AIR NEW ZEALAND

Air New Zealand Limited
185 Fanshawe Street
Private Bag 92007
Auckland 1142
New Zealand
Facsimile 64 9 336 2667
Telephone 64 9 336 2910

Cartel Criminalisation
Ministry of Economic Development
P O Box 1473
Wellington

9 April 2010

Attn: Philippa Yasbek
cartels@med.govt.nz

Dear Sirs

Cartel Criminalisation – Discussion Document January 2010

Air New Zealand welcomes this early opportunity to comment on the proposal to criminalise cartel conduct in New Zealand. We do so conscious that we can contribute a relatively rare perspective as a commercial business based in New Zealand with international operations and direct experience of the differing approaches to competition law by a number of regulators, including the USA where criminal penalties have applied for many years.

Introduction

Air New Zealand wishes to make clear at the outset that we fully agree that cartel conduct is damaging to an economy and should be illegal except where proven in advance to the relevant regulator to be of net economic benefit.

There can be no doubt that competition law is one of the more complex areas of commercial law. Difficulties of definition and boundaries engage the minds of lawyers and judges at considerable length. As the Discussion Document amply demonstrates over its 98 pages, attempts by other jurisdictions to impose criminal sanctions have created differing, complex laws in attempting to apply criminal liability and penal sanctions.

The issue under consideration is simply how best to detect and deter cartel conduct.

The observations and conclusions of this submission are that:

- there is no evidence at all of a need to criminalise cartel conduct in New Zealand;
- the existing regime of a leniency policy and civil penalties for companies and individuals meets the needs of detection and deterrence; and
- criminalisation will add unwarranted and highly inefficient cost in terms of corporate compliance, regulatory enforcement and most significantly in the consequences of the "chilling effect" of deterring legitimate, productive commerce.

Lack of Evidence

It is accepted that cartels are by their nature difficult to detect. As a consequence the complete lack of empirical evidence of any need to criminalise cartels in New Zealand is hardly surprising. However even a brief consideration of the history of discovered cartels in New Zealand indicates that instances are quite limited in number and many are very "local" in their geographic and/or market scope.

The conclusions of the Discussion Document are all necessarily reached in the absence of evidence but instead in reliance on a variety of principles, assumptions and purely subjective selection and opinion. This approach to important policy setting is far from conducive to making good law.

The Discussion Document places emphasis on the importance of aligning policy with Australia. This is not "evidence" of any need; it is merely a potential policy choice. It does though raise the question of what may be sufficient to "align" the policy?

Despite the complexities of competition law in the many jurisdictions which legislate on the subject, the core principles of competition law are reasonably consistent. Also common to the jurisdictions of most concern to New Zealand is the imposition of a deterrent to companies and individuals. If the conduct is similarly defined and in each case is the subject of an effective detection and deterrent, that would seem to be sufficient "alignment" at a policy level.

In any case, complete alignment appears unlikely under any scenario. As the Discussion Document notes, entire adoption of the new (and already widely criticised) Australian law is unlikely to work for New Zealand. Similarly, criminalising the existing Commerce Act provisions is not a recommended approach in the Discussion Document - and we concur. A New Zealand "greenfields" approach is unlikely to do better than any of Australia, United States and United Kingdom has managed to achieve. Nothing other than adoption of the new Australian law as is will provide complete legal harmonisation and the other options will inevitably continue to require slightly different compliance considerations on either side of the Tasman. This indicates that total alignment with Australia is neither required by policy nor a compelling reason.

Proponents of criminalisation claim as "evidence", the reported increases in the number of cartelists being jailed in the United States and an increase (reportedly to 15) in leniency applications in Australia ahead of the effective date of criminalisation.

The United States has imposed criminal sanctions on cartel behaviour for many years. Contrary to increasing imprisonment of offenders being "evidence" of the need to criminalise cartel conduct, this indicates that criminalisation is <u>not</u> working as a deterrent.

The leniency applications in Australia may not in any case all prove to be actual cartels. At best this is a one-off gain and not a compelling statistic in the context of a market the size of Australia.

In our view, there is a lack of any evidence that criminalisation of cartels is necessary in New Zealand or that in principle it is sufficiently more effective as a detection and deterrence approach than the current leniency and civil penalty regimes. In particular there is no evidence and no analysis supporting criminalisation on a cost – benefit basis.

Existing Regime meets New Zealand's Needs

It is difficult to see sufficient if any incremental gain for the New Zealand economy from burdening ourselves with a complex, expensive, ineffective and probably economically detrimental regime of criminalised cartel conduct.

Conversely, it is clear from jurisdictions that have adopted them, that leniency policies are highly effective in bringing cartel conduct to the attention of regulators. Such policies have the added benefit of being highly cost efficient.

It is understood that most of the prosecutions by the Commerce Commission have been a consequence of leniency applications either in New Zealand only or in New Zealand as part of multi jurisdiction leniency applications. Only very few overseas jurisdictions would have criminalised cartel behaviour at the time of such leniency applications, so it is a reasonable conclusion that leniency policies are highly effective regardless of whether the deterrent is a civil penalty or a criminal sanction.

What then is the incremental benefit is for New Zealand in going to the considerable lengths and costs required, to criminalise cartels? The proposal rests solely on the unsubstantiated assumption that individuals will be deterred by a potential prison sentence when they would not be deterred by the prospect of a very substantial personal fine (unable to be indemnified), considerable legal costs, loss of job and probably loss of career and reputation. Moreover, even a threat of civil prosecution can hang over an individual for literally years after an investigation commences, effectively putting their personal lives and careers "on hold".

The reality is that most cartel conduct (including the "hard core" conduct yet to be legally defined) occurs at a management level where the civil regime consequences constitute an enormous risk. Such individuals are unlikely to gain personally from their conduct significantly, if at all. There may be rare exceptions where very wealthy individuals stand to gain substantially and accept the risks, but that is inadequate justification for the solution proposed.

This suggests that most individuals participating in cartels do so in sheer ignorance of the law or under a mistaken belief about the legality of their conduct. Very few would make a calculated acceptance of risk, carefully weighing the comparative exposures of financial and related civil penalties against criminal sanctions.

In cases of ignorance or mistaken belief, the nature of the penalty cannot logically make any difference. At best, criminalisation will motivate a desire to learn more or to be more certain of the law and possibly on occasions to deter a risk taker from flagrant breach. These are marginal gains. The creation of a further, complex overlay of criminal law to possibly deter and only potentially to punish very few offenders is the proverbial sledgehammer to crack a walnut.

The Discussion Document (Section 1.4) considers a number of options for increasing deterrence. Each of these – or even all of them together – involves a significantly lower cost than criminalisation. Most effective as a deterrent, due to increased risk of detection and successful prosecution and least cost of all is further enhancement of the Commerce Commission's leniency programme. As noted, this is already under review. We strongly urge that time be taken to assess the effectiveness of such initiatives and to truly examine whether we even have a problem of inadequate detection and deterrence before concluding that the current competition law regime, with modest enhancement, is not suited to New Zealand's needs.

Costs of Criminalisation

The issue about which there can be little debate is that criminalisation imposes significant legal, financial and economic burdens.

The Discussion Document outlines the additional legal burdens involved in adequately defining the offence, establishing a suitable prosecution regime, conducting an investigation in a criminal context and meeting the required standard of proof – even before a New Zealand Court ever comes to consider whether a custodial sentence is warranted.

This additional legal cost of establishing and implementing a process is just the tip of the iceberg. Funding of investigations and prosecutions under the current regime must run to many millions of dollars for very little demonstrable public benefit other than the need to be seen to be enforcing the law. How much more expensive will it be to investigate and prosecute to the standards required for a criminal penalty?

There will be added financial costs of compliance for companies and individuals driven by the added complexity of already difficult and deficient law. The basic principles of competition law are internationally quite uniform and are easy to understand and apply in the context of most operational compliance and training. Beyond the "basics", competition law quickly becomes complex and there are numerous areas where expert advice and then subjective judgement are required. The issues become even more difficult as different jurisdictions apply these principles in different ways and with different consequences, let alone considering matters of international conflict of laws, jurisdiction, "double jeopardy" and market definition.

All these will translate into additional costs of doing business for a responsible "corporate citizen" concerned to comply with the law and to equip its employees and business associates to do likewise. The complexity and consequences for the vast majority who do not want to knowingly break the law will drive a need for more legal advice, training and compliance costs.

The most significant cost of all is of course the constraint on economic efficiency. The Discussion Document appropriately addresses this difficult area at some length, but other than observing the difficulties of avoiding legislative over-reach or under-reach, is unable to offer much in the way of solutions or indeed any attempt at quantification.

Given that the whole premise of competition law is the promotion of economic efficiency, there is a risk that criminalisation (and particularly if it is ill defined and complex) becomes a cure that is worse than the complaint. The lost economic opportunity arguments of course pre-suppose that criminalisation is a more effective deterrent than civil penalties. The irony is that it will be a stronger deterrent for law abiding corporate citizens but not for those minded to breach regardless of the consequences, or those who infringe through ignorance or mistake. Consequently the so called "chilling effect" will be suffered across the greatest proportion of the economy.

How extensive this chilling effect will be can never be known with any certainty but anecdotal evidence and experience suggests that it will be significant. Where a potential activity or transaction is high value, there is incentive to explore the legal position. The loss will be at the level of numerous small initiatives which are either never put forward for analysis because of misunderstanding of the law or are discarded at an early stage due to the difficulty of achieving clarity. Even initiatives which are within the law and proceed will inevitably leave a margin for error.

Enforcement Considerations

There is an uncomfortable mismatch in a criminal offence arising from conduct which is also capable of receiving regulatory approval. This underlines the importance of a clear legal definition of "hard core" cartel offences with no possibility of overlap. Complexity and confusion will lead to difficulties of enforcement. Once an investigation commences, it will be too late to seek regulatory approval, but how do those involved in enforcement approach the issue? Should it be a criminal or civil matter and how can that be determined before sufficient evidence is properly analysed?

It will be a tempting easy gain for an investigator to point to criminal sanctions to secure co-operation. This places enormous pressure on individuals to satisfy investigators' requests, even to the point of an "enhanced" confession. At least one executive has recently been imprisoned in USA based on a "confession" which he publicly retracted as having been his only practical option when confronted with no job and no ability to fund a legal defence. Even under leniency regimes, parties have admitted to being "overly inclusive" in their recollections of others' participation, in the interests of maximising the benefits of leniency for themselves.

The unreliability of evidence obtained under these kinds of pressures has been a recognised threat to justice for centuries and safeguards exist in many instances to minimise the risk. When we contemplate criminalisation and potential imprisonment for individuals, it is essential that the right to justice and the credibility of our legal system are not undermined by inexperienced and over zealous enforcement of new and complex laws.

There is a clear admission in the Discussion Document that complexity is almost inescapable, when it suggests the right to trial by jury should be denied (#333), noting that, "Competition law is difficult for the average member of the public to understand. Even judges can struggle with economic evidence...." and "even relatively simple price fixing conspiracies are likely to be complex in comparison with most other crimes."(#331) Yet these are decisions which commercial managers (average members of the public) are expected to make correctly in their day to day employment – on pain of imprisonment if they get it wrong.

Conclusions

The important economic objective in considering competition law is to deter cartel behaviour by the most efficient means possible. The basic elements defining what is considered to be "cartel behaviour" are aligned with our key trading partners and there is significant deterrent in the civil sanctions, the limits of which have yet to be tested. The recently enhanced leniency programme is claimed by the Commerce Commission to be producing valuable results.

Criminalisation is undeniably a stronger deterrent, but not an effective one in this context. It will not deter those who transgress through ignorance or naïve belief that they are within the law. It may deter the very few who might chose to take a calculated risk of severe financial and career penalties but would not risk criminal sanctions. Most importantly it will deter those whose philosophy is to know and comply with the law. This will create conservative approaches to quite legitimate, economically beneficial, commercial co-operation in a range of activities on a scale that will never be known.

Yours faithfully

John Blair
General Counsel
Air New Zealand Limited