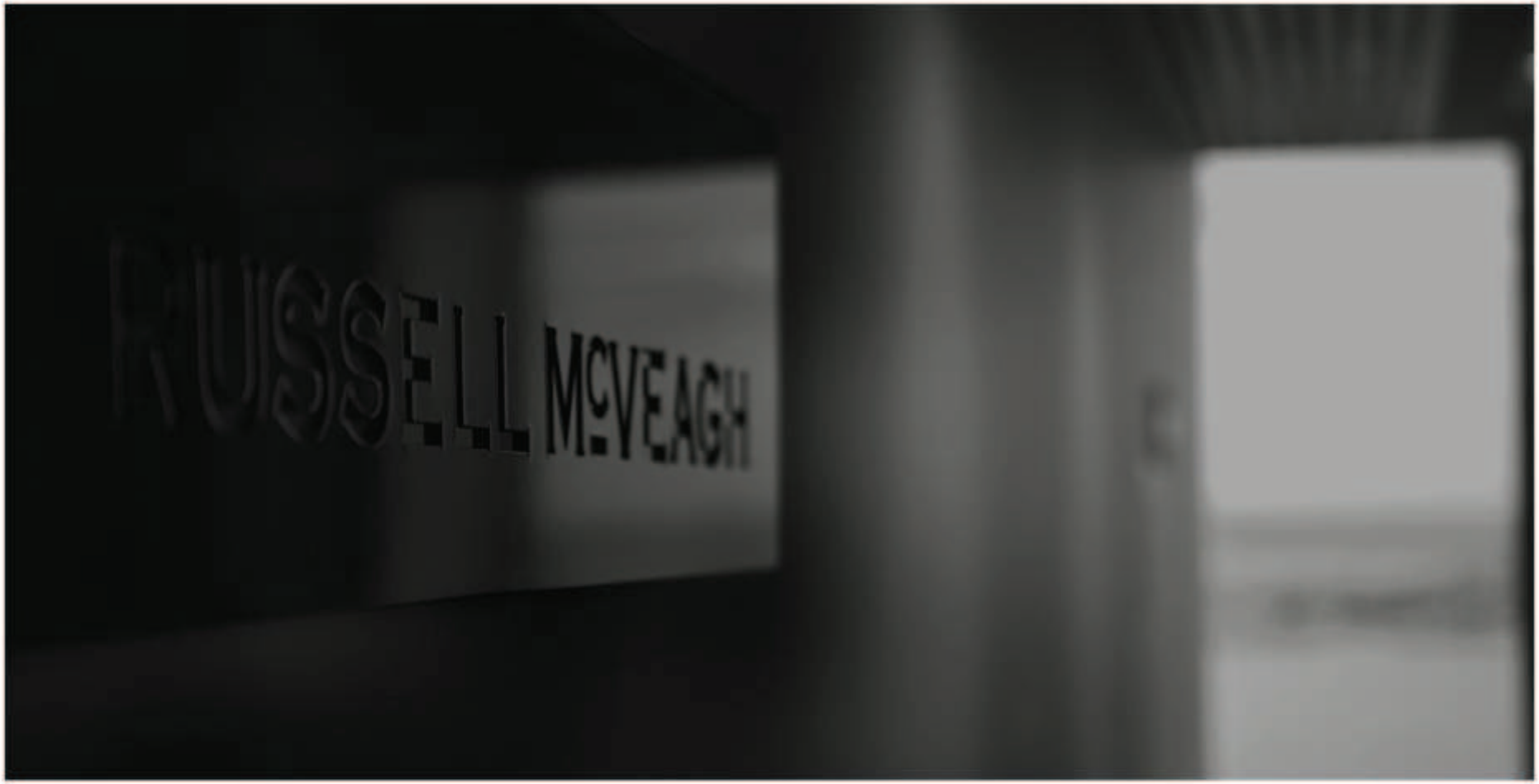

12th Annual Competition Law and Regulatory Review

Enforcing the Air Cargo decision (Part 1): A new "effects test" for New Zealand?

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28 May 2012

Air Cargo Cartel

- **Courts around the world have brought proceedings against airlines party to an alleged air freight cartel from New Zealand, Japan, the UAE, Malaysia, Korea, Thailand, Singapore and Australia.**

- **The Commerce Commission issued proceedings concerning the operation of the cartel in New Zealand. However, some of the airlines claimed that the jurisdiction of Commerce Act 1986 ("Act") did not apply to inbound cargo because the markets in which airlines competed in the provision of inbound air cargo services were located wholly outside New Zealand.**

- **Before hearing the substantive trial, the High Court decided that there should be a preliminary trial on the issue of market definition. The "Part I" trial was conducted on the basis of agreed facts, and the only witnesses were economic experts.**
  - Whether there was a "market in New Zealand" for inbound air cargo services alleged to be the subject of price fixing by defending airlines.
  - No dispute that outbound air cargo services were the subject of the Court's jurisdiction.

Overview of Part I

The Court was asked to determine the following questions:

(1) Do the activities undertaken by the defendants with respect to inbound air cargo services constitute the supply by them of air cargo services in competition with each other in New Zealand?

(2) Are the relevant pleaded markets "markets in New Zealand"?

(3) Does the Act apply to the engaging in conduct outside New Zealand by any person resident or carrying on business in New Zealand where:

(a) as the Commission says, that conduct comprises any act (or refusal to act) to the extent that such an act (or refusal to act) has some impact or influence on any market in New Zealand; or

(b) as the Defendants say, the conduct:

(i) would be prohibited by a substantial provision of the Act if it occurred in New Zealand; and

(ii) "affects a market in New Zealand" by affecting competition in the market in New Zealand in respect of which that substantive provision is alleged to have been breached.

(1) The "section 30" issue

Do the activities undertaken by the defendants with respect to inbound air cargo services constitute the supply by them of air cargo services in competition with each other in New Zealand?

- Section 30 **deems** contracts, arrangements or understandings (**"arrangements"**) that involve pricing fixing between parties who are "in competition" to the arrangements to have the purpose or effect of substantially lessening competition in a market.
  - **Section 27** then prohibits entry and/or giving effect into arrangements that have the purpose/effect of **substantially lessening competition in a market in New Zealand**

- Court: s30 issue an exercise in statutory interpretation:
  - Parliament did not intend to assert extraterritorial jurisdiction: *Poynter* and section 4
  - Meaning of s30 must be ascertained in light of its purpose

- **HELD:** where s30 is invoked in respect of conduct that occurred overseas, the Commission must demonstrate that the parties alleged to have breached s30 were "in competition" **"in a market in NZ"**.

(1) The "section 30" issue

- The Court acknowledged:
  - That the purpose of the s30 deeming provision was to avoid the Commission being required to prove the limits and extent of competition in the relevant markets where price fixing had occurred.
  - That it would not be necessary for the Commission to plead and prove a market in a s30 claim where it is clear competition occurs in NZ; and
- The Court's concern that the Commission was trying to use s30 to extend the extraterritorial reach of the Act (as warned against in *Poynter*) would have been equally and adequately addressed by requiring only that the Commission demonstrate that the parties supplied goods and services "in competition in New Zealand".
- The Court's approach imposes extra costs and complexity in proving the existence of a market to proceed against overseas cartelists for breach of Act via s30, where it is not so required in respect of local actions.

(2) Markets "wholly or partly" within New Zealand

Do the airlines compete in a market for the supply of inbound freight services in New Zealand?

- Agreed that contracts for the supply of inbound freight into NZ were entered into between freight forwarders and airlines *outside* NZ

- The Commerce Act provides a definition of "market" and effect on competition in sections 3(1A) and 3(3), as follows:

> 3(1A) Every reference in this Act, except the reference in section 36A[[2]](b) and (c) of this Act, to the term "market" is a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter and commercial common sense, are substitutable for them.
>
> …
>
> 3(3) For the purposes of this Act, the effect on competition in a market shall be determined by reference to all factors that affect competition in that market including competition from goods or services supplied or likely to be supplied by persons not resident or not carrying on business in New Zealand.

- Section 4(1) provides that if a person that carries on business in New Zealand engages in conduct in breach of the Commerce Act overseas, then that conduct is only caught to the extent that it **"affects a market in New Zealand".**

(2) Markets "wholly or partly" within New Zealand

- Uneasy interaction between analysis of dynamic commercial behaviour driven by economic incentives, and statutory construct that creates a prohibition on certain types of behaviour when it is detrimentally affecting competition and can be identified and fitted within the statutory construct.

- Exemplified by Tipping J in *New Zealand Magic Millions*, who noted...

> "*in purely economic terms it may well be that auction sales in Queensland, Sydney, and perhaps elsewhere in Australia, should be regarded as forming one market with New Zealand.*"

...but went on to conclude:

> *"Put shortly, overseas conduct by New Zealand organisations is relevant to the extent that it affects a market in New Zealand. Overseas conduct by non New Zealand organisations should not be regarded as providing effective competition in a New Zealand market unless the goods or services are supplied within New Zealand.*"

(2) Markets "wholly or partly" within New Zealand

- ***Commerce Commission Merger and Acquisition Guidelines*:**
  - The Commission may define a national market and then consider the extent to which overseas suppliers or importers exercise a competitive constraint on the participants *in the domestic market.*
  - "*the appropriate market is the area of close competition within which commercial commonsense would accept the actual and potential,* but not purely theoretical *substitution, in response to the right price incentive*".
  - define the geographical dimension to include all relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.
  - Central to both product and geographic market substitution analysis is practical or common responses to price incentives.

(2) Markets "wholly or partly" within New Zealand

- The airlines argued that the geographic extent of the market for the supply of inbound airfreight services into NZ was determined by reference to the alternative offerings at the origin (being the sources of supply that purchasers could switch between in response to price and terms).

- **Nevertheless, the Court held the airlines activities in the supply of inbound air cargo services constituted supply in competition with each other for New Zealand customers, in a market that was partly within and partly outside New Zealand, being therefore a market in New Zealand.**

(2) Markets "wholly or partly" within New Zealand

Key reasons for finding a "market partly in and partly outside" of NZ:

- Freight forwarders are just agents for the importers located in NZ- demand for services is a direct function of importer demand (in NZ)
- NZ customers are significantly affected by the terms of the service contracts between the freight forwarders and airlines- airlines charges amounted to 30-95% of freight forwarders charges to the importer, and if the charges were too high, the importer could substitute origins, or decide not to import at all.
- By reference to the definition of "supply", provision of the service does not stop at the point of departure: activities undertaken by airlines in NZ amount to supply by them of air cargo services in competition with each other in NZ.
- Examples of freight integrators, who combine the operations of freight forwarders and airlines, to conclude they reveal the artificiality of creating an impermeable seal around the origin freight forwarders and airlines - the "reality of the market".

(2) Markets "wholly or partly" within New Zealand

An "effects test" for New Zealand?

This inference seems particularly strong in the following passage:

"...market definition may lead to the drawing of different boundaries in different circumstances depending on the purpose of the statutory provision in question. This case concerns allegations of price fixing, a per se offence under the Act. While there are many dimensions in which rival firms compete, the most fundamental is in pricing and the principal means by which price fixing imposes aggregate economic harm is through its impacts on outputs...if a price fix occurs in a market for a good that is purchased by middlemen who simply turn around and sell it on to consumers, ***then the anti-competitive effect of the price fix really occurs in the next market downstream, to the extent that the price increase faced by the middlemen is simply passed through to their customers...it is reasonable to ask****, to what extent a particular intermediary transforms and adds value to the good or service that they buy upstream and sell downstream, and* ***who in the end controls demand****?"*

(2) Markets "wholly or partly" within New Zealand

Analysis:

- It is possible in economic terms to have close competition between suppliers located in different countries, and customers located in a different country again.
- Accurate that it could not offend international comity for the Act to be concerned only with conduct to the extent that its effects are felt in NZ.
- Sympathy for Court to look through the agency of the freight forwarders to the NZ importers who drive demand and would be directly affected.
- Does not offend scheme of s4 provided prohibitions only apply to conduct undertaken overseas by persons resident or carrying on business in NZ.
- **Remaining question of statutory interpretation:** whether the natural and ordinary meaning of the term "a market in New Zealand" can properly encompass a market where the customers are obliged to transact their business entirely overseas.

(2) Markets "wholly or partly" within New Zealand

"Get off my land!"

(3) The sting in the tail- section 4

Does the overseas conduct need to be conduct that would be prohibited by the Act if it had occurred in NZ, and does the market affected need to be the same market in which prices are said to have been fixed?

- The Court found that s4 **must be applied in conjunction with the substantive prohibitions in the Act** to extend their reach (it does not create any new offences or prohibitions and can't of itself sustain a cause of action).
- Accordingly, it held:
    - An interpretation of s4 whereby it is invoked where there is an effect on any downstream market in NZ, no matter how distant, is implausible.
    - The fact that NZ consumers were affected because of an effect on a NZ market is not relevant when set against the purpose- to stop anticompetitive behaviour in this country, not to stop ripple down effects from overseas price fixing which might indirectly affect a NZ market.

Cartel Criminalisation

- ***Air Cargo*** **and** ***Poynter*** **combined appear to set a relatively narrow basis for the Commission proceeding in respect of conduct that occurred overseas.**

- **Parliament is in the process of attempting to clarify the question of the jurisdictional reach of the Commerce Act. The Commerce (Cartels and Other Matters) Bill, introduced in 2011, proposes reform aligning jurisdiction of the Commerce Act with the conspiracy rules under the Crimes Act 1961.**

- **In an addition to section 4 of the Commerce Act, the Bill provides:**

(4) For the purpose of determining jurisdiction,—

(a) if an act or omission that forms **part of a contravention** of this Act occurs in New Zealand, **the contravention is deemed** to have occurred in New Zealand; and

(b)if **an event** that is necessary to **the completion of a contravention** of this Act occurs in New Zealand, the contravention is deemed to have occurred in New Zealand. **[Emphasis added]**

Cartel Criminalisation

- **Proposed amendment could be interpreted as extending the Act's extraterritorial reach along the lines of that established in *Air Cargo*, providing jurisdiction to capture conduct carried out anywhere by any person, as long as that conduct forms part of a contravention of the Act in NZ…but perhaps not…**
- **Questionable whether proposed amendments go far enough to provide sufficient clarity and certainty to jurisdiction of the Act**
  - Any conduct overseas that is not *a component of a contravention* in NZ remains governed by s4, subject to its residency, "carrying on business", and "effect competition in a market in NZ" requirements

Cartel Criminalisation

Alternative option: an *implementation test*

- **UK test permits penalisation of any anticompetitive conduct carried out anywhere to the extent that it is *implemented or intended to be implemented* in the UK.**

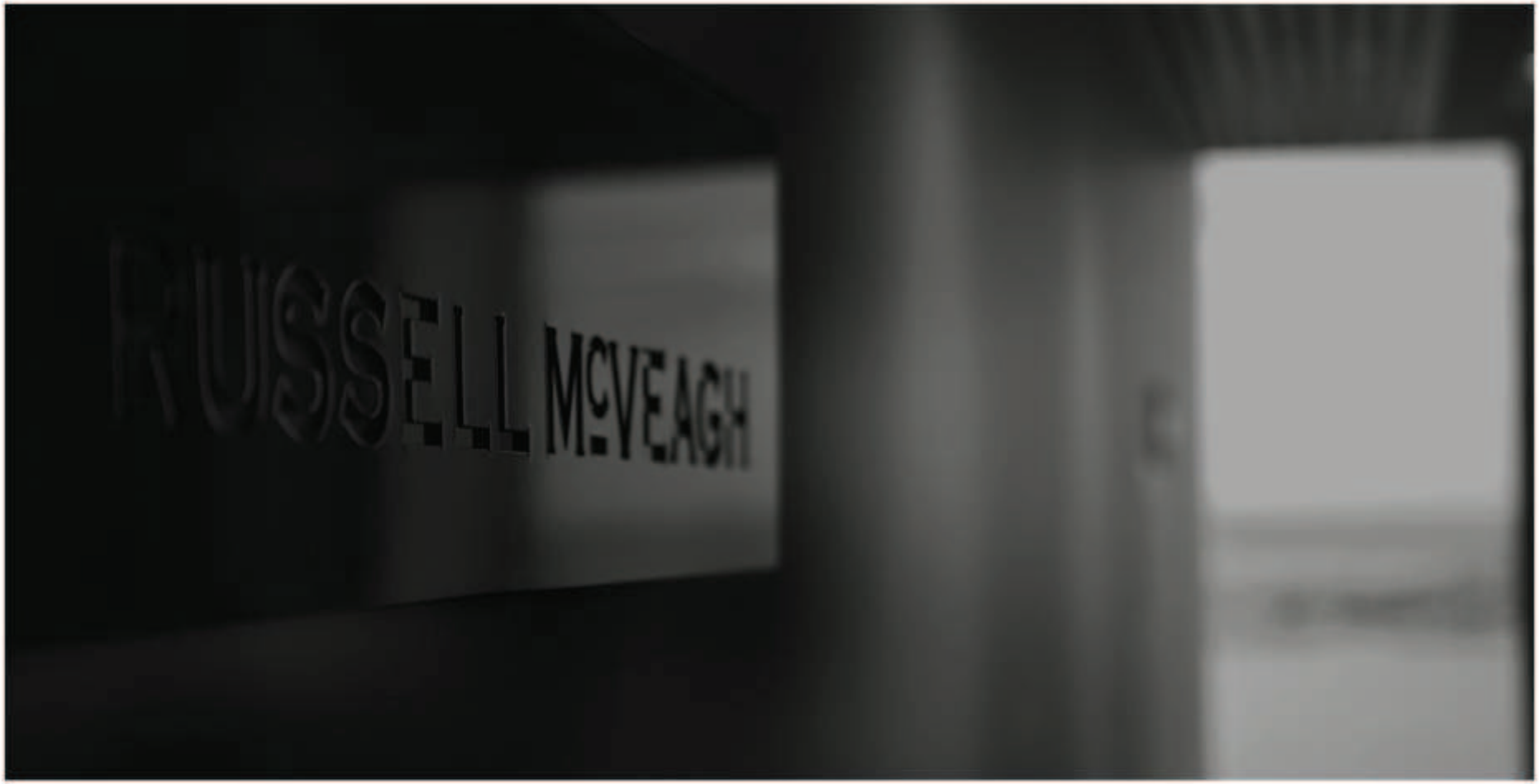
- **An amendment legislated for along these lines would:**
  - Reduce litigation relating to the jurisdiction of the Act.
  - Remove the need to establish the attributes of the person carrying out the anticompetitive conduct.
  - Remove the extensively debated jurisdictional hurdle requiring that the act or event that is part of the contravention takes place in NZ, which exists for persons not resident or carrying out business in NZ.
  - Remove need to extend the legal test for market definition through complex economic analysis.

Conclusion

- *Air Cargo* establishes the proposition that a market in New Zealand can be a market in which all the transactions occur overseas, only a significant proportion of the demand for the service emanates from New Zealand, and alternative sources of supply are only located outside New Zealand.

- Although this does not offend principles of economic analysis or international comity, it remains to be seen whether the appeal courts take the view that the interpretation otherwise offends the scheme of the Commerce Act or the ordinary and natural meaning of the words "in New Zealand".

- An appropriate amendment to the Commerce Act to capture conduct that is *implemented or intended to be implemented* in New Zealand, regardless of whether it occurs in a market in New Zealand or not, would limit such costly litigation in the future.



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