COMPETITION LAW

Commerce Act: cartelling is now a crime

By Gary Hughes

A significant change in anti-competitive cartel law is almost upon us, after a decade's worth of debate, policy u-turns and delayed implementation.

From 8 April 2021, engaging in cartel conduct will attract criminal sanctions under the Commerce Act 1986. Directors and officers of a business who are actively involved in collusion may in future land themselves a jail sentence.

This is the first in a series of articles to provide a refresher to busy commercial/corporate practitioners on key aspects of the law of cartels and collusion. The goal is to improve accurate issue-spotting in commercial transactions and contracts. For clients and advisers, imminent criminalisation means the stakes are now higher if straying close to such conduct.

Although the law change was passed in 2019, as the Commerce (Criminalisation of Cartels) Amendment Act 2019, the two-year lead time before implementation means it has flown under the radar, understandably buried beneath coronavirus news.

Reform process
The biggest law changes have come about in two phases.

Before 2017, price fixing was illegal and already subject to heavy civil penalties in the Commerce Act. Amendments in 2017 significantly redefined and broadened the scope of what is deemed cartel conduct (in s 30A). That expressly added (to traditional price fixing) arrangements affecting supply or acquisition of goods or services by allocating markets or restricting output (including bid rigging).

Policy arguments raged about whether the campaign against cartels needed stronger criminal penalties, especially to target individual wrongdoers.

The 2017 reforms were originally supposed to include criminalisation. But after an off-again, on-again series of party-political proposals, the Labour-led government in 2019 finally made criminalisation effective.

Across the ditch
Australia changed its law in 2009 towards a criminal regime. After a slow start, since 2016 we have seen more severe outcomes there, with the ACCC succeeding in criminal cases against three shipping lines, most recently a A$24 million fine against Wallenius Wilhelmsen in February 2021.

And a prosecution that recently committed to trial six high-profile bankers and their firms (ANZ, Citigroup, Deutsche Bank) looks set to be a

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blockbuster in the Federal Court.

New Zealand's Commerce Commission is likely to begin slowly too, although there are no guarantees. It is raising awareness through mass-market advertising and has several investigations in the pipeline that may attract attention later in 2021.

The commission will have the option to consider how each case should be addressed – by the existing civil regime seeking a pecuniary penalty or by laying criminal charges.

Temptation to go criminal may be tempered by the additional complexity of the task, such as availability of criminal defence procedures. A new iteration of its *Enforcement Response Guidelines* due soon should give clues on how the commission intends to approach these issues.

Nuts and bolts
Potential maximum penalties are one way to grab attention. For an individual committing the new offence (s 82B) of entering into a contract or arrangement, or arriving at an understanding, that contains a cartel provision (or giving effect to one), imprisonment for up to seven years is possible. This is on par with Crimes Act fraud, money laundering and bribery offences, and can be imposed alongside a fine of up to $500,000.

For corporations, the existing penalty regime remains: $10m per offence, or up to three times the commercial gain, or 10% of group turnover.

The *mens rea* element that will apply is an intent to engage in one of the defined categories of cartel conduct, at the relevant time. That does not require any intention to deceive or mislead or screw the market, simply to engage in the proscribed conduct.

Statutory defences are provided in the 2019 amendments (s 82C) if the defendant believed at the time, on reasonable grounds, that one or more of the Commerce Act exceptions applied in relation to the conduct.

Importantly, the defence cannot stretch to scenarios where the belief is based on "ignorance, or mistake, of any matter of law". So, reliance on legal advice alone won't assist.

Exceptions
The Commerce Act exceptions were restructured in the 2017 expansion of cartel conduct notions beyond price fixing.

At least three general exceptions, along with several sector or statute-specific exemptions and carve-outs, might now afford reasonable belief as a defence, covering:

- collaborative activities, replacing the narrow joint venture pricing exception, where a cartel provision is reasonably necessary for a genuine collaborative activity between competitors;
- vertical supply agreements; and
- joint buying and promotion agreements.

There have been no court cases examining the interplay of the new cartel definitions and the available exceptions. However, even the commission acknowledges (in its *Competitor Collaboration Guidelines*, 2018) that cartel conduct can cover a wide field of activity, and "the role of the exceptions is to mitigate the potential for overreach by the cartel prohibition".

Key legal battlegrounds in future criminal cases might include questions of whether:

- the conduct fits the defined categories
- the parties reached an arrangement or understanding
- they reached that position, or "engaged in conduct", with the requisite intent
- the parties were truly "in competition with each other" in a particular market
- one or other of the new 2017 exceptions (eg, "collaborative activities") applies.

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Next week: price fixing

COMPETITION LAW

Price fixing: we know it when we see it?

By Gary Hughes

My first article in this series noted the categories of defined cartel conduct: price fixing, market allocation and output restriction including bid-rigging. This week, we take a closer look at price fixing, the most well-known form of conduct. Or is it?

To some, price fixing has an old-fashioned image of covert deals done in smoky rooms to deliberately stitch up pricing to customers. Fairly blatant, even if secretive and hard to detect. Some lawyers may think it so obvious that "we knew it when we see it".

The trouble is that beyond those hard-core, blatant agreements, the law actually extends a long way into provisions that impact pricing in more subtle ways. This can mean unexpected or merely ancillary restraints, well short of covert cartels, can still affect pricing in one of the forbidden ways and end up being treated as cartel conduct.

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Surprisingly broad terms
Under s 30A(2) of the Commerce Act, price fixing means a provision with purpose, effect, or likely effect of "as between the parties to a contract, arrangement, or understanding, fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining of:

- the price for goods or services that may be supplied/acquired by the parties; or
- any discount, allowance, rebate, or credit in relation to goods or services..."
  in both cases, where at least two parties are in competition with each other.

It is important to recognise some subtle but serious ways in which the core concept of price fixing is widened by the statutory language.

First, it is not just setting actual prices, but other things that "provide for" such setting. Pricing formulas, times and implementation process for intended price rises, algorithms and price-matching clauses. Even key input price components in contracts may tend to maintain/stabilise a general level of pricing. Depending on the facts, these can all come under scrutiny.

Second, the notion of 'price' is broader than headline price and includes any discount, allowance, rebate or credit – essentially any key aspect of pricing decision-making. The Commerce Commission's lengthy series of cases against major airlines up to 2013 was for jointly agreeing to impose (and then update, in concert) fuel and other ancillary cargo surcharges, not base freight rates.

Further, the phrase "controlling or maintaining" extends beyond direct setting/fixing of pricing.

Nuts and bolts
The law focuses on any provision in an agreement, or part of an understanding, that amounts to price fixing. That clause or provision is deemed automatically illegal, regardless of whether the rest of the contract is fine or even has pro-competitive features. Joint ventures or commercial contracts often have ancillary clauses relating to price, even if not the core part of the agreement.

Characterisation as a cartel provision can be avoided if an exemption clearly applies (ie, deemed not to be cartel conduct) or if the parties go to the commission in advance, seeking clearance for that provision.

"Contracts, arrangements or understandings" in the language of the Act include not just formal or written contracts, but oral or informal understandings between competitors (ie, a "nod and a wink"). Email evidence is a frequent source of material to infer an understanding has been reached.

Engaging in the cartel conduct is directly prohibited, regardless of whether it harms competition. It is said to be a per se breach, unlike the general test in s 27 of the Act for agreements intending or resulting in a substantial lessening of competition.

Key NZ case
The most recent cartel prosecutions involved real estate agency house-listing markets. The Supreme Court in *Lodge Real Estate v Commerce Commission* [2020] NZSC 25 upheld breaches by Hamilton real estate companies (and two individuals) who met with rivals to determine an industry approach to cope with TradeMe radically increasing fees for listings on its website.

In agreeing to on-charge the new cost to their vendor customers and not absorb it, the parties were to some extent controlling the price eventually paid for listings/advertising. That was so, even if the TradeMe fee of $159+GST was a tiny part of the overall real estate fee. Although a small component, it was not insignificant in competition terms. Beyond mere mathematical calculation, it had the effect of interfering with the competitive process that should otherwise have applied.

Australian example
In 2016, the High Court of Australia decided that the Flight Centre travel agency had breached equivalent price-fixing provisions in their law. It was selling international air tickets as agent of airlines, but also in competition with those airlines which sold direct to customers. Flight Centre tried to stop airlines undercutting it by cheaper prices they offered to customers direct via internet bookings.

Despite Flight Centre not being an airline, Australia's highest court agreed it was in competition broadly with airlines to sell international air travel tickets to travellers. It had been in litigation with the regulator since 2012 and a $A12.5 million penalty was eventually imposed in 2018.

Key risk areas
Various commercial contracts, distribution agreements, collaborative mechanisms and business sale agreements include clauses potentially falling into the ancillary restraints area.

Those enthusiastically adding restrictive clauses, most-favoured-nation or price-parity clauses or price-matching or notification duties to a mundane commercial contract risk becoming accidental cartelists.

Leaving aside the collaborative conduct exemption, two other useful exceptions might ameliorate the broad sweep of price fixing:

- vertical supply contracts, where supplies to a customer or intermediary are then resold in competition with the original provider; and
- joint buying or promotion agreements, when competing buyers arrange to purchase collectively on terms they might struggle to negotiate on their own (typically, small buyers without bargaining power).

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Next week: market allocation

COMPETITION LAW

Sharing the pot around: market allocation

By Gary Hughes

When markets turn south or experience some sort of external shock – for example, technology, input cost or government policy change – incumbent suppliers may struggle to react.

Sometimes, rival firms look to each other for dialogue about ways to prop up a diminishing pot of gold. Those conditions are ripe for cartel conduct.

Firms may find it easier to agree to reduce the fields in which they compete, rather than try to co-ordinate and maintain outright prices. This week's focus is agreements that have the purpose or effect of sharing (ie, allocating) aspects of a market.

Competitors who try to divvy up the market between themselves (eg, 'we will let you have the South Island if you leave our North Island customers alone') will readily feel the wrath of the Commerce Commission, as with any blatant price fixing arrangement. But often things are not so obvious.

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Market sharing

Even under older price fixing rules, an arrangement to divide up markets – by customers, regions or product/service – was illegal, regardless of actual impact on competition. It was treated as an indirect means to fix prices, as economic theory suggests sharing out supply areas amongst should-be competitors can operate so as to maintain the price to affected customers.

The case that confirmed market sharing can be treated as equivalent to price fixing was *CC v Eli Lilly* in 1999, albeit only in an agreed penalty/settlement hearing. Wholesalers of animal health products to vets agreed that one would sell only to customers buying more than $10,000 worth of products annually, while the other would exclusively focus on smaller customers under $10,000 sales. Penalties of $700,000 were ordered by the High Court.

Nuts and bolts

Commerce Act cartel provisions (s 30A(4)) now directly define and outlaw arrangements to allocate markets in these terms:

"...allocating between any two or more parties to a contract, arrangement, or understanding, or providing for such an allocation of, either or both of the following:
(a) the persons or classes of persons to or from whom the parties supply or acquire goods or services in competition with each other:
(b) the geographic areas in which the parties supply or acquire goods or services in competition with each other."

Firms cannot agree amongst themselves which customers, or groups of customers, to each supply, or on the buying side which ones they will support. Similarly, clauses that allocate products, services, distribution channels or geographical areas will be caught. Extended wording for clauses that merely 'provide for' such things to happen aims at indirect mechanisms to the same end.

The policy intent is that rivals should not agree to allow each other freedom in those areas without competition. An arrangement that has a *quid pro quo* nature, for other business or benefits, or involves one firm withdrawing from a market it previously supplied, in exchange for reciprocal treatment elsewhere, is risky.

Firms should make their own independent decisions and be wary of information exchange with competitors that might be misconstrued later, in the cold light of a commission investigator's day.

Australian example

The ACCC started court action in 2020 against an overhead crane company in the construction sector. The regulator alleges that a distributorship agreement signed with a competitor crane hire firm included a provision not to target each other's existing customers in Brisbane and Newcastle.

The case is ongoing. Design, supply, servicing and spare parts aspects of crane markets are affected.

New exemption

This should not mean all dealings with competitors are off-limits or all routine restraint clauses in contracts are problematic. But it does require that clients put some thought into what they are agreeing and the business necessity or rationale for it.

Recognising the frequently pro-competitive nature of collaboration, and the need to compromise wide cartel definitions, a 'collaborative activity' exemption exists (s 31) if it can be shown that:

- two or more parties are involved in genuine collaborative activity carried on in co-operation;
- the activity is not carried on for the dominant purpose of lessening competition; and
- the cartel clause or restraint is reasonably necessary for the purpose of the collaboration.

JVs, franchises and distributorships might arguably have multiple purposes. If the prevailing or most influential purpose relates to dampening competitive activity, it could fail the test.

The restraint must be reasonably necessary to make the collaboration work, not necessarily 'essential'. Guidelines suggest the parties must demonstrate they would be otherwise 'materially hindered' in achieving the collaborative purpose.

If this exemption applies, cartel conduct is avoided. But this protects only against risk under s 30; s 27 still applies if a likely effect of substantially lessening competition arises.

Key risks

A wide range of unincorporated strategic alliances, partnering deals or joint initiatives could be affected. Industries such as construction or manufacturing may be in the spotlight. Franchises and national distributor systems frequently organise around exclusive geographic territories.

Many should be protected under the new exemption. There might be good reason to allocate aspects of the alliance and confirm it by written restraint. Those incentives may facilitate a new product, service or app coming to market more quickly and efficiently than one party trying to do it alone.

However, to get the benefit of the exemption the commission will test the purpose and rationale, and whether that allocation was reasonably necessary. Could one party have gone it alone, and why didn't it? Was that for reasons to do with competition, as opposed to efficiency and resource-pooling?

The commission has outlined its general stance in guidelines but to date there have been no public examples or court guidance. So, it is well-intentioned but remains to be seen in practice how useful the exemption really proves.

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Next week: restricting output

COMPETITION LAW

Artificial restrictions on output are now criminal

By Gary Hughes

Last week, on 8 April 2021, the cartel criminalisation changes took effect. From that date, competitors who enter into an arrangement with a cartel provision in it face potential criminal consequences.

Even continuing to 'give effect to' a pre-existing arrangement can have the same unpleasant outcome.

That means rivals who collaborate, including through a trade body, or tend to supply each other may need to assess with advisors whether aspects of their business dealings stray into cartel definitions. And, if so, whether they sit safely and squarely within the terms of an available exemption.

To date, we have looked at price fixing and market allocation as key forms of cartel conduct. This week's focus is output restriction.

Restricting output

Output restrictions occur when suppliers agree to prevent, restrict or limit their supply or production into a market where they are, or otherwise would be, competing.

Section 30A(3) of the Commerce Act has since 2017 defined cartel provisions to include restricting output in:

- the production or likely production by any party to a contract, arrangement or understanding of goods, which two or more of them supply or acquire in competition with each other;
- the capacity or likely capacity of any party to a contract, arrangement or understanding to supply services if in competition with each other, as above;
- supply or likely supply of goods or services, if in competition; and
- acquisition or likely acquisition of goods or services, again in competition.

Nuts and bolts

Attempts to cut production arise in industries subject to over-supply or excess capacity issues. When facing a glut in the market that won't soon correct itself, firms may feel compelled to manage site closures or reductions in capacity, or effect structural changes in the supply chain.

Notably, output restriction can also occur on the buying side – where two buyers or bidders agree to limit acquisition of an item they ordinarily compete to acquire. Key inputs and raw materials can be artificially limited to create bottlenecks that benefit sales or harm a third party.

Exclusionary conduct, where some providers attempting to gang up in a targeted way against

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a third competitor (who may be causing the over-supply), can sometimes fall foul of these provisions. That can include understandings reached via trade associations or intermediaries such as advisors and industry brokers or agencies.

The Commerce Commission has previously argued that price fixing implicitly included both market allocation and output restriction, at least indirectly, having an impact or impairment on market forces setting a price.

However, the specific wording of the old price-fixing law led the Court of Appeal to disagree, when it came to output restriction (in *Todd Pohokura* – see below). The court doubted that arrangements to fix output should be treated as price fixing unless carefully crafted, knowing that lower output would closely affect price, and seeking to avoid the literal wording of s 30. Such arrangements should be tested under s 27 instead, where illegality will depend on a purpose, effect or likely effect of substantially lowering competition.

Therefore, having output restriction expressly as part of cartel conduct is a new substantive change. Far more types of commercial contract clauses may be caught, unless being saved by an exemption.

Remember also the extended definition including the phrase 'providing for' a restriction, which deliberately widens the ambit of what is caught. Indirect methods or mechanisms not overtly or directly restricting supply, may still have an effect on production or likely production, supply or acquisition, or market capacity. Breach might arise if a provision creates a basis or system which causes/allows such outcome.

Kiwi cases

The *Todd Pohokura* case in 2015 concerned New Zealand's largest natural gas field and a dysfunctional joint venture where the owners were by that stage at loggerheads.

In litigation over off-take rules for gas, it was argued 'arrangements as to level of output between joint owners of production facilities' may have legitimate gas-balancing rationale other than intent to influence price – and so was not price-fixing conduct.

Another illustrative case saw the commission issue a public warning to Consolidated Alloys, a metal-roofing manufacturer. It had been in a commercial IP dispute with a local competitor, arguing its patent for soft-edge roofing flashing products had been infringed.

Part of the settlement of that dispute included clauses trying to restrict products being made available by the competitor in the whole soft-edge flashing products category.

Requiring the competitor to agree not to sell those was seen as cartel-like behaviour and likely to substantially lessen competition. The commission chair said: "We believe the clause would have restricted competition after the patent expired, ultimately impacting on customers' choice. Clauses like this protect established products by limiting innovation and the development of more efficient or better-value products that benefit consumers."

Australian example

The ACCC took action against poultry companies, an egg producer trade association and several individuals based in part upon an egg over-supply crisis meeting held in 2012. This allegedly attempted to reach a coordinated solution to reducing egg production, in response to perceived over-supply.

After a costly few rounds of litigation, the prosecution failed on the basis there was not a sufficient degree of reciprocal obligation/ expectation reached amongst competing producers.

Key commercial risks

Industries that are dominated by interventionist trade bodies, or key supply facilities, and production alliances might be obvious areas of interest. But conceivably a lot of commercial restraint-of-trade clauses, or carefully-managed national distributor systems, might have clauses touching on volume and type of supplies to market.

Note also extended s 30B situations where it may be another group entity ('interconnected bodies corporate') that end up in competition with each other.

Close analysis will then be needed to demonstrate how the exemption for collaborative activity, including some types of restraints, or on the procurement side for joint buying or promotion agreements, applies.

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Next week: bid-rigging

COMPETITION LAW

How bid rigging works and why it is a crime

By Gary Hughes

This is the last of a series of five articles looking at the nuts and bolts of recent cartel criminalisation law reforms (in force from 8 April 2021), and ramifications of the increased scrutiny it brings upon the actions of individual directors and managers.

This has included a dive into each of the main forms of cartel conduct: price fixing, market allocating and output restricting, and the key exemptions that might retrieve many commercial collaboration clauses from being consigned to an unsavoury bin labelled "cartel provisions".

This week's concluding focus is on bid rigging.

Gary Hughes

Not defined?

Bid rigging is a descriptive, readily understood label and, in the past, has been central to many Commerce Commission investigations.

The commission website retains a helpful factsheet addressing warning signs to look for in procurement departments. But OECD guidance and the equivalent criminal cartel law in Australia's Competition and Consumer Act 2010 explicitly define bid rigging as one of the forms of cartel conduct.

Proposals to change our Commerce Act originally included a definition of bid rigging, by "restraining one or more parties to a contract, arrangement, or understanding from making a bid, or requiring a bid to be in accordance with a contract, arrangement, or understanding..." where:

- 'bid' includes a tender, expression of interest or any step preliminary to making a bid; and
- the features of the side arrangement are not disclosed to the person running the bid.

However, in the parliamentary submission process, MBIE officials decided that defining it was too hard, and all forms of bid rigging would likely fall under one of the market allocation, output restriction or price fixing definitions anyway.

Technically, that may be right. But it feels like a triumph of economic theory over accessibility of the law. People have a ready feel for bid rigging as a concept and, given the primary importance of tenders and auctions to procurement processes in many industries, it still deserves its own attention.

Nuts and bolts

Defined or not, collusive tendering is squarely in the commission's sights. A variety of practices can take place around bidding behaviour, short of submitting fixed prices. Companies may agree not to bid on this occasion, thereby allowing a rival to take the lead (bid suppression). They may communicate about plans to pull out of negotiations after a first-round bid (bid withdrawal) or take turns at winning/leading for different customers at different times (bid rotation).

To keep the buyer/tenderee from suspecting, they may inflate prices to make an unattractive offer (cover bidding) which helps ensure another designated player wins the contract, as planned.

A *quid pro quo* benefit from another colluding party later going softly in a future tender round is usually essential to the arrangement. Buyers, sellers, end-customers, and the taxpayer (in public procurement) end up suffering as a result.

Brokers, agents, industry standard-setting bodies, and consultants involved in tender process can sometimes act as a hub for this type of communication or co-ordination. The regulator often eyes those intermediaries suspiciously as fostering poor transparency or loose practices.

Case examples

Some cases are simple, deriving from ignorance of the law or perceived low risk of getting caught.

In 2018 the commission took a pipeline supplier in the construction industry to task. Its employees communicated via WhatsApp with a rival about pricing for pipeline maintenance service tenders in Christchurch. A warning letter was issued. Post-criminalisation, it is doubtful the commission will be so gentle.

Other scenarios are more elaborate and complex. In 2019, Auckland residential property investment expert Ron Fong found his mentoring business Ronovationz in court, penalised $400,000 plus costs for developing rules through which his members/mentees would send notification of houses they were intending to bid for. In a bubbly Auckland real estate market, the aim was to suppress the degree of fierce auction contests involving members. The High Court confirmed that cartel behaviour applies to the buyer side of markets as well.

Even rigging a single sale/purchase process is enough to trigger problems.

A tender process for sale of a mining industry business, run by financial broker UBS, went badly off the rails. The vendor (Norcast) had a poor relationship with a competitor (Bradken) and specifically did not want to sell the assets to them. Using a private equity intermediary, Bradken got involved anyway, arranging a same-day, undisclosed on-sale process if the private equity bid succeeded.

When that all tumbled out, the vendor sued, cartel conduct was upheld in court and sums approaching $US25 million were awarded to the vendor.

Joint bids, co-suppliers, subcontracting

A regular source of uncertainty surrounds joint bids made as part of collaborative JVs, or shared resources, to increase the chances each competitor will get at least a share of the spoils rather than miss out.

Did the party calling for tenders expect they would each bid separately? Was some contestability in the process lost as a result? And do the justifications for a shared bid stack up?

Often the collaborative activity exemption will apply but some analysis and evidence should be explored before the bid proceeds. Sometimes a joint bid is dressed up as sub-contracting to a rival.

Concluding thoughts

Issue-spotting and recognising potentially risky scenarios is the first step for busy corporate lawyers.

Beyond that, the nuances of competition law often derive from case-law developments rather than general wording in the statutory prohibitions. And unexpected extensions of the law arise, such as for a travel agent found to be in cartel relations with its airline principal, or property coach guru acting as a cartel hub for individual investors. Staff training and working through scenarios is important.

These introductory articles sprang from a cartel training series the author offers for SME law firms and in-house teams. Working through specific fact situations tailored to each industry is the best way to help clients develop better instincts for where the (now criminal) boundaries lie.

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