

COMMERCE ACT UPDATE - POT POURRI

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1. THE COMMISSION'S COMPLIANCE PRIORITIES

a) Introduction

"The theory of competition is a fundamental feature of our free market society. From the time of Adam Smith until today, competition has been viewed as an important tool for achieving social welfare as well as other social goals. As Kenneth Train observes: '*Competition, in theory if not always in practice, is nothing short of a miracle. Each firm tries to make as much profit as possible without regard (at least directly) for social welfare. Each consumer maximizes his own utility, ignoring others. Yet the result is that social welfare ... becomes as great as possible.*'"¹

Often referred to is this invisible hand that molds individual action to socially desirable goals.² New Zealand adopted this approach in the economic reforms of 1986 with the introduction of the Commerce Act and the establishment of the Commerce Commission charged with enforcing competition law. New Zealand is a small economy and as such it is believed by some that it needs special protection. "The natural conditions of many markets in small economies that tend to limit competition increase the need to regulate the conduct of market players to ensure that competition occurs in those industries in which competition is feasible, that limits are set on the conduct of firms operating in markets that are not self-regulating, and that importers do not behave anti-competitively."³

The Commerce Commission is an independent, quasi-judicial Crown Entity responsible for enforcing a number of general and specific regulatory regimes under the Commerce Act 1986, Fair Trading Act 1986, Electricity Industry Reform Act 1998, Dairy Industry Restructuring Act 2001, Telecommunications Act 2001 and Credit Contracts and Consumer Finance Act 2003, for the purpose of promoting dynamic and responsive markets so that New Zealanders benefit from competitive prices, better quality and greater choice.

This paper focuses on the Commission's compliance priorities under the Commerce Act. Last year marked the 20th anniversary of the Commerce Act, and in recent years the Commission has earned itself a reputation as being more assertive and aggressive in its investigation and prosecution of anti-competitive conduct than ever. Certainly, 2006 was one of its most successful years to date, including record penalties of \$3.6 million in the wood-preservative chemicals cartel (with more to come), the successful prosecution of Palmerston North eye surgeons for price-fixing the fees that they individually charged

¹ Michal S Gal, *Competition Policy for Small Market Economies*, Harvard University Press 2003, at page 13.

² Ibid.

³ Ibid, p7.

the district health boards for their services, and successfully seeking its first Cease and Desist order to promptly restore competition in the market for marshalling at Northport.

b) The Commission's current enforcement priorities

The Commission's presence has been felt. Its successes have been widely reported in the media, contributing to greater public awareness of the Commission's role and activities. However the Commission's success is not a product of the over-zealous canine-like aggression it has been attributed with, so much as targeted enforcement action. Consistent with the approach of international competition agencies, the Commission has made a conscious effort to deter anti-competitive conduct by focusing on activities that cause the greatest detrimental impact on competition and consumers, and taking flagship cases that establish precedents and send clear messages to the market. Measures used to prioritise the Commission's activities include the volume of commerce affected, the strategic importance of the sector, and the duration and nature of the conduct.

While the Commission continues to pursue prosecutions across a range of Commerce Act areas, its current focus is on targeting cartels and investigating breaches of s 36 relating to the abuse of market power. As a part of prioritising cartel conduct, the Commission has also focused on prosecuting obstruction of its investigations and promoting the use of its Leniency and Co-operation Policies to maximise the chances of uncovering, and taking effective action against, cartel behaviour. The Commission's approach to cartel conduct, obstruction and its Leniency and Co-operation policies is outlined more fully below.

In terms of s 36, the Commission recognises that there can be a fine line between aggressive competition and market-distorting monopolistic behaviour - it is important for us to seek greater clarity from the courts on where that line should be drawn. The Commission will strategically pursue investigations in relation to s 36 that are most likely to provide greater clarity about the application of the law. The Commission is currently prosecuting three s36 cases before the courts.

The Commission's current enforcement strategy is in harmony with the general trend observed internationally. By adopting a targeted enforcement action, the Commission and its international counterparts have sought to achieve more with their resources.

c) Obtaining further information about the Commission's compliance priorities

This paper makes reference to a number of cases, papers and policies. The Commission publishes a large amount of information each year on its activities, from our Annual Report and newsletter *Communique*, to the decisions and media releases posted on our website (www.comcom.govt.nz). The Commission's website also gives access to general information about the Commission and its enforcement areas, as well as recent speeches and papers delivered in the public forum by Commissioners and members of the Commission's staff.

Keeping well abreast of the Commission's enforcement activities through the Commission's publications and the media is a good place to start for those businesses interested in compliance and avoiding the bite of the targeted enforcement action.

2. CARTELS, OBSTRUCTION AND THE LENIENCY AND CO-OPERATION POLICIES

a) Introduction

Cartels are an international problem, the subject of targeted enforcement action by competition agencies world-wide. In the Report to the ICN Annual Conference in May 2006 it was reported that Competition enforcers around the world have proclaimed the investigation and prosecution of cartels their highest priority.⁴ In 1998 the OECD initiated an anti-cartel programme with the adoption of the Council Recommendation Concerning Effective Action against Hard Core Cartels. The Third Report on the Implementation of the 1998 Recommendation regarding Hard Core Cartels, published by the OECD, reports that efforts to detect, investigate, and prosecute domestic and international cartels have continued at high levels with more competition authorities focussing efforts and resources on the prosecution of cartels and severe sanctions being imposed against cartels.⁵

The Commission, consistent with its overseas counterparts, has made the investigation and prosecution of cartels a major priority. In a recent speech to the New Zealand Institute of Management, Paula Rebstock commented, "Where ever cartels may be, the Commission will use all the tools at its disposal to discover, pursue and attack them. New Zealand is a country where cartel participants should never feel safe".

b) The harm caused by cartels

Internationally, competition agencies unanimously condemn cartels as the most egregious violations of competition law.⁶ In the United States case of *Verizon Communications v Trinko*, 540 US 398, 408 (2004), cartel conduct was described as the "supreme evil of antitrust".

Cartels directly undermine the Commission's mission to promote dynamic and responsive markets – they create fixed and unresponsive markets, to make higher profits than they would in a competitive market, and in doing so deny New Zealanders the benefits of choice and competition. Cartels harm not only competitors and consumers; they also undermine the dynamic functioning of markets and remove incentives for innovation and efficiency. A cartel that has cornered a market becomes, in effect, a monopoly. As such it can charge inefficiently high prices, while feeling little pressure to deliver quality products or services.

⁴ http://www.internationalcompetitionnetwork.org/media/library/conference_5th_capetown_2006/ObstructionPaper-with-cover.pdf

⁵ <http://www.oecd.org/dataoecd/58/1/35863307.pdf>

⁶ *ibid*

In its Third Report on the Implementation of the 1998 Recommendation, the OECD notes that recent research on overcharges in cartel cases, based on a review of a large number of cartels, estimated that the average is somewhere in the 20-30 percent range, with higher overcharges for international cartels than domestic cartels.

International cartels are a particular problem. In the modern economic environment of widespread international trade, the impact of cartel agreements entered into in one jurisdiction is likely to impact on markets in other jurisdictions. Most of the cartels coming to the Commission's attention are international cartels. The OECD report states that international cartels are especially difficult to detect as they use the most sophisticated measures to conceal their activities, the amount of commerce affected by these cartels is disproportionately large, and they are widely considered the most harmful type of cartel because of the magnitude of harm that they inflict on businesses and consumers. International cartels are particularly harmful for small economy like New Zealand's, where we are highly dependent on imports and exports, relative to other countries. They mean New Zealand producers can be facing cartel prices for key inputs in their production process, but may have to compete with overseas companies who do not face similar cartel prices for key inputs. As a result, New Zealand companies may be less competitive internationally.

Given the inter-territorial nature of cartel conduct, co-operation between international agencies in the investigation of cartels has become an increasingly important priority for the Commission. More effective international co-operation can enhance the ability to detect and investigate international cartels. The Commission can benefit greatly from the sharing of investigative strategies, market information and witness evaluations, as well as the sharing of information obtained from common leniency applicants where confidentiality waivers have been granted. Formal agreements for information sharing will further enhance the Commission's ability to investigate and prosecute international cartels.

Because cartels are most often found in industries that do not sell directly to the end consumer but that supply commodity or undifferentiated type products to a manageable number of manufacturers or service providers, the harm caused by cartels is not always immediately obvious to the public. It is important for competition authorities to raise public awareness of the harm caused by cartels. The Commission has sought to raise public awareness through the prosecution of high profile cases, press releases and public statements.

c) Recent cartel cases

The Commission's prioritisation of cartel conduct has begun to bear fruit in the last year with record penalties, successful prosecutions for obstruction of Commission investigations, and the more effective detection of cartel conduct facilitated by cartel participants utilising the Commission's Leniency and Co-operation Policies to secure a less detrimental outcome for themselves at the expense of their fellow carteliers.

The Commission prosecuted its first price-fixing case in 1990, and it resulted in five dollar fines for the 14 vegetable growers involved. Last year, the Courts fined the

Koppers Arch and Osmose companies over \$5 million for participating in a cartel in the wood preservatives industry. In that case, the Commission achieved a critical milestone with the High Court imposing 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. The judge noted that the penalty would have been \$7.2 million, but 50% discount was given because the companies admitted the breach shortly after proceedings were filed. Another member of the cartel, Osmose was fined a total of \$1.8 million. Action against other cartel participants is ongoing.

d) Cartels and the leniency and co-operation policies

The Commission's Leniency and Co-operation Policies are the Commission's newest tool in uncovering cartel conduct, and a key part of the Commission's enforcement strategy in relation to cartel investigations. Under both the Leniency and Co-operation Policy, 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 party's co-operation. Leniency and co-operation policies are internationally regarded as a key tool in breaking cartels.

The Leniency Policy offers immunity from prosecution to the first cartel member to break ranks and advise the Commission of a cartel. The Commission has not yet adopted a "marker" system for reserving a place in the leniency queue. It is only available if the conduct discovered is not already the subject of a Commission investigation. The policy extends to cartel conduct under Part II of the Commerce Act, expressly including price-fixing, competitor exclusion, collusive tendering, bid-rigging, production or sales quotas and market sharing. Conduct taking advantage of a substantial degree of market power is not covered. Strict adherence to the conditions of leniency is required, including confirmation that the leniency applicant has ceased his or her involvement in the cartel. Failure to fully comply with the conditions of leniency may result in leniency being revoked and their information being used in proceedings against them. Full, free, and frank information is the key to satisfying a party's obligations under a leniency agreement.

If an investigation is already underway, or a leniency application has already been received by the Commission, a co-operation agreement may be sought under the Commission's Co-operation Policy. 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 defendant agrees to fully cooperate with the Commission by admitting a contravention of Part II of the Act and by providing evidence/assistance to the Commission, in expectation of obtaining a reduced penalty from the Court, and having the Commission support its penalty recommendation to the Court. As with leniency, full, free, and frank information is the key to satisfying any agreements sought under the Co-operation Policy and those parties who do not fulfil

their obligation risk their agreements being revoked, and their information being used in proceedings against them.

In a recent paper one commentator observed that, in the Wood chemicals case, a Koppers Arch whistle-blower had received full immunity after the Commission's investigation had commenced, and that this was "contrary on the face of it, to the CC's policy."⁷ In fact that informant received immunity from suit under the Commission's co-operation policy, which makes up in flexibility what the leniency policy may lack. The Commission's investigation was well advanced, so no person was eligible for leniency. But the co-operation policy allows for the Commission to take no enforcement against a person where his or her assistance is usually critical to the success of the investigation or Court proceeding. In that case, the informant's affidavit evidence as to meetings, events and transactions was invaluable in satisfying other defendants that they had breached the Act, and for use in Court to establish whether, when and where specific conduct occurred. Without his co-operation, much of this evidence could not have been obtained by other means.⁸

The Leniency programme creates incentives for cartel members to break ranks and admit their behaviour, and is proving to be one of the best ways to discover these secret arrangements with eight leniency applications received to date, two of which were received the day after the Leniency Policy's introduction in late 2004. The Leniency Policy increases the chance of detecting a cartel by creating distrust among its members. Companies face a race to the Commission both at a corporate and individual level. Not only do companies involved in cartels need to fear each other, they must also face the possibility that one of their senior executives or directors may go to the Commission, leaving the others in the gun.⁹

If a party believes it has evidence of cartel conduct and wishes to apply for leniency or co-operation with the Commission, a copy of the Commission's policies are available on the Commission's website. In the case of leniency, the Commission will advise the applicant as soon as possible whether he or she is first, and will grant that person conditional immunity. 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*".¹⁰

e) Obstruction

⁷ Miriam Dean QC and Matt Sumpter, "*The Commercial Regulators' Armoury*" for Legal Research Foundation Conference, The Modern Reality of Dealing with Commercial Regulators 29 September 2006 at 2.54".

⁸ Mary-Anne Borrowdale, *Altered States: Co-operation between Cartelers & Commerce Commission - 7th Annual Competition Law & Regulation Review* at <http://www.comcom.govt.nz/MediaCentre/Speeches/SpeechesList.aspx>.

⁹ For further information on the Commission's leniency and co-operation policies, see Mary-Anne Borrowdale, *Altered States: Co-operation between Cartelers & Commerce Commission - 7th Annual Competition Law & Regulation Review* at <http://www.comcom.govt.nz/MediaCentre/Speeches/SpeechesList.aspx>.

¹⁰ *ibid.*

The ICN has reported that there is a broad consensus that obstruction of cartel investigations is a roadblock to successful anti-cartel enforcement and that if “competition enforcers are to be successful in detecting and deterring cartel activity, protecting the integrity of governmental investigations and proceedings must also be a paramount priority.”¹¹ The Commission too recognises the prosecution of obstruction of Commission investigations to be a corresponding enforcement priority.

Cartels are by their nature secretive, and cartel participants are by definition dishonest. One of the challenges of investigating cartel behaviour is that at every step of our investigation process, we are likely to encounter obstruction, uncooperative attitudes, and outright lies. Indeed, this was the Commission’s experience in the wood chemicals investigation which gave rise to four sets of s 103 criminal prosecutions for acts and omissions that obstructed the Commission’s investigation. Koppers Arch NZ and a director were convicted, respectively, of furnishing false or misleading information and failing to comply with a statutory notice, and were fined \$24,000 and \$8,000 respectively. Documents relevant to the Commission’s investigation were concealed under a house, and others were deleted from computer hard-drives. A director of Osmose NZ was convicted of attempting to deceive or knowingly mislead the Commission by way of lying in a voluntary interview, and was fined \$7,000, and Osmose NZ was convicted of failing to comply with a notice issued by the Commission, in that the company failed to produce relevant documents, that were held in the General Manager’s office. The company was fined \$13,000.

The Commission will not tolerate obstruction of its investigations. Not only will the Commission consider prosecution under s 103 of the Act, but it will also consider prosecutions under the Crimes Act for obstructing the course of justice. This charge carries a maximum penalty of seven years’ imprisonment. A Leniency or Co-operation Agreement will not protect a party from any such criminal prosecutions. Those who try to hide their business dealings from the Commission’s scrutiny must realise that failure to cooperate with a Commission investigation is a serious criminal offence.

f) Future developments in the crusade against cartels

While the Commission has made considerable inroads in the investigation and prosecution of cartel conduct, it recognises that there is still capacity to more effectively combat cartels.

The achievement of record penalties does not mean that the penalties currently imposed for cartel conduct have reached an adequate level. The Commission believes that the discount of 50% given for admitting breach shortly after proceedings were filed in the Koppers Arch case was too generous, and that greater differentiation in penalty should be given depending on the level of co-operation given and at what stage in the Commission’s investigation that co-operation is given.

The OECD’s Third Report on Hardcore Cartels reports that in general, fines for cartel conduct remain substantially below the harm that cartels cause. At the current levels,

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financial sanctions cannot be considered an optimal deterrent, especially considering that not all cartels are discovered and financial sanction should therefore substantially exceed the harm caused by a cartel. The OECD's Second Report on this subject suggested that a fine would have to be three times the actual gain realised by the cartel to be an effective deterrent. One of the challenges with cartels is establishing the commercial gain achieved. In some jurisdictions the approach is to a deeming provision based on an assumption as to the level of gain likely to have been realised.

Many countries in the OECD have adopted criminal sanctions against individuals involved in cartels. Individual sanctions can strengthen the incentive of directors and employees to resist corporate pressure to engage in unlawful activity, and thus enhance the level of deterrence, as well as increase the effectiveness of leniency programmes as they are a powerful incentive for individuals to reveal information about existing cartels and to cooperate in investigations. The prospect of spending time in jail can be a particularly powerful deterrent for business people considering entering into a cartel agreement.¹² Australia has proposed new legislation including the criminalisation of cartels – likely to be introduced this year. With the increased focus on harmonising business law, including competition law across the Tasman New Zealand will have to consider its position in this regard.

f) summary

Cartel conduct is an international problem under the magnifying glass of international competition agencies. It is in this active pursuit of cartels and corresponding obstructive conduct that the Commission has most often been attributed with the image of a gnarled-tooth baring watchdog on an aggressive crusade. In a *New Zealand Herald* article celebrating Paula Rebstock's status of New Zealander of the year 2006, Claire Harvey commented that "None of her work is making her popular with the business sector. Various money types describe her public accusations about cartels and monopolies as 'bewildering', 'far too aggressive', 'extraordinary', and 'driven by some kind of leftie agenda to redistribute wealth' in the economy".¹³ Clearly then, the message is getting through, New Zealand is a country where cartel participants cannot feel safe – and with this fear, it is hoped, will come a greater culture of compliance.

3. SETTLEMENT OPTIONS, AND COMPLIANCE PROGRAMMES

The Commission expects that responsible businesses will increasingly find ways to improve compliance and correct breaches of the law without the need for the Commission to exercise the full extent of its powers. In the Commission's Statement of Intent for 2006/2007 Paula Rebstock commented that the "goal of any enforcement agency is for its intervention to be required as little as possible. ... The Commission expects that responsible businesses will increasingly find ways to improve compliance and correct breaches of the law without the need for the Commission to exercise the full extent of its powers." Ensuring compliance with competition laws through targeted

¹² <http://www.oecd.org/dataoecd/58/1/35863307.pdf>

¹³ NZ Herald 9 December 2006, Claire Harvey, *New Zealander's of the Year: Paula Rebstock*.

enforcement action and increased public awareness is an overarching priority for the Commission.

The leniency and co-operation policies provide businesses with an opportunity to assist the Commission with its investigations whilst conferring benefits on both parties. For the Commission, the policies result in cost savings in the way of avoided investigation and trial costs, early resolutions, the securing of evidence against other defendants, greater certainty as to penalty and promotes compliance. For the cartelier, entering into a leniency or co-operation policy also has considerable advantages including the avoidance of considerable costs of contested litigation, lower penalties, increased certainty, diluted media interest, mitigation of harm in the eyes of customers and the avoidance of business disruption. In the leniency context, when a party comes forward with evidence of a cartel, an agreement is entered into whereby the Commission agrees not to prosecute the party in return for full and frank disclosure and continuing assistance in the investigation. With respect to co-operation, when a defendant indicates a willingness to discuss admissions and quantum of penalty, the parties aim to enter into a negotiated settlement in the form of a co-operation agreement. This will involve agreeing on a statement of facts to submit to the Court, and, where agreement on a suitable penalty range can be made, the Commission will often support the co-operating party's penalty recommendation. Where the parties cannot agree on penalty, they will submit the agreed statement of facts to the Court and make separate submissions on penalty for the Court to consider.

The Commission will also consider entering into settlement agreements in appropriate cases where the Commission considers there is enough evidence to issue proceedings and a party is willing to admit a breach. As a prosecutor, the Commission ensures that charges laid bear a reasonable relationship to the defendant's conduct, that there is adequate evidence to support the charge and only pleads those cartel breaches for which it believes there is sufficient evidence, keeping the sufficiency of evidence continually under review. The Commission will not initiate bargaining over admissions. The Commission does not approach defendants with a view to compromising all or part of a claim – if a defendant wishes to enter into settlement negotiations, they must approach the Commission and put their cards on the table first. Further, the Commission will not accept a penalty or costs in lieu of an admission.

The Commission actively encourages businesses to proactively develop a compliance culture. A culture of compliance can be achieved in different ways. Businesses can establish an internal compliance programme through independent legal advice. A compliance programme is an in-house checking system designed to ensure that businesses and their staff do not breach the Act. While the Commission does not run or endorse company compliance programmes itself – to do so would risk compromising its independence – a compliance programme that effectively eliminates systemic breaches of the Act may be taken into account as a positive factor by the courts when imposing penalties for breaches of the Act by members of its staff. A company may also introduce a whistle-blowers policy, and take active steps to educate its staff - making it more likely to discover illegal behaviour if it occurs, have a deterrent effect, and send a clear message to its staff about the organisations' values.

4. USE OF CEASE AND DESIST ORDERS

Cease and Desist orders are another tool available to the Commission to combat anti-competitive conduct, added to the Act in 2001. For a Cease and Desist order to be issued, the Commission must be satisfied at first sight, on the face of the evidence, that there is an anti-competitive conduct occurring and the Commission needs to act urgently.

Last year, the Commission successfully sought its first Cease and Desist order. At the end of June 2006, the Commission applied for an order from Cease and Desist Commissioner Terence Stapleton to order Northport Limited to cease and desist from behaviour that the Commission and Northport agreed amounted to a prima facie breach of s 36.

The issue involved cargo marshalling and stevedoring services provided at the port. Northport operated the port and a subsidiary (NSS) provided marshalling services. A company called International Stevedoring Operations Limited (ISO) competed and provided similar services. Northport required ISO to use NSS for any forklift services for loading ships or to load directly from its trucks. The Commission contended that this created a cumbersome and costly requirement on ISO.

The Cease and Desist Commissioner after reading the papers and the in particular the consent by Northport, made orders by consent ordering Northport to desist from:

- (a) refusing to permit ISO or other providers of general cargo marshalling services to access the Marsden Point Port for the purposes of delivering cargo for export shipment;
- (b) requiring, as a condition of approval for it to access the Marsden point Port for the purposes of delivering cargo for export shipment, that ISO or other providers of general cargo marshalling services deliver cargo direct by truck under the ship's hook and load that cargo into the ship's hold direct from the truck;
- (c) refusing to permit ISO or other providers of general cargo marshalling services to use forklifts at the berths at the Marsden Point Port for the purposes of unloading cargo from trucks at the berth and moving that cargo under the ship's hook for loading into the ship's hold.

An order was issued within a month, promptly restoring competition in the market for marshalling at the port. The issue of a Cease and Desist order avoided the delays of court action. The time taken to stop the behaviour in this case can easily be contrasted with other litigation where it can be hard to stop behaviour quickly, such as in the Commission's recent case involving Bay of Plenty Electricity Limited. In that case, behaviour the Commission alleges contravenes s 36 continued for a number of years and we have only just had the trial.

This case is a milestone for this jurisdiction. The Commission learned a number of lessons in the case and has now developed its processes and procedures to better deal with appropriate cases.

The Commission will routinely consider whether a Cease and Desist order is appropriate in a given case, and in appropriate cases the Commission will consider using Cease and Desist orders in conjunction with Leniency and Co-operation.