

CARTEL CONDUCT

OVERVIEW OF HOW THE CARTEL LAWS MAY APPLY TO YOUR BUSINESS

May 2018

INTRODUCTION

Most people think of drug smugglers when they hear the word "cartel". However "cartels" and the laws against them are a lot wider following recent changes to the Commerce Act 1986 (**Commerce Act**). Under the Commerce Act it is unlawful for a business agreement or arrangement between competitors to include a "cartel" clause unless one of the Commerce Act exemptions apply.

A "cartel" in the general sense refers to an association of competing businesses designed to limit competition or control prices. This is broadly what the new cartel rules seek to prohibit.

In a nutshell, arrangements between competitors are illegal – and there are big fines – where competitors are:

- fixing prices;
- allocating markets; or
- restricting output.

All businesses are subject to the cartel laws. Accordingly, it is important that you understand how these apply to your business.

This article discusses how to assess if your business is affected, summarises the cartel laws, and highlights some key risk areas to watch out for.

A. CARTEL LAWS SUMMARY

Set out in this section is a summary of the cartel laws to allow you to understand:

- how these apply to your business; and
- if the cartel laws do apply, whether an exemption may permit you to engage in the underlying conduct.

ARE YOU IN COMPETITION?

Cartel laws only apply to businesses who are in competition. If you are in competition with the other party to the proposed arrangement, or would be but for the terms of your arrangement, then the cartel laws will apply. We think you are better to assume that a counterparty is your competitor until you can prove otherwise – otherwise you may mistakenly assume that the cartel laws do not apply.

The Commerce Commission says in its [Price Fixing and Cartels fact sheet](#) the following about the meaning of "in competition":

"At least two parties to the agreement must be in competition with each other. This means that they compete with each other in the same market, and that the agreement relates to buying or selling goods or services in that market.

If there are more than two parties to the agreement, only two of them need to be in competition with each other."

If you are worried about what another business is doing, we think you are likely to be in competition with them.

The rules extend to associated persons of each of you. For example, shareholders, group or associated entities. Economic and legal analysis is recommended to confirm there is no competitive relationship.

CARTEL LAWS APPLY EQUALLY TO AGREEMENTS & INFORMAL UNDERSTANDINGS

A business arrangement does not need to be a formal written contract to be caught by the cartel laws. Informal (including verbal) agreements, arrangements and even understandings are caught.

ARE YOU ENGAGED IN CARTEL CONDUCT?

Cartel law prohibits clauses or arrangements that have the purpose, effect or likely effect of fixing prices, allocating markets or restricting output. Cartels apply to:

- both procurement (inputs) and sales (outputs); and
- both goods and services.

The categories can overlap so your conduct may fit into more than one of the three categories.

Price fixing

Price fixing is controlling the price (or any related element of price) at which one or both parties buy or sell goods/services from or to others. Essentially, *how much* you are selling or buying for.

It includes prices (minimum, RRP or maximum), discounts, rebates, add-ons, giveaways, packages and loyalty schemes.

Examples:

- If you are a winemaker, agreeing to not sell your wine for less than \$20 per bottle.
- Agreeing with a supplier a minimum price at which you can resell the goods purchased.

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Market allocation

Market allocation is when businesses agree to divide markets up amongst themselves. Essentially, *who* a party may sell to or buy from.

It includes geographic restrictions, channel restrictions, limitations to types of customer or account, restrictions on approaching a customer or supplier. Basically, if you are looking to cut up a territory you are likely to be allocating markets.

Example:

- If you are a winemaker, agreeing to only sell your wine in the Hawke's Bay, not in Wellington.
- If you are in Auckland City, agreeing with a North Shore-based competitor to refer people in the North Shore to the competitor or agreeing not to take on new clients based on the North Shore.

Output restrictions

Output restrictions prevent, restrict or limit production, supply, capacity to supply or the purchase of goods or services. Essentially, *what/how* goods and services are produced, bought or sold.

It includes limitations on amount of output, times of sale, types of goods or services, purchase of competitor's goods, restraint of trade, number of stores or plants, restrictions on supplying to certain persons and approved supplier arrangements.

Example:

- If you are a winemaker, agreeing to only produce and sell Chardonnay and Pinot Noir (even though you can also make sparkling wine).
- Agreeing with a competing business not to be open on weekends.

COMMERCE ACT EXEMPTIONS

If you have identified that you are engaged in cartel conduct, next you need to consider whether you need the cartel clause or if an alternative arrangement can achieve the same or similar commercial outcome without infringing the cartel laws. If there are no other options then you may wish to consider whether one of the below exemptions applies.

You cannot presume that an exemption will apply. You need to do analysis (and get advice) to support your conclusions and you need to carefully document how any applicable exemption applies. If an exemption does apply you may still need amendments to your agreements to ensure the cartel clause is reasonably necessary for the exemption. Also note that an exemption will not necessarily apply to all of your cartel clauses.

You will still need to ensure that the arrangement does not substantially lessen competition in the relevant market/s.

Collaborative activity exemption

This is an exemption for permitted "collaborative activity".

The criteria for this exemption are:

1. The parties to the arrangement are involved in a *collaborative activity*. This means:
 - a. the arrangement is between two or more parties who are carrying on a business activity, enterprise or venture *in co-operation*; and
 - b. the venture does not have the *dominant purpose* of lessening competition between two or more of the parties. This step requires an assessment of the relationship between the parties, and its purpose.
2. The cartel clause is *reasonably necessary* for the purpose of the collaborative activity. This important step requires assessment of each cartel clause. Given that the cartel clause is otherwise illegal, there needs to be strong justification for the clause to be "reasonably necessary".

The collaboration exemption does not make all cartel activity within your collaboration okay. It only applies to the cartel activity that can satisfy the exemption criteria. You can seek clearance for a collaborative activity.

Vertical activity exemption

This is an exemption for cartel provisions that are included in vertical supply contracts. The criteria for this exemption are:

1. The contract is between a *supplier* and a *customer*;
2. The cartel clause *relates to the supply* (including maximum price for resale); and
3. The cartel clause does not have the *dominant purpose* of lessening competition between the parties to the contract.

Joint buying & promotion exemption

This is an exemption for competing buyers who arrange to purchase goods or services together to get better terms than they would be able to negotiate individually (where certain requirements are met). This exemption only applies to price fixing cartel clauses.

The competing buyers need to be free to sell the goods or services at whatever price they choose.

See the flowchart below for this exemption's criteria.

International liner shipping exemption

This is an exemption for international liner shipping.

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PENALTIES FOR BREACH

The penalties for breach are high:

- **Individuals:** Up to \$500,000 fine and/or an order not to be a director or involved in the management of a business for up to 5 years.
- **Corporates:** The greater of up to \$10 million or either:
 - three times the commercial gain from the cartel conduct; or
 - if ascertaining the commercial gain is not possible, 10% of turnover.

As individuals can be liable (and staff can lead to company liability) it is very important that senior management/directors ensure their managers and staff understand the cartel laws.

Bill to criminalise cartel conduct

Currently unlawful cartel conduct is only a civil offence. However there is a Bill before Parliament that, if passed, would make cartel conduct a criminal offence. Under the Bill's current drafting, this means individuals could also face up to 7 years imprisonment for engaging in cartel conduct.

B. KEY STEPS TO ASSESS IF CARTEL LAWS APPLY TO YOU

We recommend the following key steps to assess if the cartel laws apply to you and any agreement or arrangement you are proposing to enter into:

1. Identify if you are involved in cartel conduct:
 - a. Do you have or are you proposing a contract or informal understanding or other arrangement with a third party business?
 - b. Are you in competition with the third party?
 - c. Does the contract/arrangement include a cartel clause?
2. If you have identified that you may be engaged in cartel conduct, then ask:
 - a. Is there another way to achieve the same or similar commercial outcome? If so, do that.
 - b. Are you covered by a Commerce Act exemption? If so, that cartel clause may be permitted.
 - c. If your answer is no to both questions above, your cartel clause is illegal under the Commerce Act.

We have attached a flowchart below to help you identify if the cartel laws apply to you and, if the law applies, whether your cartel conduct may be permitted.

C. WHAT STEPS DO YOU NEED TO TAKE TO COMPLY?

How the cartel laws apply to your business will depend on your arrangements, and the competitive market you operate in. If you have not done so already we recommend that you:

1. ***Become familiar with the cartel laws (and other applicable laws!):*** This will enable you to respond to potential competition issues as they arise in your day to day business.
2. ***Review and amend your existing arrangements:*** We recommend you review your current agreements and arrangements with third parties and:
 - identify any potential cartel clauses;
 - consider whether an exemption applies and carefully document how any applicable exemption applies; and
 - consider amendments that may be needed to ensure that the clause is reasonably necessary for the exemption (if one applies).
3. ***Review and update your policies, and any other contracts or template agreements with cartel clauses.***
4. ***Train your staff.***
5. ***Keep records:*** It is important to keep records justifying your decisions etc, particularly if you are relying on an exemption. Good records will ensure you comply in the first place and protect you in the event of an investigation.
6. ***Schedule regular compliance checks:*** As your business changes over time, so too will the assessment of whether your business complies with the Commerce Act. We recommend you schedule regular compliance assessments as part of your compliance programme – this will be important to protect you from a cartel investigation.

D. FOR MORE INFORMATION

The Commerce Commission issued helpful Competitor Collaboration Guidelines which can be found on the Commerce Commission's website (click [here](#) on pdf).

Cartel and other competition laws are complex and often difficult to apply. For further information or to discuss how cartel laws may impact on your business, please call or email one of the Jackson Russell business lawyers listed below.

E. CARTEL RISK AREAS AND WHAT YOU CAN DO

Cartel risk areas

Activity/area likely to breach cartel laws	Potential issue
1. Reaching an agreement, an arrangement or even a “nudge and a wink” understanding with competing businesses about pricing or promotions	Price fixing
2. Agreeing with a competing businesses standard pricing	Price fixing
3. Agreeing with competing businesses discounts or promotions that one or more of you might run or when the promotions may be run	Price fixing / Market allocation / Output restriction
4. Agreeing with competing businesses on the goods and services available from your or their business, opening days or hours, or other output restrictions	Output restriction
5. Sales staff discussing pricing, promotions, market allocation or output etc. with competitors – everyone should be aware of this	Price fixing / Market allocation / Output restriction
6. Joint marketing with competing businesses	Price fixing / Market allocation / Output restriction
7. Procurement team being alert to restrictive deals with suppliers where the suppliers are also competitors – some corporate groups have many parts	Price fixing / Market allocation / Output restriction
8. Allocating areas/suppliers/customers/channels/potential customers between competing businesses – you cannot have any discussions or arrangements for carving up the market	Market allocation
9. Supply agreements you enter into that may have a cartel clause. Suppliers should not (generally) be seeking to fix: <ul style="list-style-type: none"> a. your resale prices b. where or who you can sell goods or services c. limiting your ability to sell competing goods 	Price fixing Market allocation Output restriction

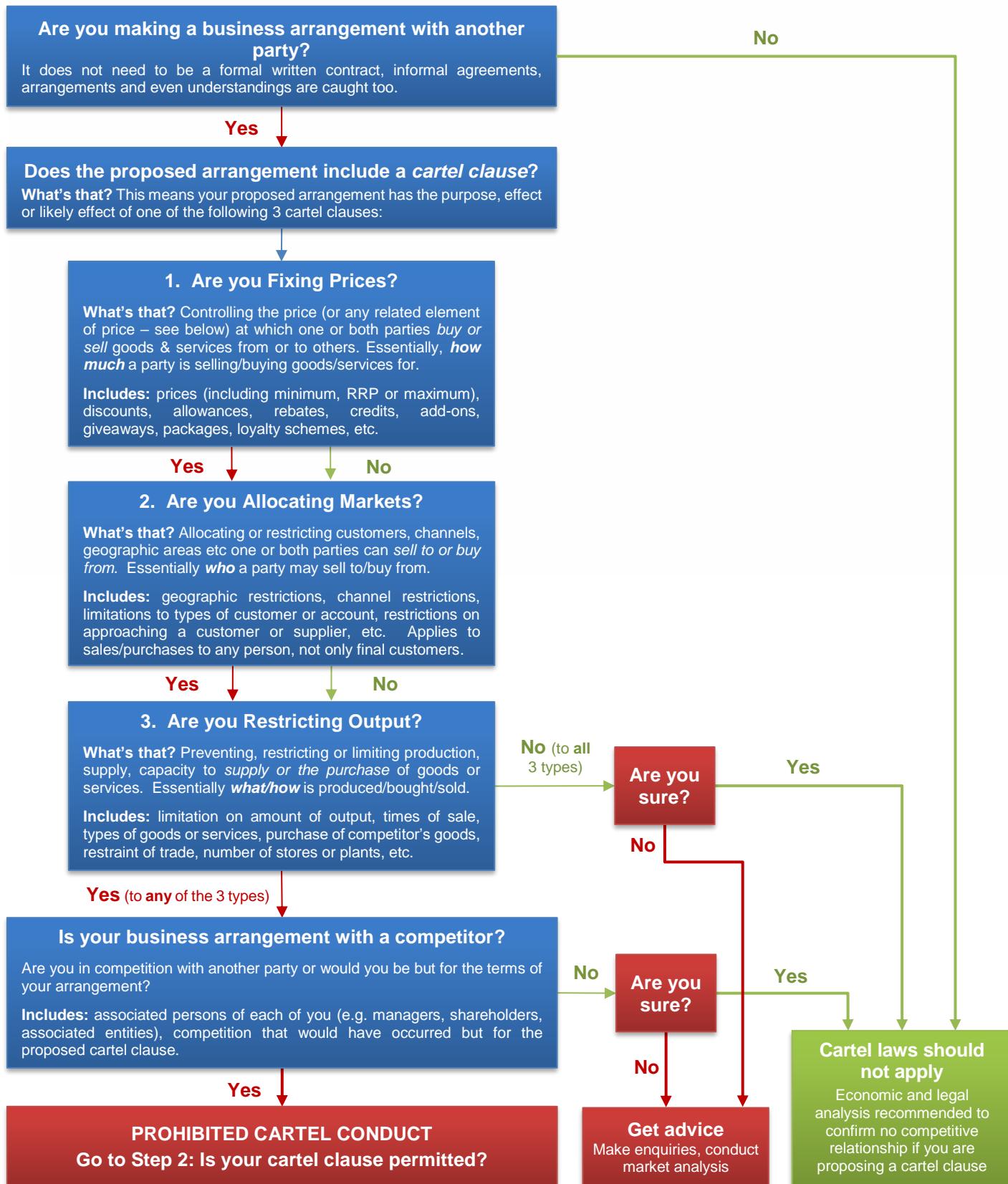
Permitted activities – in each case ensure there is no cartel activity and that you are not competitors

Activity/area that is allowed	Comments
1. Discussing with businesses <i>who are not your competitors</i> (e.g. a business who only operates in Christchurch could speak with a business who only operates in Auckland but not with a business who operates in Christchurch) pricing and promotion strategy or other matters that would be an illegal cartel clause if the businesses were in the same markets and therefore your competitors	Any discussions with current or potential future competitors involves risks, including under competition law. Commerce Commission have issued guidance about competitor collaboration. Refer to our discussion above about who your competitors are – be conservative in your analysis.
2. Discussing with competing businesses operational or staffing matters (not including pricing, market allocation or output restriction)	There are a vast number of things you can discuss that do not involve pricing, market allocation or output restrictions. However, see above comment in bold.
3. Discussing with competing businesses industry specific matters (not including pricing, market allocation or output restriction)	However, see above comment in bold.
4. A franchisee entering into joint local area marketing with other franchisees in its area led by the franchisor/master franchisee (within the collaborative activity exemption)	
5. Attending an industry meeting or conference – ensure no discussions about pricing, market allocation or output restriction	Great care should be taken to avoid cartel conduct if two or more members are competitors. See Commerce Commission guide.
6. Franchisor/master franchisee setting approved supplier and goods or services lists	Franchisor/master franchisee will have obtained legal advice to ensure compliance
7. Pricing set by the franchisor/master franchisee for standard prices and promotions	Franchisor/master franchisee will have obtained legal advice to ensure compliance

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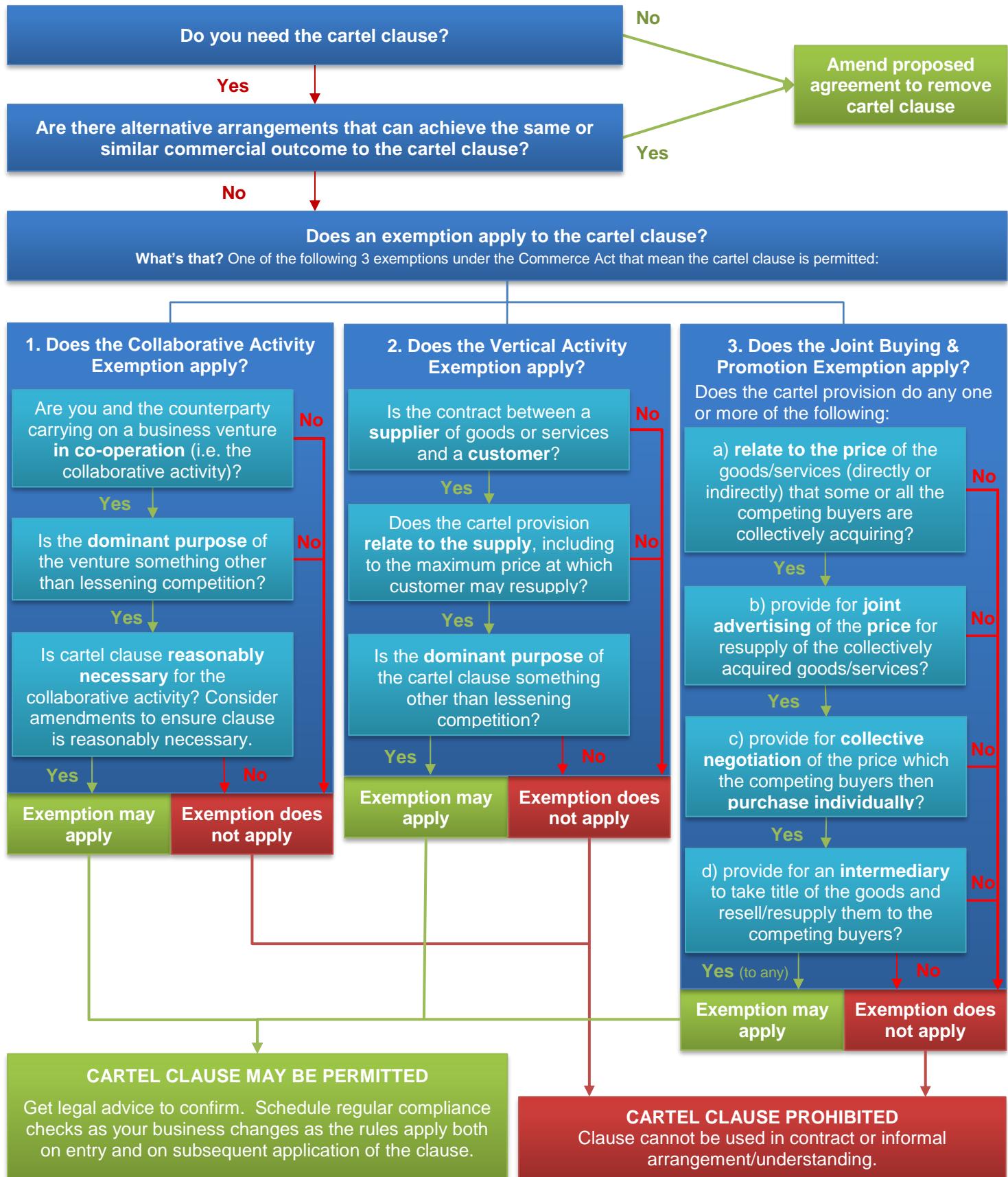
F. CARTEL FLOWCHART

STEP 1: ARE YOU PROPOSING CARTEL CONDUCT?



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STEP 2: IS YOUR CARTEL CLAUSE PERMITTED?



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