

GUIDELINES FOR TRADE ASSOCIATIONS

COMMERCE ACT

Belonging to a trade association can bring many benefits for members. Trade associations play a useful role in enabling businesses to meet and discuss industry-wide issues and practices and to share knowledge and technical information.

However, members of trade or industry associations are usually competitors. This means that care must be taken to ensure that associations and individual members do not engage in anti-competitive behaviour that may breach the Commerce Act 1986 when taking part in association activities. An individual member of a trade association can be held liable if the trade association they belong to acts in an anti-competitive way, even if this has occurred without the individual's knowledge or involvement.

For this reason all businesses and trade associations should familiarise themselves with the relevant provisions of the Commerce Act, and take steps to ensure they are not at risk of breaching the Act. The purpose of the Act is to promote competition in markets for the long-term benefit of New Zealanders. Breaches of the Commerce Act may result in penalties being imposed by the courts on businesses, associations and individuals. The Commerce Commission is responsible for investigating alleged breaches of the Commerce Act.

These guidelines explain some key sections of the Commerce Act for businesses and trade associations and suggests some practical tips to reduce the risks of breaching the Act. Examples are given for each key section. As the Australian Trade Practices Act has similar provisions to New Zealand's Commerce Act, some examples given are from Australia.

WHAT IS UNLAWFUL?

There are a number of provisions of the Commerce Act of which businesses, trade associations and members of trade associations should be aware:

- Section 27, which makes anti-competitive agreements unlawful. It prohibits anyone from entering into contracts, arrangements or understandings (agreements) if those agreements have the purpose, or effect or likely effect of substantially lessening competition;
- Section 30, which makes price-fixing agreements between competitors unlawful. Price-fixing agreements are deemed to substantially lessen competition in breach of section 27 – so price fixing is referred to as a breach of section 27 via 30.
- Section 29, which makes exclusionary conduct unlawful. Competitors may not enter into agreements which have a purpose of restricting goods or services to a particular person or class of persons, if those agreements have the purpose, effect or likely effect of substantially lessening competition.

These practices are also sometimes called restrictive trade practices. While there are other provisions in the Commerce Act, these guidelines focus on those provisions most likely to be relevant to businesses, trade associations and members of trade associations.

SPECIAL PROVISIONS FOR TRADE ASSOCIATIONS

AGREEMENTS MADE BY ASSOCIATIONS – SECTION 2(8)(A)

The Commerce Act recognises that trade associations can become a vehicle for anti-competitive behaviour, such as the restrictive trade practices mentioned above.

Under Section 2(8)(a) of the Act any agreement entered into by a trade association is considered to be entered into by *all* the association's members. In other words, this section deems *all* the members of an association to be parties to any agreement made by that association, regardless of an individual member's involvement or knowledge of the agreement, unless one of the following two situations apply:

- Section 2(9)(a) states that a member will not be seen as party to an agreement made by the association if the member expressly notifies the association in writing that they wish to disassociate themselves from the agreement, and who then takes steps to disassociate themselves.
- Section 2(9)(b) states that if a member can establish that they had no knowledge, and could not reasonably have been expected to have any knowledge of the agreement, they will not be deemed to be a party to the agreement.

RECOMMENDATIONS MADE BY ASSOCIATIONS – SECTION 2(8)(B)

Section 2(8)(b) states that any recommendation made by the association is deemed to be made both:

- between the association and its members; and
- between the members.

The next section gives specific examples of the types of conduct prohibited by sections 27, 27 via 30 and 29, under which trade associations and their members may be liable.

SECTION 27

Under Section 27 no one may enter into an agreement that contains a provision that substantially lessens competition in a market. To determine whether competition has been substantially lessened, the Commission considers the impact of the provision on the overall competitive process. This involves assessing the ability of other market participants to compete effectively and the ability of prospective participants to enter the market. Section 27 prohibits both:

- entering into an agreement that has the purpose, or effect or likely effect, of substantially lessening competition; and
- giving effect to an agreement that has the purpose, or effect or likely effect, of substantially lessening competition.

SECTION 30

The following four kinds of agreements between competitors are illegal:

- bid rigging;
- market sharing;
- price fixing; and
- agreements to restrict output.

These kinds of agreements are sometimes referred to as cartel agreements. These agreements aim to maximise the profits of those involved, while maintaining the illusion of competition. This kind of conduct can damage the welfare of New Zealanders by raising prices and reducing choice, innovation, quality and investment.

BID RIGGING

Bid rigging, or collusive tendering, is when there is an agreement between businesses as to which of them should win the bid, thus eliminating competition among the colluding bidders.

EXAMPLE

Christchurch bus cartel

The chief executive officer of Christchurch Transport Limited had approached its next biggest competitor in the market for subsidised passenger bus services in metropolitan Christchurch. He had proposed an exchange of tender information with a view to bid rigging in order to ensure the retention of the routes historically held by each of the companies.

Despite the discussions, the businesses did not enter into a bid-rigging arrangement. Accordingly, this conduct amounted only to an attempt to breach the Commerce Act. However, the High Court of New Zealand accepted that if major competitors had exchanged sensitive information or bid-rigged, there would have been considerable scope for profit to be made in the form of an increased subsidy to be paid by the Regional Council to the successful tenderer.

The High Court ordered Christchurch Transport Limited to pay a fine of \$380,000, and its chief executive officer a fine of \$10,000, for an attempt to fix prices by bid rigging.

MARKET SHARING

Market sharing, or market allocation, is when businesses agree to divide markets up amongst themselves. This could be by allocating customers, products or geographic regions to particular businesses.

EXAMPLE

Visy packaging cartel

Visy and its competitor Amcor coordinated price rises and swapped information when negotiating quotes for larger customers to ensure that each would retain specific customers, thereby maintaining stable market shares in the corrugated fibre packaging (cardboard) industry. On occasions when the collusion was unsuccessful and a customer elected to swap supplier, another customer contract of around the same value would be exchanged.

Amcor management notified the cartel to the Australian Competition and Consumer Commission (ACCC) through its leniency policy and Amcor and its employees were accordingly granted immunity from prosecution.

The cardboard industry in Australia is worth around A\$1.8 billion to A\$2 billion per year. As a result of the cartel, many customers were significantly overcharged for their packaging purchases, and ultimately this was passed on to their own customers.

The Federal Court of Australia, following a settlement agreement between the parties, fined Visy A\$36 million, and two of its top executives A\$2 million in total, plus costs for participation in a cartel in the cardboard industry.

Proceedings are currently before the High Court of New Zealand in relation to the same or a similar cartel, as it allegedly operated in New Zealand.

PRICE FIXING

Price fixing is when there is an agreement between competitors to fix, control or maintain the price, or any component of the price of goods and services. In effect, price fixing includes any agreement or conduct that interferes with the competitive determination of price, and includes agreements to:

- set a minimum price;
- eliminate or reduce discounts;
- adopt a formula for computing price;
- increase prices; or
- hold prices firm.

EXAMPLE

Koppers Arch, Nufarm and Osmose wood preservatives cartel

Following an investigation into the markets for two wood preservatives, the Commerce Commission brought proceedings in the High Court of New Zealand against Koppers Arch Wood Protection (NZ) Limited, its Australian parent company, three Nufarm companies and two Osmose companies including individual executives for breaches of the price fixing provisions of the Commerce Act. The unlawful conduct included competitors agreeing to:

- share pricing information;
- simultaneously raise prices;
- not compete on price; and
- not compete for each other's customers.

As a result of the cartel, farmers paid higher prices for fenceposts and homeowners paid more for their house framing and decking timber.

The High Court imposed fines totalling \$6.75 million on the parties to the cartel and imposed an additional \$750,000 penalty on Koppers Arch for attempts to exclude a new entrant.

One executive, the former group general manager of Osmose, was fined \$100,000 after admitting involvement in the cartel. This is the highest penalty imposed in New Zealand on an individual cartel member and reflected a discount for an early guilty plea.

OUTPUT RESTRICTIONS

Output restrictions occur when competitors agree to reduce or restrict supply of a good or service with the aim of limiting availability, and therefore increasing prices.

EXAMPLE

Tasmanian salmon growers' cartel

In 2003 the ACCC commenced proceedings against salmon producer Tassal and the Tasmanian Salmon Growers Association, alleging they entered into an arrangement to limit the supply of salmon and to fix, control or maintain the price of salmon.

It was alleged that Tassal and the Association had agreed that the five major growers would 'grade out' 10 per cent of salmon from the 2001 year class, and that they would later consider a possible grading out of a further 5 per cent. The purpose of these agreements was to reduce fish numbers to ensure the financial viability of the salmon farming industry in Tasmania. At the time the arrangement was entered into the Tasmanian salmon industry was in financial difficulty and supply was outstripping demand.

The Federal Court of Australia held that there was an arrangement or understanding between competitors to limit the supply of fish and that this would likely have the effect of controlling or maintaining price, in breach of the anti-competitive provisions of the Australian Trade Practices Act. Tassal and the Association agreed with the Court's findings.

Because of the very difficult state of the industry, and the fact that legal advice had been sought and cooperation shown, the ACCC decided not to pursue penalties. Instead, court orders were obtained that required the industry to establish a trade practice compliance training programme, and stop any future culls.

EXEMPTIONS TO SECTION 30

There are some exemptions to section 30:

- joint venture arrangements (section 31);
- certain recommendations about the price of goods and services provided they apply to not less than 50 people (section 32);
- certain joint buying or advertising arrangements (section 33); and
- partnership arrangements between individuals (section 44(1)(a)).

PRICE RECOMMENDATIONS

Section 32 provides an exemption from the rule against price fixing – a price recommendation will not be illegal if there are 50 or more parties to the agreement for a recommended price, and it is a genuine 'recommendation'. In other words, the exemption only applies where members are free to depart from the recommendation and decide for themselves at what prices they will actually sell the goods or services.

However, it is very important to note that the Commerce Commission or a third party may still challenge such a scheme under section 27 via 30 and section 27 if it can be shown that the price recommendation has the purpose, or effect, or likely effect, of substantially lessening competition. If a price recommendation is made by a trade association with less than 50 members, it will be subject to section 27 via 30, and possibly also section 27.

In assessing whether a price recommendation substantially lessens competition under section 27, the Commission will consider factors such as:

- the number of association members compared with the number of competitors who are not association members;
- the amount of business done by association members compared with the market as a whole;
- the degree to which members accept and adopt the recommendations;
- the degree to which the price list and the association's involvement in the recommendations inhibit members in engaging in competition with each other; and
- how difficult it is for non-association members to enter the market.

EXCLUSIONARY PROVISIONS

Section 29 of the Commerce Act prohibits competitors from entering into agreements which have a purpose of restricting another competitor (or class of persons) from acquiring or supplying goods or services, unless it can be proven that such agreements do not substantially lessen competition.

This section is particularly important for trade associations in the following two circumstances:

- when trade associations enter into exclusive supply arrangements with suppliers; and
- when trade associations are setting membership criteria.

EXAMPLE

NZ Motor Body Building Association

The NZ Motor Body Building Association Incorporated attempted to prevent two firms from gaining membership of the association unless they stopped advertising discounts from ordinary prices for their services. The High Court found that this was a breach of section 29 of the Commerce Act. A penalty of \$15,000 was imposed.

INFORMATION EXCHANGE

Trade associations sometimes gather information about their members' activities, services and prices. This information may then be collated then redistributed back to the membership. This is not unlawful in itself unless there is an implicit understanding that association members will act in a certain way on receipt of the information.

Clearly, this is particularly important when the information gathered and shared with members relates to prices. Under section 30 of the Act it is sufficient if the arrangement to exchange information has the *likely* effect of controlling or maintaining prices – an actual effect does not have to be demonstrated.

In general terms, it is less likely that an inference of price fixing could be made if:

- the information gathered and/or exchanged is general rather than specific;
- the members, producers or customers to which the information relates are not able to be identified in any way;
- provision of information is on a voluntary basis and only relates to historical information; and
- the information is gathered and collated anonymously and independently.

Trade associations should be particularly careful when gathering or exchanging information with members such as:

- the prices of the association's or its members' services, including future pricing; and
- limits or restrictions on output or volume or quality of members' services.

CODES OF CONDUCT

Many trade associations develop and apply their own standards to promote quality, consistency and ethical standards – known as codes of conduct. While an association is entitled to make such rules and impose sanctions on members if the standards are not met, the trade association must ensure that any code of conduct, and any action it may take to ensure members adhere to the code of conduct, complies with the Act.

Well designed and properly enforced, codes of conduct can deliver increased protection for consumers and reduce the regulatory burden for members. However, trade associations must also ensure that;

- the rules are clear and transparent;
- the rules do not relate to pricing or pricing policies;
- any restrictions on members or membership rules do not restrict and reduce competition in the industry in a substantial way; and
- any disciplinary procedures do not restrict and reduce competition in the industry in a substantial way.

Associations should also consider seeking professional advice about possible competition issues arising out of the operation of their code of conduct.

PRACTICAL TIPS

There are a number of steps trade associations can take to ensure that they do not put themselves at risk of an allegation of anti-competitive conduct under the Commerce Act:

- Membership criteria. Trade associations should ensure that membership criteria are objective, transparent and impartially applied. No members should be expelled unless there is a breach of a clearly defined rule.
- Conduct during meetings. Regular reminders from the chair, perhaps at the beginning of the meeting, that those present should not discuss prices, discounts or any other matters relating to pricing. They also should not discuss nor come to any agreement which might substantially lessen competition, for example, in relation to supply arrangements.
- Price recommendations. If making a price recommendation to members, a good safeguard is for trade associations to state expressly in the price recommendation that the prices are recommended prices only and there is no obligation upon members to charge such prices.
- If pricing discussions occur during the meeting members should raise an objection straight away, leave the meeting if the discussion continues and write a letter disassociating themselves from the pricing discussion immediately afterwards.
- Review internal documentation, policies and procedures for compliance with the Commerce Act.
- Review all publications including websites, magazines and newsletters for compliance with the Commerce Act.
- Take care when gathering or exchanging information.
- Consider whether to seek an authorisation under section 58 of the Commerce Act for any agreements that may lessen competition but for which public benefits may outweigh competitive detriments.
- Seek external legal advice promptly whenever potential competition issues arise.

THE COMMERCE COMMISSION'S POWERS

The Commerce Commission is responsible for investigating alleged breaches of the Commerce Act and has significant and broad-ranging powers when doing so. This includes the power to:

- require a person to provide information, furnish documents or appear before it to give evidence under section 98 (a), (b) and (c) of the Act respectively; and
- undertake a search, and seize documents, subject to obtaining a search warrant under section 98A of the Act.

Failure to comply with a section 98 notice can result in a fine of up to \$10,000 for individuals and \$30,000 for bodies corporate. This is a criminal offence.

PENALTIES

If the courts find an individual or body corporate has breached the Commerce Act, penalties can be heavy:

- for an individual, a maximum of \$500,000; or
- for a body corporate,
 - the greater of \$10 million, or
 - three times the commercial gain (if this can be readily ascertained) or 10 per cent of turnover.

LENIENCY POLICY

The Commerce Commission offers a leniency programme. This means that the first cartel member to disclose the existence of the cartel, by applying to the enforcement agency for conditional immunity, will receive conditional immunity from prosecution. The condition on which immunity is provided is that the cartel member fully cooperates in the investigation and any subsequent proceedings. The Commission's leniency policy and process guidelines are available on the Commission's website www.comcom.govt.nz/cartel-leniency-policy

IMPORTANT NOTICE

Although these guidelines cover the main process issues for businesses and their advisers, they do not cover every issue that may arise. They are not intended to be:

- a binding statement of how the Commission will exercise discretion in a particular situation;
- a substitute for legal advice; or
- a restatement or definitive interpretation of the Commerce Act (or any regulations or orders made under it).

Anyone in doubt about whether they may be affected by the legislation should consider seeking legal advice.