COMMERCE COMMISSION NEW ZEALAND

4 September 2012

Secretariat
Commerce Committee
Select Committee Office
Parliament Buildings

Wellington 6011

Dear Sir

**Commerce Commission submission on the Commerce (Cartels and Other Matters) Amendment Bill (Bill no. 341-1)**

Thank you for the opportunity to submit on the Commerce (Cartels and Other Matters) Amendment Bill (the Bill).

Please find attached our submission on the Bill.

The Commerce Commission wishes to appear before the Committee to speak to our submission.

If you have any further enquiries regarding our submission please contact Rebecca McAtamney, Chief Adviser Advocacy and Development by phone (04) 924 3633 or by email rebecca.mcatamney@comcom.govt.nz in the first instance.

Yours sincerely

Kate Morrison
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Encl.

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COMMERCE COMMISSION NEW ZEALAND

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# The Commerce (Cartels and Other Matters) Amendment Bill

## Submission to Commerce Select Committee

Date: 04 September 2012

## Purpose

1. This submission sets out the Commerce Commission's (the Commission) views on the Commerce (Cartels and Other Matters) Amendment Bill (the Bill).

## Overview

2. The Bill is a welcome step towards improving New Zealand's competition law. However, in our view some work remains to be done. In particular, section 36 of the Commerce Act 1986 (the Act) continues to be problematic to enforce and would benefit from reform.

3. The Bill addresses a range of important issues, from jurisdiction to merger enforcement. The most significant changes are proposed for the price fixing prohibitions.

4. In the context of price fixing, the Bill does four important things.

   4.1 First, consistent with international best practice, the Bill clarifies that along with price fixing, allocating markets, rigging bids, and restricting output are prohibited cartel conduct.

   4.2 Second, consistent with the purpose of the Act "to promote competition in New Zealand markets for the long term benefit of New Zealand consumers" (section 1A), the Bill maintains the *per se* rule for cartel conduct – that is, cartel conduct is deemed to injure competition without further enquiry into its actual effects. In August of this year our Court of Appeal in the *Visy* cardboard cartel appeal on jurisdiction said "[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".[1]

   4.3 Third, the Bill introduces a criminal penalty for cartel conduct, recognising the adverse impact cartel conduct can have on the New Zealand economy.

   4.4 Fourth, recognising the potential for a *per se* rule to overreach and capture beneficial conduct, the Bill reforms the exemptions to the *per se* cartel provisions. The Minister's comments in his first reading speech indicate clearly that these exemptions are intended to enable "pro-competitive collaboration" and "efficiency-enhancing activities" to fall outside the ambit of the *per se* prohibition. We support the intention that truly pro-competitive and efficiency enhancing conduct should be exempt from the *per se* prohibition. Such an intention is consistent with the underlying purpose of the Act, and is important for New Zealand's economic growth.

5. As the agency responsible for enforcing the Act the Commission has liaised with the Ministry of Business, Innovation and Employment (MBIE) through the Bill's development, and is now able to offer an operational perspective into its clauses.

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1 *Commerce Commission v Visy Board Pty Ltd* CA 312/2011 [27 August 2012] at [32].

6. This perspective includes some concern that several of the proposed provisions may not achieve the result intended by MBIE.

7. Our submission comments on:

   7.1 The new criminal regime;

   7.2 The collaborative activity exemption;

   7.3 The honest belief defence;

   7.4 The amendments to the jurisdiction rules; and

   7.5 The introduction of a merger enforcement mechanism for overseas acquisitions.

8. In summary:

   8.1 The parallel civil and criminal regimes will be workable. The introduction of a criminal regime will provide important investigative and enforcement benefits to New Zealand.

   8.2 The proposed collaborative activity exemption should require the courts and the Commission to consider the pro-competitive purpose of the collaboration, and any efficiency likely to be produced as a result of the collaboration. This would give greater prominence and express recognition to what we understand to be the legislative purpose.

   8.3 The honest belief defence should be deleted. If an honest belief defence is to be retained, we support what we understand to be MBIE's proposed amendment. However, we consider that the defence should only apply where a defendant's belief is both honest and reasonable.

   8.4 The proposed section 4(4) should be amended to mirror section 7 of the Crimes Act 1961, as we understand it is intended to have the same meaning.

   8.5 In relation to the new merger enforcement regime:

      8.5.1 Section 47A should be clarified to indicate that it applies where an overseas person acquires an interest in a New Zealand body corporate through the acquisition of another overseas person;

      8.5.2 The "controlling interest" threshold for when the regime is available should be amended to a "substantial degree of influence" threshold; and

      8.5.3 The legislation should make it clear that sections 47A-D do not affect the general jurisdiction provision in section 4(3).

9. Where we do not comment on a provision it reflects our view that the clause is workable.

## The new criminal regime

10. In our view, the parallel civil and criminal regimes created by the Bill will be workable. We have experience working with the dual criminal and civil regimes contained in the Fair Trading Act 1986 and the Credit Contracts and Consumer Finance Act 2003.

11. We are experienced in selecting the enforcement response (civil or criminal) that is most suited to the matter at hand. Unquestionably, we exercise an enforcement discretion after closely scrutinising the evidence. We seek to generate public understanding and acceptance of our enforcement decisions through the quality of decisions that we make, through ensuring that they are made public, and through issuing public guidelines on the considerations that underpin our decision-making.[2]

12. Not only are the dual regimes workable, but the introduction of a criminal regime will also provide important investigative and enforcement benefits to New Zealand:

    12.1 It will enable us to seek the return to New Zealand of cartel offenders located overseas. Requests by a regulator for help with extradition depend heavily on an equivalent criminal regime operating in the extradition country;

    12.2 By having a criminal cartel offence in New Zealand such as those in all major overseas jurisdictions, overseas cartel enforcement agencies will also be liberated to share information more freely with us and to cooperate more extensively; and

    12.3 As the cartel offence is punishable by up to seven years imprisonment, we will be able to access the new surveillance and interception powers under the Search and Surveillance Act 2012.

## Collaborative activity exemption

13. We support the proposed exemption (clause 7 of the Bill) for cartel provisions that are reasonably necessary for the purpose of a "collaborative activity".

14. But we submit that the section should be amended to require the courts and the Commission to 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.

15. This amendment would give greater prominence and express recognition to what we understand to be the legislative purpose. It is also likely to enable us to provide more certain guidance for businesses and their advisors.

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[2] See the Commission's published Enforcement Criteria available online at http://www.comcom.govt.nz/enforcement-criteria/.

**The legislative intent is to enable pro-competitive and efficiency-enhancing collaboration**

16. As highlighted in the introduction, the section 30 cartel prohibition reflects a policy that cartels are so likely to damage competition that they should be condemned without further enquiry.

17. As the Minister explained in his first reading speech, 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.

18. This sentiment is consistent with the approach of other jurisdictions that have a *per se* criminal price fixing prohibition. In many jurisdictions, the *per se* rule does not apply where a collaboration between competitors is shown to be pro-competitive and efficiency-enhancing.

19. What is regarded as pro-competitive and efficiency-enhancing? The United States' Federal Trade Commission/Department of Justice (FTC/DOJ) and the Canadian Competition Bureau's respective guidelines provide a useful reference.

    19.1 The FTC/DOJ guidelines look for collaboration that enables participants to offer consumers cheaper or more valuable goods or services, bring new or improved products to market faster than would be possible absent the collaboration, or better use their existing assets.[3]

    19.2 Similarly, the Canadian Competition Bureau's guidelines look for collaborations that permit firms to combine capabilities and resources so as to lower the costs of production, enhance product quality, or reduce the time required to bring new products to market.[4]

**The current exemption does not refer to pro-competitive and efficiency-enhancing collaborations**

20. While it seems clear that the intention is that the exemption should apply to "pro-competitive collaboration and efficiency-enhancing activities", the current wording of the exemption does not expressly require this to be considered, or even refer to it.

21. Rather, an agreement will benefit from the exemption where:

    21.1 Two or more parties to the agreement carry on an enterprise, venture or other activity in trade in co-operation;

    21.2 That enterprise, venture or other activity is not carried on for the dominant purpose of lessening competition between the parties; and

    21.3 The cartel provision is reasonably necessary for the purpose of the enterprise, venture or other activity.

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3 Federal Trade Commission and the US Department of Justice "Antitrust Guidelines for Collaborations Among Competitors", pg 6.

4 Competition Bureau of Canada "Competitor Collaboration Guidelines", preface.

22. We acknowledge that we would interpret these three requirements in light of what seems to be a clear legislative intention to deter cartel conduct (via criminalisation) on the one hand, but to allow pro-competitive and efficiency-enhancing collaboration on the other.

23. We also accept the duty to outline our approach to the exemption in guidelines.

24. However, our view is that relying on guidelines alone is a second best approach. Section 31 exists as an exemption to a potentially criminal offence. It is therefore highly desirable that the exemption, on its face, provide as much guidance as possible on how it applies. The proposed section 31 does not provide this guidance.

**The exemption should more specifically refer to pro-competitive and efficiency-enhancing collaborations**

25. We therefore submit that the new section 31 should be amended to include a new subparagraph 4:

> 31(4) Without limiting the matters that may be taken into account for the purposes of subsection 2(b), in determining whether a collaborative activity is carried on for the dominant purpose of lessening competition between any 2 or more of the parties, the following matters must be taken into account:
>
> (a) Any pro-competitive purpose of the collaboration; and
>
> (b) Any efficiency likely to be produced as a result of the collaboration.

26. Our guidelines would then adopt this language, and could provide further and more specific guidance on the types of evidence that would be relevant to the assessment.

27. Our view is that such an amendment would strike the appropriate balance given that the exemption applies to conduct which may otherwise be a criminal offence.

28. We do not consider that the burden on businesses wishing to demonstrate why the collaboration is pro-competitive or efficiency enhancing would be significant, because:

    28.1 As described above, we are likely to interpret the exemption in light of the clear legislative intention to deter cartel conduct without deterring pro-competitive and efficiency-enhancing collaboration;

    28.2 United States and Canadian experience suggests such a requirement is workable; and

    28.3 We do not consider that it requires a detailed quantitative investigation, but rather a qualitative assessment.

29. Further, our suggested amendment does not make efficiencies a requirement for a collaborative activity to be exempt. Rather, it makes efficiencies a mandatory consideration for the Commission and the courts. It leaves open the possibility for

businesses to show in some other way that they did not have the dominant purpose of lessening competition.

## Honest belief defence

30. Clause 8 of the Bill creates a new defence in criminal proceedings if the defendant honestly believed at the relevant time that an exemption in sections 31, 32 or 33 applied.

31. We do not support the inclusion of an honest belief defence because:

    31.1 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;[5]

    31.2 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;

    31.3 This 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

    31.4 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.[6]

32. The particular enforcement difficulties referred to mean that even if the Select Committee concludes that the legislation should include an honest belief defence, two major changes are required to the current drafting, namely:

    32.1 The defence should not apply where a party makes a mistake of law, consistent with the application of honest belief defences in other contexts; and

    32.2 The defence should require that the defendant's belief be both honest and reasonable so as to ensure that careless or wilfully blind defendants cannot rely on this defence to escape charges.

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5 A party can seek a clearance from the Commission for a collaborative activity that will not have or will not be likely to have the effect of a substantial lessening of competition (clause 12). The effect of being granted a clearance by the Commission is that a party to the agreement subject to the clearance does not contravene section 27 or section 30 (clause 12).

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

**The defence should not apply to a mistake of law**

33. The defence as drafted requires a defendant to demonstrate that they honestly believed an exemption applied.

34. In the case of the collaborative activity exemption, this would require the defendant to honestly believe that they were involved in a collaborative activity, and that the cartel provision was reasonably necessary for the purposes of the collaborative activity.

35. Our concern is that whether the exemption applies is a question of law. In other words the defendant would be arguing that they were honestly mistaken as to the scope of the prohibition. This is a mistake of law. Such mistakes of law are not generally regarded as defences to a criminal charge.[7]

36. We understand that, following discussions with us on this issue prior to the first reading of the Bill, MBIE will be proposing an amended defence. We understand MBIE's proposed amendment will say:

> It is a defence if the defendant:
>
> (a) Is engaged in a collaborative activity; and
>
> (b) Honestly believed that the cartel provision was reasonably necessary for the purpose of that activity.

37. This proposed defence would require an honest belief as to the necessity of the cartel provision for the purpose of the collaborative activity, rather than an honest belief about the existence of an exemption.

38. If an honest belief defence is to be enacted, we strongly support MBIE's proposed amendment.

**The belief should be both honest and reasonable**

39. While MBIE's proposed amendment is an improvement, we submit that the defence should be available only where the defendant's belief was both honest and reasonable.

40. Where no objective reasonableness requirement is included in a statute, courts will assume that the belief need not be reasonable provided it is "honest".[8]

41. 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

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7 See for example section 25 of the Crimes Act "The fact that an offender is ignorant of the law is not an excuse for any offence committed by him." See also *Fastlane Autos Ltd* v *Commerce Commission* (2004) 11 TCLR 173 at [32] to [36] for an example in the context of the Fair Trading Act 1986.

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

defence on the basis that, nevertheless, they honestly believed the cartel provision was necessary.

## Jurisdiction

### Section 4(4) should be amended to mirror section 7 of the Crimes Act

42. The proposed section 4(4) provides that where any act or omission that forms part of, or any event necessary to the completion of, a contravention of the Act occurs in New Zealand, the contravention is deemed to have occurred in New Zealand.

43. Section 4(4) is based on section 7 of the Crimes Act 1961. We understand it is intended to have the same meaning and has been included to ensure that section 7 of the Crimes Act applies in the civil context.

44. But, importantly, section 4(4) omits the words "whether the person charged with the offence was in New Zealand or not at the time of the act, omission, or event". If section 4(4) is to have the same meaning as section 7 of the Crimes Act, then these words should be included.

45. While we understand that the Parliamentary Counsel Office who drafted the Bill have said that the provisions mean the same thing, our view is that if the wording is not identical then a court is likely to interpret section 4(4) to mean something different to section 7 of the Crimes Act. In our experience, the courts are inclined to see meaning in such deliberate adjustments to known statutory language.

46. We note that the words "charged with the offence" from section 7 need to be amended to "charged with contravening the Act" to be clear that section 4(4) applies to both civil and criminal charges.

47. We therefore submit that the proposed section 4(4) should be amended to read:

> For the purpose of determining jurisdiction,-
>
> (a) If an act or omission that forms part of a contravention of this Act occurs in New Zealand, the contravention is deemed to have occurred in New Zealand, *whether the person charged with contravening the Act was in New Zealand or not at the time of the act or omission*; and
>
> (b) If an event that is necessary to the completion of a contravention of this Act occurs in New Zealand, the contravention is deemed to have occurred in New Zealand, whether the person charged with contravening the Act was in New Zealand or not at the time of the event.

## Declaration regime for overseas business acquisitions

48. Clause 8 of the Bill is designed to remedy an anomaly in our ability to enforce divestment remedies against certain overseas acquirers.

49. The proposed sections 47A-D would enable us to apply to the High Court for a declaration that an overseas acquisition will result in a substantial lessening of

competition in New Zealand. We could apply only when the overseas acquisition acquires a "controlling interest" in a New Zealand company.

50. Following such a declaration, the High Court could order that a body corporate cease carrying on business in New Zealand, dispose of shares or assets, or take any other action consistent with the purpose of the Act.

51. While we support these new provisions in general terms, we submit that:

51.1 The current draft may not solve the enforcement problem it is designed to address and requires amendment;

51.2 The "controlling interest" threshold for when the regime applies is too high and should be reduced to a "substantial degree of influence" threshold; and

51.3 The legislation should make clear that sections 47A-D do not affect the general jurisdiction in sections 4(3) and 47 of the Act. That is, the existence of the sections 47A-D enforcement regime does not affect the jurisdiction of the Commission to examine all mergers that affect a market in New Zealand.

**The rationale for sections 47A-D**

52. The prohibition in the Act on business acquisitions that substantially lessen competition in a New Zealand market extends, via section 4(3), to a business acquisition outside New Zealand, provided the acquisition affects a market in New Zealand.

53. In many situations, the ideal remedy for an anti-competitive acquisition will be an order that the acquirer divest sufficient assets or shares to remove any anti-competitive effects. However, where an overseas person does not directly own assets in New Zealand, there are serious questions over our ability to enforce such a divestment order.

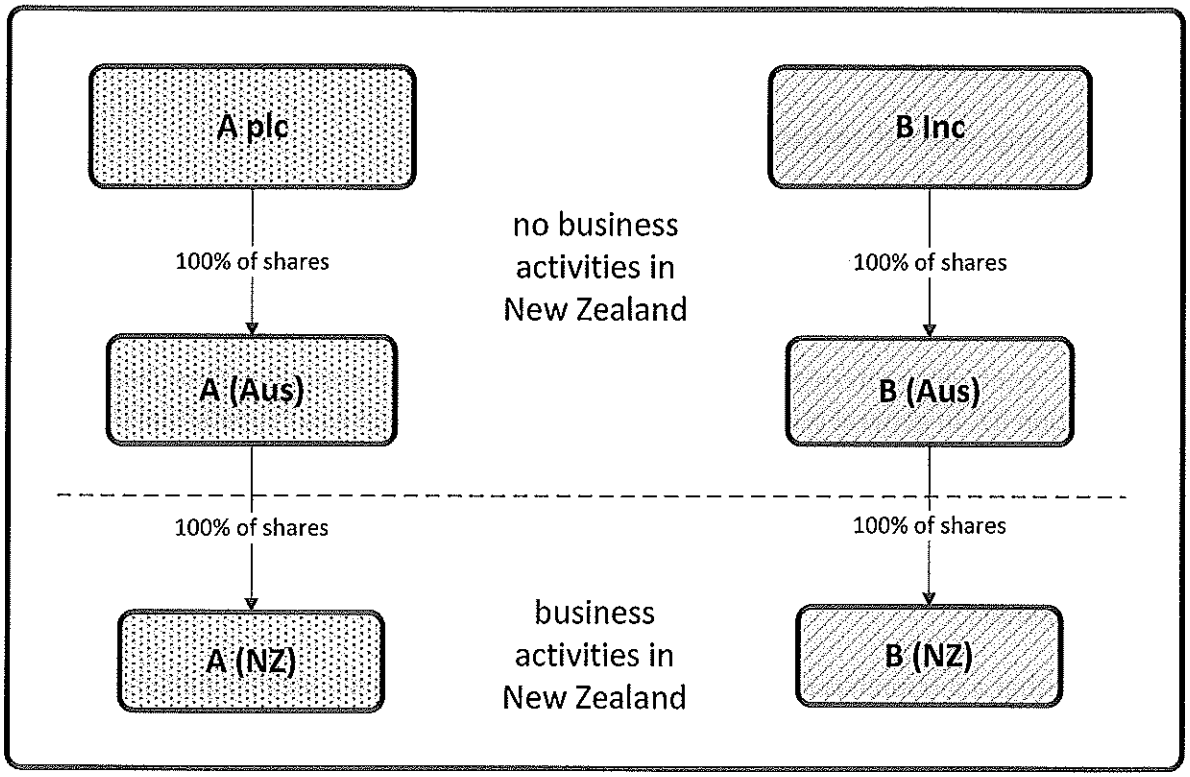
54. This creates the peculiar situation that, while we have jurisdiction to examine the overseas acquisition, we have no real ability to preserve competition for the long term benefit of New Zealanders.

55. The following example highlights the issue.

56. *A plc* is a company incorporated in the United Kingdom. It does not carry on business in New Zealand or have any assets in New Zealand. It does, however, have a wholly owned subsidiary in Australia, *A (Aus)*. *A (Aus)* does not carry on business in New Zealand, but it does itself have a wholly owned subsidiary in New Zealand, *A (NZ)*.

57. Similarly *B Inc* is a company incorporated in Delaware, United States. It does not carry on business in New Zealand or have any assets in New Zealand. It does, however, have a wholly owned subsidiary in Australia, *B (Aus)*. *B (Aus)* does not carry on business in New Zealand, but it does itself have a wholly owned subsidiary in New Zealand, *B (NZ)*.

58. This is illustrated in the diagram below.




59. Suppose that *A plc* acquires all the shares in the capital of *B Inc*. Suppose also that *A (NZ)* and *B (NZ)* are the only producers of a product in New Zealand and there is no significant import competition. The ultimate result of *A plc's* acquisition of *B Inc* is a substantial lessening of competition in New Zealand.

60. While section 47 applies to the acquisition, the question over our ability to enforce a remedy arises because *A plc* has no assets in New Zealand.[9]

61. The proposed declaration mechanism is intended to resolve this issue by enabling the court to order the New Zealand body corporate – ie *A (NZ)* or *B (NZ)* – to cease carrying on business in New Zealand, dispose of shares or assets, or take any other action consistent with the purpose of the Act.

**Sections 47A-D may not resolve the issue that they are intended to resolve**

62. We are concerned that section 47A may not address this enforcement problem and it therefore requires amendment.

63. The current wording of the proposed section 47A requires an overseas person to "acquire shares" in a New Zealand body corporate before the provision applies. Using the fact scenario above, where *A plc* acquires shares in *B Inc* it is not clear that *A plc* would acquire shares in *B (NZ)*.

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[9] Further, any subsequent merger of *A (NZ)* and *B (NZ)* would arguably not result in any substantial lessening of competition as both those companies would already be under the common ultimate control of *A plc*. See *Commerce Commission* v *British American Tobacco Holdings (New Zealand) Ltd* (2001) 10 TCLR 320.

64. To ensure that section 47A applies to the acquisition of *B Inc* by *A plc*, section 47A could be amended to clarify that it applies where an overseas person acquires an interest in a New Zealand body corporate through the acquisition of another overseas person.

**The "controlling interest" test sets too high a threshold**

65. Based on the current drafting, the sections 47A-D enforcement method will only apply if the overseas person acquires a controlling interest in a New Zealand body corporate. A "controlling interest" as defined in the proposed section 47A(4) is essentially majority (51%) ownership.

66. This "controlling interest" test can be contrasted with the general test applied under section 47. In general terms, if an acquiring business acquires a "substantial degree of influence" in a target, then that acquisition has the potential to substantially lessen competition. The logic of this approach is simple: if the acquirer has a substantial degree of influence, then it may be able to blunt the target's competitive threat to the benefit of the acquirer and to the detriment of New Zealand consumers.

67. Whether a person has a substantial degree of influence over another person depends on a range of factors. However, importantly, it does not require majority ownership or control. For instance, in the case of listed companies, the Commission examines shareholdings of 15% or more.[10]

68. Since section 4(3) is being retained, the controlling interest test in section 47A would permit some anomalies.

69. Using the example above, and assuming the clarification requested has been made, suppose that *B (Aus)* owns only 49% of *B (NZ)*. If *A plc* acquired *B Inc*, *A plc* would not gain a controlling interest in *B (NZ)*. It would, however, in most cases, obtain a substantial degree of influence. In a scenario where *A (NZ)* and *B (NZ)* are the only two domestic competitors, such a substantial degree of influence is highly likely to raise competition concerns.

70. The anomaly arises because sections 47A-D would not be available in that scenario despite the fact that competition is likely to be lessened to the long-term detriment of New Zealand consumers. If that was a domestic transaction, then enforcement action would be highly likely. And if a breach was found, the court would likely order a remedy to preserve competition in the market.

71. For this reason, our view is that the threshold for section 47A to apply, which is set in the current test for "controlling interest", is too high.

72. The current drafting could lead companies to structure their transactions to take advantage of this discrepancy and avoid possible action by us.

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[10] Commerce Commission's Merger and Acquisition Guidelines, pg 8.

73. We submit that the threshold should be consistent with the "associated person" threshold in section 47, ie, a substantial degree of influence over a New Zealand body corporate, or similar.

**Section 47A does not override the general jurisdiction in sections 4(3) and 47**

74. The current drafting of sections 47A-D creates a parallel jurisdiction to one that already exists. Section 47A arguably narrows what a court can do, as under that provision the Commission can only seek a declaration where an overseas party acquires a controlling interest.

75. The legislation should make it clear that when assessing overseas acquisitions where appropriate the Commission (and the court) can rely on sections 4(3) and 47, as section 47A is not the only avenue when considering an overseas acquisition.