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Cartel Criminalisation
Ministry of Economic Development
Wellington

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Submission on Cartel Criminalisation Discussion Document dated January 2010

I am writing in my private capacity to provide views on the proposed Cartel Criminalisation Discussion Document. I am a commercial lawyer based in New Zealand with 24 years legal experience in large international commercial law firms and as a General Counsel in large companies, both listed and privately owned, headquartered in Australia, the US and New Zealand. My current professional role is General Counsel and Company Secretary of Fonterra Co-operative Group Limited.

I met with Ms Phillipa Yazbek from the Ministry of Economic Development together with other senior lawyers working for some of New Zealand's largest companies to discuss the proposals in the Discussion Document. The proposals did not have general support within that group. For this reason alone I believe that serious consideration should be given to discontinuing the proposals.

I am concerned that the proposals have been generated by a desire to harmonise with Australian law. However, it is likely that Australia only criminalised cartel behaviour as a concession in negotiations to gain a Free Trade Agreement with the US. Furthermore, when Australia introduced similar laws it failed to properly consult with New Zealand despite previously agreeing to consult on changes to competition law to assist harmonisation. It was the decision of the Australian Government to proceed without consultation that affected harmonisation in this area. Harmonisation should not be pursued unless new laws are better. New Zealand should not replicate poor Australian policy decisions.

The Discussion Document concludes at paragraph 83 that there is a prima facie case for criminalisation of cartels. This is based on two primary observations:

1. First, that the Commerce Commission has failed to detect domestic cartels (para 21). It would be extraordinary to criminalise conduct based only on the observation that there is very little evidence that the conduct is occurring. This is particularly so where the Commission has nearly $14m in annual funding, in addition to access to the Treasury litigation fund for prosecutions.

2. The second observation is reflected in the occasional paper by Mr David King from the Ministry of Economic Development which has reviewed recent thinking in this area. The fashionable theory behind criminalisation of cartels is that with the introduction of leniency provisions the number of notifications of cartels "sky-rocketed", and there must therefore be a lot more cartels than anyone thought. However, as Mr King notes in his paper there is no empirical evidence to support this theory of increasing cartel behaviour.

   An opposing view, supported by my discussions with lawyers practicing in the filed, is that the upswing in leniency applications in Australia after criminalisation does not indicate that the civil regime was not working. Rather, it appears that compliance programs and legal advisors are ensuring that many transactions (whether or not they risk breaching the competition law) are notified, with the objectives of demonstrating a culture of compliance to regulators and establishing a basic plank in a defence against any potential allegation in the future.

   Competition authorities have used the statistics from increased notifications to convince legislators that there must be a problem. However, despite the "skyrocketing" notifications and laws criminalising cartel behaviour in a number of countries, the rate of convictions remains low.

I am strongly of the view that criminalisation of any form of competition law is detrimental to ongoing honest entrepreneurial activity (see point 3 in "Further Discussion Points" below).

The Discussion Document provides no real evidence of any benefit from these proposals and has not demonstrated that criminalisation will increase the detection or prevention of cartels.

I do not believe that the New Zealand economy can currently afford the dampening effect that this type of legislation will have on entrepreneurial activity and as a result these proposals should be discontinued.

Yours faithfully

David Matthews

SUBMISSION ON MED CARTEL CRIMINALISATION DISCUSSION DOCUMENT DATED JANUARY 2010

SUMMARY OF KEY SUBMISSIONS

Criminalisation of cartel behaviour is not necessary in New Zealand. Illegal cartels must continue to be stamped out. However, criminalisation of cartel behaviour is not necessary in New Zealand. These proposals will add another redundant layer of onerous legislation to an already complex business environment and dampen business activity. New Zealand is a small economy and simply cannot afford the inefficiency caused by over regulation of business activity.

There are much bigger issues to be dealt with in New Zealand business. For example, questionable behaviour in the securities markets, insolvent trading and insider trading have gone relatively unpunished over recent times, with very few criminal cases being pursued to conviction. These very important areas need to be addressed before criminalisation of cartels.

Criminalisation of cartel behaviour will have a net detrimental effect on New Zealand's economy by dampening entrepreneurial activity and economic growth. The proposals in the Discussion Document should be halted until criminalisation of cartel behaviour can be demonstrated to provide a net benefit to New Zealand.

These proposals do not meet the Government's standards on new Regulation. The challenge to the Government is to provide proper evidence of any benefit from the criminalisation of cartels to business or New Zealanders generally. The Discussion Document fails to do this and falls short of the standard set in *Better Regulation, Less Regulation,* the Government's statement on further regulation published on 17 August 2009.

The Commission cannot identify examples of local 'hard core' cartel activity to show there is a problem with the existing law. This demonstrates how unnecessary the proposal is. It is certainly not a reason to impose more layers of new law in an already complex area. In no other area of law would government recommend conduct be subject to the extreme penalty of deprivation of liberty because the regulator cannot find incidences of it occurring.

These proposals are simply a misconceived attempt to harmonise with unnecessary and ill advised Australian law. The legislation to criminalise cartel behaviour in Australia was passed as a concession to US demands in negotiating a free trade agreement between Australian and the US. There is no need for New Zealand to change its laws on cartels to fall in line with Australia and the US. Those jurisdictions should consider their own laws and abolish cartel criminalisation to reduce the regulatory burden on business activity.

Enforce current laws and penalties. The Commerce Commission should focus on pursuing current fines and penalties rather than criminal convictions. If the Commission can demonstrate there is a problem with local cartel activity by enforcing significant fines then this will provide the justification for introducing criminal sanctions and the funding for resourcing the Commission to deal with those new sanctions. If the Commission cannot currently demonstrate cartel behaviour through prosecutions then there is no necessity for criminal sanctions.

The proposals should be discontinued. The bulk of the Discussion Document is devoted to the different options available for criminalisation. However, the proposal to criminalise cartel behaviour should be discontinued to avoid the adverse consequences of these proposals on business activity and economic growth generally in New Zealand.

FURTHER DISCUSSION POINTS

1. **There are already significant penalties for cartel behaviour. Criminalisation will not provide a greater deterrent.** Cartel behaviour is reprehensible. However, there are already major penalties for engaging in such behaviour: significant fines, massive claims through civil action, management banning orders as well as social and commercial ostracism. Criminalisation will not provide significant additional deterrence.

2. **There is not a sufficient case for criminalisation**: The Discussion Document does not provide a sufficient case (or any case at all) for criminalisation of cartels. The only case that can be made is a hypothetical one which has no basis or data to substantiate it. The discussion document provides no data or evidence to back up the introduction of cartel criminalisation in New Zealand.

3. **Criminalisation of cartels will add to business anxiety and dampen entrepreneurial activity**: New Zealand business people should be left alone to get on with the business of growth and prosperity in a manner that is compliant with the Commerce Act and other laws, without the burden of potential criminal sanction adding further complexity to business decisions. These proposals, without providing any benefit, just create more anxiety for the majority of New Zealand business people who are honestly going about their business and striving to achieve a vision of a better, more prosperous New Zealand.

   Business people have significant issues to contend with: volatility in foreign exchange, financial and commodity markets; availability of capital; solvency; business growth; international competitiveness; competing for quality employees; health & safety of staff; and environmental sustainability. These are the big issues confronting business in New Zealand today. Criminalisation of cartels is something that will increase the nervousness of New Zealand business people and act as an inhibitor to entrepreneurial activity.

   The author's own experience is that this type of legislation will dampen entrepreneurial activity. As a commercial lawyer working within companies I have personally been aware of situations where business people seeking to be compliant with competition laws have actively avoided acceptable profit making opportunities which they believed (erroneously) risked breaching competition laws. With the introduction of criminal sanctions the only possible outcome is that this type of caution and nervousness will increase. The caution may not be rational, but it will inevitably cover behaviour which is often legally without reproach. With the economy already having significant challenges it is not the time to introduce new legislation which will impact on the intangible entrepreneurial spirit and confidence of business people generally.

4. **There is no evidence of any benefit from this legislation, but the cost may be significant.** The Discussion Document suggests some kind of incremental benefit to an unobservable "deadweight loss from cartels". This is based on the possibility of increased cartel activity assumed because of an initial flurry of notifications to authorities when leniency provisions have been introduced. Based on the paper by Mr David King referred to in the Discussion Document, even the economic commentators disagree on the conclusions to be drawn in this area. Given the uncertainty and the lack of evidence of what the benefit could be, the introduction of a fundamental change to the law in this area cannot be justified. The Discussion Document also raises Trans Tasman harmonisation in the context of benefits from the legislation. However, there is no suggestion or evidence that this law will provide any economic advantage to Australia or New Zealand.

5. **Criminalisation of cartels will not have a significant impact on preventing cartels**. It is suggested in the Discussion Document that criminalisation of cartel behaviour is the only way to stop wealthy individuals from engaging in cartels. However, this is not supported in other areas. For example, there is no evidence that criminalisation has prevented wealthy individuals from engaging in insider trading in New Zealand. Cartel criminalisation in the US has not proved to be successful as the Discussion Document notes, with conviction rates in the US being low.

6. **Criminalisation of business activities can have unintended and devastating impact on secondary individuals**. The author has personal experience of long, drawn out criminal investigations into commercial behaviour that has devastated the lives of middle managers and salaried staff. Where criminal investigations are undertaken, prosecuting authorities tend to take an aggressive approach to as many individuals as possible in order to force cooperation and, hopefully, prosecution higher up the chain of command. Unfortunately in all of the cases in the author's experience it has been the salaried personnel who have born the brunt of the investigation, crippling legal costs and the huge impact on family lives. This is a very real downside of introducing criminal charges into a business environment where they have not been considered necessary in the past. Fines, civil actions and penalties deal with this much more effectively because they impact on the wealthy owners and leaders of cartel behaviour.

7. **Criminalisation of business activity uses massive resources** both within the Government sector prosecuting criminal behaviour, and in the private sector defending against criminal charges. The cost of criminal charges to companies, individuals and prosecuting authorities is significantly higher than the cost of civil proceedings or fines because of the higher standard of proof and the significantly more onerous consequences for individuals. The Commerce Commission's personnel have not to date required the skills necessary to prosecute criminal behaviour under the Commerce Act. Such enforcement action would require a significant increase in resources within the Commission, with no corresponding benefit to match the increase in resources.

8. **The case for criminalisation has not been made strongly enough.** In the case of cartel behaviour there are proposals that leniency can be granted as a matter of policy. It is difficult to accept the leniency proposals in a criminal context. In a commercial context where only fines are levied the leniency provisions are more supportable. However, in the criminal context there appears to be significantly less justification. In other criminal contexts, any person or entity taking part in the criminal behaviour is generally likely to be charged. The Discussion Document suggests that in the case of a criminal cartel there will be a policy that one of the main protagonists will be able to receive complete immunity. While immunity does exist in other criminal areas, it is not often total immunity, nor available as a matter of policy. This suggests either that the behaviour itself is not appropriately classified as criminal in the first place, or that the leniency policy is flawed.

9. **The ability to "authorise" certain behaviour demonstrates it is not appropriate for criminal sanction.** In the case of cartel behaviour there are suggestions that certain behaviour could be exempted, or consented to by the relevant authority, or allowed because of public disclosure. It is submitted that where these types of exemptions and consents etc are available then the behaviour should not carry a criminal sanction in the first place.

10. **The introduction of this fundamental change to the law does not meet the Government's policy on increased regulation**: It is important that appropriate analysis is done on fundamental changes to the law to ensure that decisions are based on robust information and analysis. This is reflected in the Government's own Statement on Regulation*: Better Regulation, Less Regulation*, 17 *August 2009*, which states, among other things *[commentary in italics has been added]*:

    We will also be looking for significant changes in the approach both Ministers and government agencies take to regulation. To this end we will resist the temptation or pressure to take a regulatory decision until we have considered the evidence, advice and consultation feedback, and fully satisfied ourselves that:

    - **the problem cannot be adequately addressed through private arrangements and a regulatory solution is required in the public interest**; *[There is no evidence to indicate that current penalties and laws are insufficient to deter cartel behaviour – the "problem" is therefore already adequately addressed. The fundamental flaw in the Discussion Document is that it relies on the fact the Commission does not seem to be able to find a local problem, in its case for a 'fix' which would only have effect locally]*
    - **all practical options for addressing the problem have been considered**; *[There is no need for any further options to be addressed in addition to current sanctions]*

- **the benefits of the preferred option not only exceed the costs (taking account of all relevant considerations) but will deliver the highest level of net benefit of the practical regulatory options available;** *[there is no demonstrable benefit from the proposals. The potential cost of dampening economic activity in New Zealand is significant]*

- **the proposed obligations or entitlements are clear, easily understood and conform as far as possible to established legislative principles and best practice formulations**; and *[the proposals for exemptions, immunity, compliance through notification etc mean that the basis for criminalisation is significantly eroded and will lead to uncertainty and injustice]*

- **implementation issues, costs and risks have been fully assessed and addressed**. *[significant issues have been outlined in this submission*]

Require there to be a particularly strong case made for any regulatory proposals that are likely to:

- **impose additional costs on business during the current economic recession;**

- **impair private property rights, market competition, or the incentives on businesses to innovate and invest; or**

- **override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee guidelines)**;

[As noted these proposals suggest a fundamental change to this area of law. They propose criminal sanctions on individuals without a providing a strong case for doing so. They also have the potential to create significant costs on business and to substantially impair innovation and investment]

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