive means, then the Agencies conclude that the agreement is not reasonably necessary.[26]
>
> In making this assessment, except in unusual circumstances, the Agencies consider whether practical, significantly less restrictive means were reasonably available when the agreement was entered into, but do not search for a theoretically less restrictive alternative that was not practical given the business realities.[27]

71. The statements make clear that a comparative analysis is implicit when asking whether a provision is reasonably necessary. This seems entirely appropriate – it seems wrong to say that a cartel provision is reasonably necessary for the purposes of the collaboration if the parties could achieve their collaboration without the cartel provision.

72. Drawing on the policy makers' intention and the US Guidelines, our Draft Guidelines recognise that by using the term 'reasonably necessary', Parliament has signalled that a cartel provision does not need to be essential for the collaborative activity. That is, a party does not need to show that the collaborative activity would not occur but for the cartel provision.[28]

73. As such, we consider that a cartel provision is reasonably necessary if the parties would be materially hindered in achieving the collaborative activity's purpose were they to use a practically workable, significantly less restrictive alternative to the cartel provision.

74. Examples where a cartel provision may be reasonably necessary include where, compared to a significantly less restrictive alternative, the cartel provision materially reduces the parties' risk in achieving the collaborative activity's purpose, or reduces the cost of achieving that purpose, or shortens the timeframe for parties to do so.[29]

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24 Explanatory materials [50].

25 Federal Trade Commission and US Department of Justice "Antitrust Guidelines for Collaborations Among Competitors" (2000) Federal Trade Commission www.ftc.gov.

26 Ibid.

27 Ibid.

28 Of course, however, if the collaboration could not be achieved absent the cartel provision, then this would be sufficient to demonstrate that the cartel provision is reasonably necessary for the collaborative activity.

29 In a similar vein to the US Guidelines, when discussing the requirement for a restriction to be reasonably necessary for giving effect to a broader objective so as to qualify for the ancillary restraints defence, page 14 of the Canadian Guidelines state:

> There is no requirement … that the challenged restraint be the least restrictive alternative. Accordingly, in determining whether a challenged restraint is reasonably necessary, the Bureau will not "second guess" the parties with reference to some other restraint that may have been less

75. On the other hand, a cartel provision may not be reasonably necessary when it applies for a significantly longer period of time, or has a significantly greater geographic scope than is in fact required for the parties to achieve the purposes of the collaborative activity.

76. The practical point, which we explain in our Draft Guidelines, is that parties should be able to explain why other alternatives to the cartel provision are inadequate or unavailable, or why such alternatives would not allow the parties to pursue their collaborative activity. It is not enough for a party to merely assert that they would not enter into the collaboration in the absence of the cartel provision, or that they would face materially greater obstacles if they did so.

E. The clearance regime for collaborative activities

77. The Bill introduces a clearance regime for collaborative activities. This regime will enable a party proposing to enter into an arrangement containing a cartel provision that is part of a collaborative activity, to apply for clearance.

78. If we clear an arrangement, it will neither contravene the cartel prohibition nor the general prohibition on arrangements that substantially lessen competition.

79. In essence, therefore, a clearance provides certainty that we do not consider that the cartel provisions in the arrangement are unlawful.

80. Like our merger clearance regime, the collaborative activity clearance regime will be voluntary as well. There will be no statutory requirement to seek clearance. Parties will make their own assessment whether or not to seek clearance.

The clearance test

81. We are required to give clearance where:

    81.1 the parties are or will be involved in a collaborative activity (see discussion of this requirement above);

    81.2 every cartel provision in the relevant arrangement is reasonably necessary for the purpose of the collaborative activity (see discussion of this requirement above); and

    81.3 the arrangement, will not substantially lessen competition.

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restrictive in some insignificant way. The Bureau will not examine theoretically less restrictive alternatives that are not practical given the business circumstances. .... Unless there are significantly less restrictive alternatives to give effect to the objective of the broader agreement, the Bureau is likely to conclude that the restraint is reasonably necessary. Where there are significantly less restrictive alternatives available to the parties, the parties must demonstrate that the other alternatives were inadequate or impractical, or that such alternatives would not allow the parties to achieve the objective of the agreement. If the parties could have achieved an equivalent or comparable arrangement through practical, significantly less restrictive means that were reasonably available to the parties at the time when the agreement was entered into, then the Bureau will conclude that the restraint was not reasonably necessary.

82. The applicant must satisfy the Commission that each of these criteria is met. If they do not, the Commission must decline clearance.

83. The first two requirements of the clearance test are identical to the collaborative activity exemption criteria, which I discussed above. The third requirement is designed to determine whether the arrangement (or any provision within the arrangement) will substantially lessen competition in a market.

The substantial lessening of competition test

84. This last requirement may well require a significant level of analysis, given that this is the same test we undertake in relation to mergers.

85. New Zealand courts have described the substantial lessening of competition (which includes a hindering and/or prevention of competition) test as a relative standard. The question is would the parties' market power increase relative to what it would be without the arrangement?

86. Furthermore, only a lessening of competition that is substantial will prevent the Commission from clearing an arrangement containing a cartel provision. New Zealand courts have held that a lessening of competition will be substantial if it is real, of substance, or more than nominal, while some courts have used the word material to describe a lessening of competition that is substantial.[30]

87. Consequently, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we ask whether competition will be substantially lessened on the basis of whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

Cartel clearance process

88. In our Draft Guidelines we have proposed a process for cartel clearances. This is largely based on our merger clearance process.

89. One of things that is likely to be controversial, and which may limit the extent to which firms avail themselves of the exemption, is the public nature of the clearance process.

90. This is largely driven by the need to determine whether the arrangement actually substantially lessens competition. To us it seems difficult to make this assessment without investigating the arrangement and talking to people in the market. This is the process we follow in merger clearances and is entirely orthodox in that field.

91. The problem with this is its intersection with the prospective nature of clearances. Because we cannot grant clearance for arrangement that has already been entered into, firms would have to come to us prior to implementing their arrangement. However, they may not wish to expose their thinking and strategy at such an early stage.

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30 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [129].

92. It is for that reason that some submitters to the Select Committee suggested a two-track clearance process.[31] Under that proposal firms could apply for either:

92.1 a clearance that the collaborative activity exemption applies (ie, without the need to assess whether it substantially lessens competition) – in that case the general prohibition on anti-competitive arrangements would continue to apply; or

92.2 a clearance that the collaborative activity exemption applies and that the arrangement is not anti-competitive.

93. The Select Committee declined to make that change on advice from officials.

94. However, this does raise a practical issue as to how often the clearance regime will be used. This is an open question on which different stakeholders have different views. Some practitioners express scepticism that any firms will apply for clearance. Conversely, international shipping carriers – which may become subject to domestic competition law for the first time – are expressing the view that all carrier collaborations will require clearance. Where in fact the balance will lie remains to be seen and I would not wish to hazard a guess at this point.

Authorisation remains available

95. Even if a clearance is not available, parties can still apply for an authorisation as they can under the current Act.

F. The criminal offence and the defence of honest belief

96. In addition to clarifying the scope of the exemption, the Bill introduces a criminal sanction for cartel conduct. In fact, criminalising cartel conduct was the original underlying policy goal of the changes.

97. Criminalisation was a lightning rod issue in the policy making process, with strong views both for and against.[32] However, it is fair say that by the time the Bill was introduced there was a sense of inevitability that a criminal offence would be enacted.

Civil and criminal sanctions available

98. Under the Bill those who engage in cartel behaviour may be subject to civil and criminal sanctions.[33]

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31 Simpson Grierson "Commerce (Cartels and Other Matters) Amendment Bill, Submissions to the Commerce Select Committee".

32 See for example, Bell Gully submission on MED Cartel Criminalisation discussion document, 9 April 2010 (available at http://www.med.govt.nz/business/competition-policy/pdf-docs-library/bell-gully.pdf), Buddle Findlay "Submissions on the Commerce (Cartels and Other Matters) Amendment Bill", Russell McVeagh "Submission to the Commerce Committee "Commerce (Cartels and Other Matters) Amendment Bill" and Dr Peter Whelan "Submission to the Commerce Committee of the New Zealand Parliament on the Commerce (Cartels and Other Matters) Amendment Bill.

33 The criminal regime does not come into effect until two years after the Bill comes into force.

99. In a civil proceeding, if a court considers that a person has entered into, or given effect to a cartel provision,[34] then the court may order various remedies, such as:

    99.1 for an individual, a penalty of up to $500,000, and/or an order that a person must not be a director, promoter, or involved in the management of a body corporate for a period of up to 5 years;

    99.2 for a body corporate, a penalty of up to the greater of $10 million, or three times the commercial gain, or, if this cannot be easily established, 10% of turnover; and/or

    99.3 for both individuals and a body corporate, an award of damages and/or exemplary damages.[35]

100. When the criminal regime comes into effect two years after Royal Assent, the maximum criminal penalty for an individual will be up to seven years' imprisonment.

101. A company will be liable on conviction to pay a penalty of up to the greater of $10 million, or three times the commercial gain, or, if this cannot be easily established, 10% of turnover.

The criminal offence and the honest belief defence

102. To be criminally liable a person must intend to engage in cartel conduct. This is, in effect, a knowledge requirement. In essence, the person must know what they are doing is prohibited and do it anyway.

103. The potentially problematic part of the criminal offence is that it provides an honest belief defence. This provides:

> In a prosecution under this section, it is a defence, for a defendant involved in a collaborative activity, if:
>
> (a) the defendant honestly believed that the cartel provision was reasonably necessary for the purposes of the collaborative activity; and
>
> (b) that belief existed at the time the defendant entered into or arrived at the contract, arrangement, or understanding that contained the cartel provision, or at the time the defendant gave effect to the cartel provision, as the case requires.

104. While the Commission took no view on whether cartel conduct should be criminalised, we did express concern at the inclusion of this honest belief defence. We did not support the inclusion of an honest belief defence for the following reasons.

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[34] The Act also prohibits any person from aiding, abetting, counselling, or procuring any other person to contravene the cartel prohibition, inducing, or attempting to induce, any other person to contravene the cartel prohibition, or otherwise being in any way, directly or indirectly, knowingly concerned in, or party to, a contravention by any other person of the cartel prohibition.

[35] Damages are only available to third parties, while pecuniary penalties and banning orders are only available to the Commission.

104.1 First, such a defence is unnecessary given that a party who is uncertain about the legality or otherwise of their proposed collaboration can seek clearance for their collaboration in advance.

104.2 Secondly, an honest belief defence is out of step with international anti-trust law. Such a defence is not available in any other jurisdiction that has criminalised cartel conduct.

104.3 Thirdly, the defence has the potential to avoid the application of the criminal sanction where reliance is placed on legal advice. In any case where cartel participants obtain and rely upon prior legal advice, they may well have a defence under this provision, whether or not that advice is correct, and whether or not the advisor has been provided with all the salient facts.

104.4 Fourthly, and related to the third point, the defence does not require the belief to be 'reasonable'. New Zealand courts have held that where no objective reasonableness requirement is included in a statute, courts will assume that the belief need not be reasonable provided it is "honest".[36] Lack of a reasonableness requirement may mean that careless or wilfully blind defendants could potentially rely on this defence to escape charges. For example, a defendant who chooses not to take professional advice may seek to rely on the defence on the basis that, nevertheless, they honestly believed the cartel provision was necessary.

104.5 Finally, dishonesty is an element of proof of the cartel offence in the United Kingdom and has proven problematic. The United Kingdom government is proposing to take the dishonesty requirement out of its cartel criminal offence, in the expectation that this will improve enforceability, and increase deterrence.[37]

105. We remain of the view, therefore, that the honest belief defence remains problematic.

G. Conclusion

106. The Bill is a welcome step towards improving New Zealand's competition law. First, it brings our cartel prohibition (by and large) in line with international best practice. Secondly, it reforms the exemptions to the per se rule. The new exemptions appear an improvement on the existing overly restrictive exemptions, although seeing how they will play out in practice is something we all await with interest.

23 August 2013

[36] See for example *Hayes* v *R* [2008] NZSC 3 at [53].

[37] Department for Business, Innovation and Skills "Growth, Competition and the Competition Regime – Government Response to Consultation" March 2012, at pg 69.