

# The Application of the Leniency Policy

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## Introduction

In 2000 the Commission launched a Leniency Policy and a Co-operation Policy. The Commission significantly revised these policies in 2004, with the sole aim of maximising the Commission's prospects of uncovering cartel activity and of taking effective action against cartels. As the OECD noted in 2000:

"In sum, cartels are unambiguously bad. They cause harm amounting to many billions of dollars each year. They interfere with competitive markets and with international trade. Their participants operate in secret, knowing that their conduct is unlawful. Their detection and prosecution should be a top priority of governments everywhere."<sup>ii</sup>

Cartel conduct is a serious economic issue. A recent study of cartels uncovered over the period 1990-2005 placed the cost at US\$300 billion.<sup>iii</sup> Another study suggests that cartels result in overcharging of 20-30% on average.<sup>iv</sup> While the cost to New Zealand of domestic and international cartel conduct is unknown, it is clearly substantial.

Given the diverse range of views on the Commission's other work, it is pleasing that the greatest criticism of the Commission's leniency policy has been that it was not needed. As the Chair of the Commission recently noted, such notions were dispelled when two leniency applications were received the day after the policy's introduction.<sup>v</sup> Prior to the Commission's revised policies the Commission had received no leniency applications relating to cartel activity.

The Commission has recently launched proceedings against a number of foreign defendants in respect of an alleged international cartel in the supply of gas insulated switchgear. The Commission's investigation in this case was triggered by an application for leniency from one of the participants in the alleged cartel. This alleged cartel operated from 1988 until 2004, ceasing only after a participant sought leniency from competition authorities.

## The Commission's Leniency and Co-operation Policies

The ultimate goal of the Commission's Leniency Policy is the long term benefit to New Zealand economy which flows from healthy competition. Leniency increases detection of cartels, thereby increasing compliance with the Commerce Act, bringing increased competition and improved social benefit.

As the Commission has recently noted self reporting of cartel conduct is intuitively against the interests of the reporting party.<sup>vi</sup> The Commission, as with enforcement agencies the world over, recognises that commercial parties require predictability and certainty of outcome before leniency will be an attractive option.<sup>vii</sup> The Commission's Policy is designed to meet this objective.

For self reporting to be an economically rational act a party must be able to predict how it will be treated if it cooperates, and what the consequences will be if it does not. This factual/counter-factual requires knowledge of:

- the risk of detection, including defection by another cartel member;
- the likely penalty in the absence of leniency/co-operation;
- how a party can qualify for leniency and thereby gain immunity from this penalty; and
- if it is unable to gain immunity:
  - when and how a party can co-operate with the Commission; and
  - the reduction in penalty available in exchange for timely and valuable cooperation.

### **Probability of detection**

It is internationally recognised that no leniency policy, no matter how generous or well drafted, will be effective unless there is fear of imminent detection and prosecution.<sup>viii</sup> Competition enforcers around the world have proclaimed the investigation and prosecution of cartels is their highest priority.<sup>ix</sup> It is no surprise then that the Commission has made it very clear that cartel enforcement is a high priority, and that it will pursue cartels operating in or affecting New Zealand markets.

However the leniency and co-operation policies are not the only tools at the Commission's disposal. Robust and rigorous investigation of unlawful conduct is essential. In that regard, it is worth noting that the Commission's high profile prosecution of the Wood-Chemicals industry resulted from a Commission investigation, not a leniency application.

As a result of increased investigative expertise in cartel conduct, in conjunction with the Commission's Leniency Policy, the Commission is uncovering far more cartel conduct than it has in the past. The Commission is currently has six or seven investigations into what could be characterised as "hard core" cartel conduct. We expect to initiate three or four cartel cases in each of the next two years. Over the long term, the Commission expects its cartel enforcement to continue at higher than historical levels.

### **Penalty in the absence of leniency/co-operation**

The Commission, through its work, continues to develop useful jurisprudence on the appropriate level of penalty under the Act as amended.<sup>x</sup> It shares concerns expressed judicially that penalties in this area do not yet reflect the serious harm caused by cartel conduct.<sup>xi</sup> It notes that overseas courts have referred to cartel conduct as "the supreme evil of antitrust"<sup>xii</sup>

Of particular moment are the penalties against Koppers Arch and Osmose in a cartel in the wood preservatives industry. The Commission's action against other cartel participants is ongoing. These proceedings have already provided useful guidance to the Commission on issues of jurisdiction, accessory liability and penalty.

Last year, the Courts fined the Koppers Arch and Osmose companies over \$5 million for participating in a cartel in the wood preservatives industry. The High Court, in agreement with the parties, imposed a record penalty of \$3.6 million on Koppers Arch Wood Protection (NZ) Limited and its Australian parent, Koppers Arch Investment Pty Limited. This penalty is more than double the previous highest, and comprises \$2.85 million for price-fixing and \$750,000 for attempting to exclude a new competitor from entering the market. Another member of the cartel, Osmose was fined a total of \$1.8 million.

Importantly the High Court noted that the agreed penalty imposed on Koppers Arch would have been \$7.2 million, but for a 50% discount given because the Koppers Arch companies had admitted the breach shortly after proceedings were filed. The Commission considers that in future, given the operation of the Commission's Co-Operation policy, it is unlikely that such a penalty recommendation would be made in respect of an admission after proceedings are filed. Such a large discount is more appropriate in the case of a cartel participant who has co-operated fully with the Commission from the outset. The Court noted that although the penalty is a civil one, there is a similarity with criminal sentencing practice. If that is correct, this would suggest a reduction of no more than 25% – 33% for early admission.<sup>xiii</sup> Going forward, the Commission will look to the approach of other jurisdictions that differentiate between immunity and co-operation.

### **Qualification for Leniency**

At the outset it is important to note that the Commission will **automatically** provide immunity from suit to the first cartel participant (company or individual) to:

- provide information to the Commission about a previously unknown cartel; and
- agree to co-operate fully with the Commission's investigation and prosecution of the cartel.

To be absolutely clear, there is no discretionary aspect on behalf of the Commission. A grant will be made to the first qualifying cartel participant. As noted above, for the policy to be effective companies require certainty, and in the Commission's view this is the only way to provide it.

The Commission will advise an applicant as soon as possible whether he or she is first, and will grant that person conditional immunity. It should be noted however that "first" means the first person to make a formal leniency application. In the absence of a marker system conducting your own internal investigation before formally applying may cost an applicant leniency.

Second, the leniency policy extends to all types of cartel conduct under Part II of the Act, expressly including price-fixing, competitor exclusion, collusive tendering, bid-rigging, production or sales quotas and market sharing. Other breaches of the Act are dealt with under the Co-operation Policy.

Third, some have taken the view that a party is not eligible to apply for or be granted leniency unless the relevant conduct is a breach of Part II. On that basis, applicants have not come forward where there is some doubt as to jurisdiction, or other issues such as limitation. The Commission's view is that it need not answer such questions as a precondition to granting leniency, and leniency may be terminated (at no risk to the applicant) if the conduct is found not to concern New Zealand. It is dangerous for parties not to apply given the development of the law as to jurisdiction and limitation.

Fourth, the Commission notes that leniency comes with conditions, including that the applicant confirms that his or her involvement in the cartel has ceased. In the *Stolt-Nielsen case*, the US DOJ has revoked leniency and commenced prosecution where the cartel conduct continued in breach of the agreement.<sup>xiv</sup>

Generally, applicants should be mindful that while they receive the benefit of their agreement at the start, the Commission's expectation of compliance with the agreement is ongoing. Leniency can be revoked if the applicant does not abide by its agreement with the Commission. The Commission expects that its power to revoke leniency will be exercised rarely, and only for serious breach of the applicant's obligations. The Commission is well aware of the damage that such revocation could do to the value of the leniency policy as an enforcement tool.

Finally, it is worth noting that the Commission is prepared, to a point, to be flexible regarding some aspects of the leniency policy. For example, the Commission is aware that other jurisdictions have adopted what is known as a "paperless" leniency process, and understands the reasons why such a process may be appropriate in some circumstances.<sup>xv</sup> Companies and their advisers are encouraged to contact the Commission and deal with issues on a case by case basis, where the need for flexibility arises.

Further detail on the process around, and benefits of, gaining leniency are discussed more fully in Mary-Anne Borrowdale's recent paper, "*Altered States: Co-operation Between Cartelers and Commerce Commission*".

### **The Co-operation Policy**

While the focus of this paper is the Commission's Leniency Policy, the Commission's Co-operation Policy should not be overlooked. For the Commission it is an extremely valuable tool in ensuring the expeditious and efficient investigation and prosecution of breaches of the Act. The nearly 10 year gap between resolution of the US and EU aspects of the Lysine cartel demonstrates this dramatically.<sup>xvi</sup> For defendants (and potential defendants), it offers the prospect of significantly reduced penalties, even up to 100% as in the Koppers Arch case.

Under its Co-operation Policy, the Commission has discretion to take a lower level of enforcement action (or none at all) against an individual or company, in exchange for information about the cartel and co-operation in pursuing the other participants. The principal respects in which this policy differs from the Leniency Policy are:

- It is discretionary, and therefore does not offer the level of certainty obtained under the leniency policy;
- It does not require the Commission to be unaware of the cartel when the applicant approaches the Commission;
- It is not all-or-nothing, and the 'return' for co-operation can range from full immunity to a partial settlement (admissions agreed, penalty disputed); and
- It extends beyond cartel conduct.

The Commission requires that the co-operating party supply to it all information in his or her possession, including documentary and electronic evidence, in relation to the cartel. This includes information held overseas, in circumstances where the Commission may be unable to access that information but for the co-operation. The quality of the assistance that can be provided to the Commission will significantly contribute to the benefit received by the applicant.

Co-operation involves three stages – the proposal phase, the assessment phase and the recommendation phase. Each phase is discussed fully in Mary-Anne Borrowdale's paper, "*Altered States: Co-operation Between Cartelers and Commerce Commission*".

- The proposal phase: The applicant contacts the Commission with a "without prejudice" proposal detailing admitted breaches of the Act, the evidence the applicant provide to the Commission, and matters relevant to the appropriate penalty;
- The assessment phase: Commission staff and advisors assess the proposal, enter into discussions with the applicant over its content, and prepare the necessary documentation. If necessary, Commission staff may ask the applicant to revise the proposal so that it can be recommended to the Commission.
- The recommendation phase: Commission staff present the proposal to the Commission, with a recommendation and a view whether the admissions and suggested penalties are appropriate. The Commission may direct Commission staff to seek further revisions to the proposal.

The Commission agrees with the view of the DOJ that an effective co-operation policy requires clear guidance for parties on both penalty and discount.<sup>xvii</sup> The Commission views this as a high priority for the development of its Co-operation Policy. Over time the Commission will work to ensure there is:

- Consistency between cases over the level of discount applied to second, third and subsequent parties co-operating with the Commission;
- Differentiation within cases between the level of discount applied to second, third and subsequent parties co-operating with the Commission;
- A clear link between the assistance obtained by the Commission and the benefit received by the co-operating party;
- Clarity, around likely levels of penalty and discount.

### **Leniency and Co-operation apply to individuals and companies**

Liability under the Commerce Act is sometimes erroneously viewed as a problem for the company, and perhaps only big companies at that. While this may once have been the case, this view is clearly no longer correct. The Commission will bring actions against individuals, including company management and directors, where they have breached the Act. The Commission's position is simple. Companies only act through their staff. Deterrence requires action against the individuals involved. Experience shows that individuals know their actions are wrong and actively take steps to prevent their employer knowing about the cartel.

Individual directors and executives in the wood chemicals cartel have faced considerable fines for their breaches of the Act. Another recent decision in those proceedings has provided a timely warning to directors that they may be breaching the Commerce Act, and be liable as accessories,

where they become aware of, but fail to restrain, cartel conduct.<sup>xviii</sup> Other recent examples of include the prosecution of the Chief Executive of Giltrap City Ltd<sup>xix</sup> and penalties imposed on individual ophthalmologists involved in price fixing<sup>xx</sup>.

In the Commission's experience companies will usually seek - and be granted - leniency/co-operation in respect of directors, current employees and former employees. They need not do so, and may well exclude individuals who refuse to co-operate or were responsible for the cartel conduct. Should an individual refuse to co-operate fully with the Commission, they will place in jeopardy the leniency of both the applicant and the individual.

As the Commission has reiterated, leniency goes to the first qualifying applicant. Companies and their advisors need to be aware that an individual can be the first through the door and gazump their application. There is no reason in principle why an individual could not seek leniency on behalf of a company. However this has not happened yet in the Commission's experience. If a director or senior executive approaches the Commission without the company being included in the application, leniency will be granted to the individual and it is likely the company will need to apply for a co-operation agreement.

Finally, the Commission notes that in its experience there is often a divergence in the interests of the company, its directors and its employees.<sup>xxi</sup> Individuals may have a much greater incentive to co-operate with the Commission. The Commission encourages individuals to obtain separate representation in such cases.

### **Comparison with Australian Competition and Consumer Commission policy**

The Commission considers there are some major differences between its leniency policy and the ACCC's policy. These are:

- marker system
- immunity after discovery
- paperless process
- ring leader exception
- amnesty plus

### **Marker System**

An application for immunity in New Zealand generally involves the following:

- a hypothetical inquiry to determine if immunity is available;
- an application for conditional immunity;
- a grant of conditional immunity by the Commission; and
- a grant of final immunity by the Commission.

An application for immunity in Australia generally involves an additional step, the placement of a "marker" prior to the application for conditional immunity. The purpose of the marker system appears to be to allow an applicant to develop a full case for leniency. The time allowed varies from application to application, but is generally 28 days although an extension can be requested.<sup>xxii</sup>

A marker system allows a cartel participant to confidentially notify an enforcement agency of potential cartel conduct, and preserve first place in the immunity queue while the applicant obtains the necessary information to prepare an application for conditional immunity. Some agencies allow second and subsequent markers, reserving immunity in case the first marker applicant does not receive leniency.

A marker system encourages cartel participants to disclose their participation in a cartel by reducing the threshold for making initial contact with an enforcement agency, in return for the comfort that they will not be overtaken by other applicants while putting together an application. A marker system may be useful where cartel conduct involves multiple jurisdictions, as it allows the application to secure its place in line with multiple competition authorities within a relatively short time span. The

marker system can also encourage other participants to come forward and for a rivalry to occur between cartel participants. If the first marker falls the second marker receives full immunity and so on.

### **Immunity after Discovery by ACCC**

Under the ACCC policy, similarly to the US DOJ and Canadian positions, an applicant can receive immunity up until the ACCC has sufficient evidence to institute proceedings in respect of an alleged cartel. This provides a wider window for obtaining leniency than the position in New Zealand.

The Commission's current position is that immunity from prosecution can be granted under the co-operation policy where the Commission has already learnt of a cartel. The Commission will consider whether to deal with a similar position under the co-operation policy where an applicant is able to provide significant assistance to the Commission's investigation. Such an approach has been highly successful for the Commission in the Koppers Arch proceeding.

### **Paperless Process**

The ACCC will not require a written application for immunity if an applicant requests a "paperless process". A paperless process permits the applicant to make an application without generating any new documents which may be used against the applicant. A fear of civil liability, or liability in another jurisdiction, may discourage an immunity applicant.

Contrary to some views, a "paperless" process generally does not mean that the enforcement agency creates no records. Competition agencies are reluctant to allow their investigation to be detrimentally affected by a lack of records. Under a paperless process, the agency endeavors to ensure that the records of the application and its investigative practices (such as the recording and transcribing of interviews) do not prejudice the applicant's interests.

Unlike the ACCC, the Commission, under s106(7) of the Commerce Act, cannot be compelled to provide documents unless it is a party to proceedings. The Commission is also mindful of the possibility of an applicant being compelled to provide copies of documents provided to it by the Commission, such as transcripts being checked for accuracy. The Commission is committed to the confidentiality of leniency applicants. The Commission will take steps to ensure that, as far as the law of privilege and public interest immunity allows, communications between the Commission and applicants are not disclosed.

### **Ring leader exception**

The ACCC will not extend immunity to a company that is the ring-leader, or that has coerced another company to participate in the cartel. Immunity will not be granted to employees of a company that has coerced another company to participate in the cartel.

Both the ACCC and the Commission recognise that in many cartels there is no coercion or clear leader. The Commission's position is that in many instances it is a major challenge to determine the ring leader. Many conspiracies evolve over time and the ring leader role can fluctuate. The Commission decided that the preference was to ensure certainty as to application of the immunity and that the perceived rare cases where involving such a ring leader or coercive party do not justify a departure from the certainty offered by its current policy.

### **Amnesty plus**

The international competition community is well aware that recidivism is common in cartel conduct. A recent study analysed the membership of 283 cartels and found 174 instances of recidivism, which the study noted was likely an underestimate of the true level of recidivism.<sup>xiii</sup>

The ACCC has adopted a US DOJ practice known as "Amnesty Plus". It applies to the situation where a person is ineligible for immunity (for example, because there was a prior applicant), but co-operates in the cartel investigation and applies for immunity in respect of a second cartel. The person receives leniency in respect of the second cartel, and a penalty discount on the first cartel that is greater than that available for co-operation alone.

Although there is no formal “amnesty plus” in the Commission’s policy, the Commission’s current position is that co-operation across multiple investigations or matters will be relevant to the level of penalty imposed, or enforcement action taken, as a result of a cartel investigation. The Commission considers it has the flexibility to address similar issues as there is no limit on the mitigating factors to take into account when determining appropriate penalty. The Commission will need to consider whether to make its position more clear in this area. Potential applicants with proposals in this regard should discuss them with the Commission.

### **Review of the policy – is it likely to change?**

Following a process of review, the ACCC released an updated leniency policy in August 2005. During the course of its review the Chairman of the ACCC noted that:

“Leniency policy or amnesty is an essential tool in breaking the cocoon of secrecy that enshrouds cartels and prevents their detection. Steps taken by the ACCC to review and improve the practical operation of the policy will sharpen that tool.”<sup>xxiv</sup>

The Commission is conscious of the need to learn from its experience under its policy and the growing international experience on leniency generally. The Commission continues to welcome comment from the New Zealand competition community on how it can improve its leniency policy. The Commission has not yet fixed a timeline for a further review of its leniency policy for several reasons:

- The application of leniency is still relatively new to New Zealand. As previously noted, certainty is an essential component of a successful leniency programme, and the Commission does not want to cause uncertainty in the competition community by making major changes to the policy soon after its last review. This is of particular concern if the Commission is to consider some of the more sophisticated mechanisms
- At present there are significant differences in the operation of leniency policies between international agencies. The International Competition Network continues to develop a consensus as to best practice in this area, and the Commission will want to take advantage of developments at this level.
- The criminalisation of cartel conduct in Australia is likely to bring about an increase in cartel enforcement and leniency applications. The Commission will continue to monitor developments and unfolding experience there.

When the Commission does review the policy, the Commission will likely consider:

- The use of oral or “paperless” applications. While the Commission currently operates with a degree of flexibility on this issue, it is aware of the greater use of such applications in other jurisdictions.
- The use of a “marker” system. The Commission does not consider that such a system is currently required. As the uptake of the Commission’s leniency policy increases, such a system may assist parties in protecting their position when potential cartel conduct is first uncovered.
- Structured discounts for co-operation. The Commission considers there is a need for greater predictability in the discounts applied to second and subsequent co-operating cartel participants. The Commission is concerned to ensure that the co-operation policy provides an incentive to participants, with a greater emphasis on rewarding them for providing information which assists the Commission in its enforcement work.
- Amnesty Plus / Amnesty Minus. Internationally, cartel participants are often repeat offenders. The US DOJ has commented on the success of the Amnesty plus / Amnesty

minus aspect of its policy in bringing additional cartel activity to light. The Commission's ability to move in this area is likely to require significant support from the courts as it goes to the issue of sentencing approach.

- Trans-tasman and international harmonisation. A significant number of leniency applications involve multi-jurisdictional conduct. The Commission will look to ensure that, where possible, its procedures are in line with other relevant jurisdictions, to minimise delay and uncertainty.

The New Zealand competition community will be aware of the criminalisation of hard-core cartel conduct in Australia following the recommendations of the Dawson Report. Such approach has previously been considered in New Zealand and may well be considered again in the future.<sup>xxv</sup> The international trend towards criminalisation of cartel conduct is consistent with the treatment of tax evasion and securities offences, both of which are criminal offences in New Zealand. It is interesting, given its criminalisation of insider trading, that there is considerable evidence of significant economic damage arising from cartel conduct, without corresponding evidence of economic benefits.

The Commission will watch developments in Australia with interest. In the meantime, it notes the sentiment of the US DOJ that:

"nothing in our enforcement arsenal has as great an effect as the threat of substantial incarceration in a United States prison - nothing is a greater deterrent and nothing is a greater incentive for a cartel member, once exposed, to cooperate in the investigation of his co-conspirators"<sup>xxvi</sup>

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- <sup>i</sup> The views expressed in this paper are the personal views of the author and do not necessarily represent the views of the Commerce Commission. I am grateful for the support of Ben Hamlin Legal Counsel Commerce Commission for his tremendous assistance in preparing the paper but all errors are mine.
- <sup>ii</sup> Implementation of the Council Recommendation Concerning Effective Action Against Hard Core Cartels: Second Report by the Competition Committee at 13
- <sup>iii</sup> Statistics On Modern Private International Cartels, 1990-2005, Connor & Helmers (2007)
- <sup>iv</sup> "How High Do Cartels Raise Prices? Implications For Reform of Sentencing Guidelines", Connor & Lande (2004)
- <sup>v</sup> Speech to NZ Institute of Management, Paula Rebstock, 21 March 2007
- <sup>vi</sup> "Altered States: Co-operation Between Cartelers and Commerce Commission", Borrowdale (2007)
- <sup>vii</sup> The U.S. Model of Negotiated Plea Agreements: A Good Deal With Benefits For All, US DOJ, 2006, at 3
- <sup>viii</sup> Drafting and Implementing an Effective Leniency Program, International Competition Network, April 2006
- <sup>ix</sup> Obstruction of Justice in Cartel Investigations, Report to the ICN Annual Conference, May 2006
- <sup>x</sup> The Commerce Amendment Act 2001 increased the maximum pecuniary penalty for a company for breaches of Part II of the Act from \$5 million to the greater of: a) \$10 million; b) 3 times the Commercial Gain; or, if b) cannot be readily ascertained c) 10% the turnover of the company group
- <sup>xi</sup> See *Australian Competition Consumer Commission v FFE Building Services Ltd* (2003) ATPR 47,798, 47,805 at paragraphs 34-36
- <sup>xii</sup> *Verizon Communications v Trinko*, 540 US 398, 408 (2004)
- <sup>xiii</sup> *Commerce Commission v Koppers Arch Ltd & Ors* (Unreported, HC Auckland, Williams J, 6 April 2006) at [42] – [45]
- <sup>xiv</sup> *Stolt-Nielsen, S.A. v. U.S.* (2006) 442 F.3d 177
- <sup>xv</sup> The ACCC Immunity Programme - the "Paperless Process", Kathleen Harris, Law Council of Australia Trade Practices Workshop (2006)
- <sup>xvi</sup> Plea Bargaining / Settlement Of Cartel Cases, OECD Working Party No. 3 on Co-operation and Enforcement, 2006
- <sup>xvii</sup> The U.S. Model of Negotiated Plea Agreements: A Good Deal With Benefits For All, US DOJ, 2006, at 3
- <sup>xviii</sup> *Commerce Commission v. Koppers Arch Wood Protection (NZ) Ltd* (16 March 2007, HC Auckland, CIV.2005-404-2080) at paras 80-85
- <sup>xix</sup> *Commerce Commission v Giltrap* (2002) 10 TCLR 305
- <sup>xx</sup> *Commerce Commission v Ophthalmological Society of New Zealand Inc* [2004] 3 NZLR 689
- <sup>xxi</sup> Altered States: Co-operation between Cartelers & Commerce Commission, Mary-Anne Borrowdale, at B3.1.
- <sup>xxii</sup> ACCC Interpretation Guidelines on the ACCC Immunity Policy for Cartel Conduct
- <sup>xxiii</sup> Statistics On Modern Private International Cartels, 1990-2005, Connor & Helmers (2007)
- <sup>xxiv</sup> Graeme Samuel, Closing comments, Cracking cartels: International and Australian developments - law enforcement conference (24 November 2004)
- <sup>xxv</sup> Penalties, Remedies and Court Processes under the Commerce Act 1986 (1998), MED
- <sup>xxvi</sup> T O Barnett "Seven Steps to Better Cartel Enforcement 2 June 2006 Presentation to the 11th Annual Competition Law & Policy Workshop