AIR NEW ZEALAND

Air New Zealand Limited
185 Fanshawe Street
Private Bag 92007
Auckland 1142
New Zealand
Telephone 64 9 336 2910
Mobile 64 21 747 466
Email John.Blair@airnz.co.nz

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Cartel Criminalisation
Ministry of Economic Development
Wellington

Emailcartels@med.govt.nz

Dear Sirs

Commerce (Cartels and Other Matters) Amendment Bill

This submission is further to the Submission by Air New Zealand in response to the Discussion Document of January 2010. We maintain our views expressed in that Submission including:

- Air New Zealand supports regulation of competition as a means of promoting consumer welfare through economic efficiency;
- There is no demonstrated need for criminalisation of cartel conduct in New Zealand;
- Criminalisation will undoubtedly have a "chilling effect" on legitimate business initiatives and therefore undermine economic efficiency with little countervailing benefit; and
- There is considerable scope for improvement of other aspects of the Commerce Act which will bring greater benefits to the New Zealand.

Consultation

There are two essential elements to be considered in relation to the Bill:

- Has a case been made out for criminalisation of cartel conduct?

- Leaving aside criminalisation, do other aspects of the Bill represent an appropriate improvement in the regulation of competition law in New Zealand?

Criminalisation

Criminalisation and Imprisonment is Not the Right Answer

We note that the draft legislation is proposed for the purpose of testing "*whether it is possible to define with sufficient clarity the prohibition and exemptions, such that any downsides of criminalisation are remedied or at least mitigated*" (parag 3 Explanatory material). This is a valid methodology, but nowhere in the papers accompanying the draft Bill are there any adequate answers to the fundamental issues raised by many submissions in 2010 to the effect that;

- Criminalisation is not a sufficiently more effective deterrent
- There is no identified problem in New Zealand requiring this law
- The cost-benefit analysis is entirely inadequate and unsupportable
- The chilling effect on commerce has not been and cannot be assessed

There is a disturbing sense throughout all the material that apart from some fine tuning, "criminalisation" is the right answer. We disagree.

Criminalisation implicitly carries the threat of imprisonment. This is undoubtedly a strong deterrent for the great majority of individuals in business whose inclination will be to comply with the law. Deterrents do not work in at least two instances. First the "determined criminal" who will knowingly take the risk of detection and punishment, assessed against the potential rewards of the conduct. It is submitted that there are very few instances of such calculated conduct in cartels internationally. This largely arises from the fact that most participants in cartels are employees who derive little if any direct personal gain. Cartels tend to evolve from historic business practices and relationships which become "too close" rather than deliberate intent to create a cartel.

The more commonplace failure of the "deterrent" concept is where the accused was genuinely unaware of the illegal nature and the consequences of the conduct. This is highly relevant when considering an area of law which such complexity and uncertainty as competition law.

It is the complexity and uncertainty linked to an extreme deterrent which will result in honest business people giving legitimate business opportunities an unnecessarily wide berth. Competition law regulators recognise that very many *prima facie* anti competitive business arrangements can produce net economic benefits. That is precisely why exemptions, clearances and approvals are provided for. A business proposal which carries even a remote possibility of being labelled as "criminal" is far less likely to ever get to the point of consideration of its net economic benefits. Businesses will shy away from the aura of criminality and the substantial costs of expert legal and economic analysis required before even approaching a regulator.

Although imprisonment is assumed to be a greater deterrent than financial ruin that is disproved in cases such as McCaffrey, the Qantas cargo manager in the USA who opted for a guilty plea and imprisonment in the face of not having the resources to attempt to prove his innocence. How many more of the apparent 400 individuals imprisoned in USA for cartel offences have had the same Hobson's choice? The debate should not be just about imprisonment and fines without considering the entire costs of the criminal process for prosecutors and accused.

The imprisonment proposition also proceeds on the unsupportable assumption that employees of businesses are prepared to risk substantial personal fines in the interests of improving their employer's profitability (with little or no personal gain) but will not risk imprisonment in their employer's interests. There is no evidence for this and less logic.

Criminalisation and accompanying imprisonment is not the panacea it is perceived to be. Despite the recent horrific massacre in Norway of 76 people, that country is widely regarded as peaceful and law abiding; a reputation and stability achieved with a penal regime that results in just 66 people per 100,000 of the population being imprisoned. The New Zealand equivalent is 199 per 100,000.

A contrasting mindset prevails in the USA where that 66 is instead 1,000 imprisoned per 100,000 of population. In that environment, mass killings particularly of young people have tragically become commonplace. The Times on 25 July carried front page headlines on the Norwegian tragedy and buried in a few lines on page 26 the story of five children gunned down at a birthday party in Texas. In short, imprisonment is not reducing the incidence of crime.

Proponents of imprisonment for cartel conduct point to increasing numbers of prison sentences in USA for "anti trust" conduct as evidence that criminalisation works. In our view the statistic proves the opposite.

No Identified Need or Justification in New Zealand

In developing a law that fits New Zealand's needs, we should not follow the lead of a wild west mentality and throw more people in prison more often just because our trading partners do so. In our view the laws that control competitive behaviour need to be re-focused on maintaining the importance of competition in promoting economic efficiency.

The draft Regulatory Impact Statement is utterly inadequate to inform any decision by Cabinet about the costs and benefits of criminalisation. There is no evidence whatsoever; merely speculation and a few spurious statistics drawn from a survey of 57 countries from which no relevant conclusions can be drawn. This is not a sane basis for deciding to send people to prison. The "not statistically meaningful" data for New Zealand is 8 cases in more than 16 years, 4 of which are not yet concluded. The 26 warnings were presumably, by nature of the "penalty", not of any material economic significance. The domestic and trans Tasman cases quoted amount to a total of $2.85m of illegal overcharges per year. The air cargo case is prosecuting conduct alleged in overseas markets with an as yet unknown effect on any relevant market in New Zealand, if any. The total economy "benefit" of $2.85m pa of avoided overcharging pales into insignificance against the costs of responding to a single in depth investigation and defending a prosecution – an unproductive an inefficient activity *par excellence*. The "benefit" is also marginal in comparison to the millions of dollars of "excess returns" achieved by Auckland, Wellington and Christchurch Airports overcharging their customers, as determined by the Commerce Commission in 2002.

The other claimed "benefit" is easier co-operation among international competition regulators. There has been no previous suggestion that there was a difficulty and the papers refer to many bilateral co-operation arrangements. Certainly there was no apparent difficulty in many regulators co-ordinating the air cargo investigation on 14 February 2005 nor is any objection raised to their regular association meetings as the "International Competition Network".

A Little "Knowledge" is a Dangerous Thing

As has been pointed out in previous submissions – and accepted in the discussion papers – competition law is a particularly complex area of law where matters of definition and economic effects make certainty very difficult. The discussion papers and the draft Bill proceed on naïve assumptions that the "cartel provisions" will be readily identifiable and that individuals entering into agreements, arrangements or understandings will realise the implications. That may occasionally be the case but often the competition effects of an agreement will not be obvious, even to experienced business people. The effects will be much less obvious in the case of an "understanding".

The intent of the Bill to proceed on the basis of "conduct" rather than "effects" in the interests of certainty of the offence and efficiency of prosecution is deceptively simple. The "conduct" is entering an agreement, arrangement or understanding that contains a "cartel provision". The "cartel provision" must have one or more of the four specified "purposes" of price fixing, restricting output, market allocating and bid rigging.

The mental element of the proposed crime is in knowing at the time of entering an agreement etc that it contains a "cartel provision" or at the time of giving effect to a cartel provision that it is a "cartel provision".

This "conduct" approach disguises some considerable uncertainty. To possess the relevant knowledge about a "cartel provision", it is submitted that an individual must understand its purpose. The purpose of a particular clause may be for example to promote consistency of standards for consumers – seemingly legitimate and with that genuine commercial intent. That consistency and benefit for consumers may have unrealised price or output implications such that the provision is illegal and a crime is committed.

Some questions that need to be considered are:

- How can "purpose" be determined without considering effect or at least likely effect?
- Does an individual have to know that the purpose is price fixing etc?
- Does a primary, legitimate "purpose" over-ride an unobvious illegal purpose?
- How is "purpose" to be determined when it is not apparent from the provision but is a conclusion based on effects?
- Should there be a defence of "unintended consequences"?

A person is assumed at law to have a purpose of intending the likely consequences of their actions. This opens a whole area of debate about what the "likely" consequences of an alleged cartel provision may have been.

The issues are complicated enough in the context of someone entering into an agreement. An "understanding" creates a whole new level of uncertainty. An "understanding" is almost always unwritten and vague and at its worst may be "unilateral" – "we thought that you had agreed to that"! Although difficult to prove, it is easy to allege and difficult and costly to disprove. Consider for example the allegation by the European Commission in the air cargo proceedings that airlines had an "understanding" that they would all base fuel surcharge levels on a fuel price index published by Lufthansa. Their "understanding" was news to most if not all airlines involved in the proceedings.

Giving effect to a provision knowing that it is a cartel provision raises the same issues as outlined above, and more. Someone who has negotiated an agreement or reached an understanding has some chance of understanding its purpose and effects. Possibly years later someone carrying on business as usual in accordance with past practice has less need to consider and understand purpose. Add to that the possibility that in the meantime, market changes and new business practices could have significantly changed the effect of a provision.

The concept of "substantial lessening of competition" has existed in most competition law regimes for decades and been the subject of considerable guidance from the courts. Knowledge that a "cartel provision" will lessen competition should be an essential element of any prosecution case whether civil or criminal.

The Chilling Effect and Criminal Consequences

The currently proposed course carries a risk of back-firing in two ways.

We have commented above on the restraining effects on business initiatives. Although we have no better data than MED, our belief is that economically the so called "chilling effect" is likely to be far

more significant than appears to be assumed. Our own business experience is that management are already hesitant about legitimate business initiatives due to concerns over competition law compliance. Add to that the legal uncertainty and the spectre of imprisonment and the effect is greatly exacerbated. This can be a wonderful windfall income generator for lawyers but does little for productive efficiency.

The discussion papers have considered the possibility of extraditing overseas individuals to New Zealand, but extradition treaties work both ways. Criminalisation will expose New Zealanders to extradition to other jurisdictions where cartel conduct is a crime. Cabinet should think carefully about sending New Zealanders to face trial in the USA or Australia, particularly in view of the aggressive attitudes of some regulators and the legislative mess the Australians have produced which was rightly rejected by MED.

As if imprisonment in New Zealand or overseas was not chilling enough, consider consecutive sentences in multiple jurisdictions for the same conduct. Domestically the "double jeopardy" is protected but there is no such international protection with each regulator potentially wanting its "pound of flesh" as has already occurred between the UK and USA.

Proponents of criminalisation point to one cartel which it is claimed did not operate in USA because of the criminal regime there. No mention is made of how many legitimate business initiatives have not been pursued in the USA because of caution about the same risk.

The Exemption

There is something inherently unjust in criminalising conduct that is potentially capable of an exemption or regulatory approval. There is no exemption or regulatory approval process for manslaughter, fraud, insider trading or any of the many other offences carrying substantial prison sentences. This in itself leaves an uncomfortable question mark over the concept of criminalisation.

If the present proposal was to be adopted, there are important concerns about the exemptions regime. First, it is contrary to basic principles of criminal law to place the onus of proof on an accused, even where the onus extends only to a balance of probability test. The prosecution must be required to prove its case including the inapplicability of any exemption.

Second, the exemption itself is too uncertain in a criminal context. Whether a cartel provision is "reasonably necessary" for the purpose of an otherwise legitimate collaboration agreement is highly subjective and likely to be unfairly viewed by regulators with the benefit of hindsight, possibly when market conditions and commercial priorities have changed. The accused will have to demonstrate, possibly many years later, that at the time of the agreement the provision was and remains "reasonably necessary". An even more difficult hurdle confronts an individual accused of giving effect a cartel provision in an agreement which he or she had no part in making and which has been accepted as legitimate (reasonably necessary) within a particular business for many years, unchallenged.

The Bill further offends the principles of justice in requiring defendants to notify the prosecution of intent to rely on the exemption with sufficient detail to fully and fairly inform the prosecution of how it applies. Investigators have extremely wide, coercive powers to access information from and about a target of their investigation. If a prosecution is commenced without the regulator having investigated the possibility of an exemption, it is the regulator who should be prosecuted.

Enforcement and Prosecution

We support the proposal to separate the investigation and prosecution functions but believe it should go further. The separation should be embedded in legislation and even the laying of an information should be undertaken only by the prosecutor having considered the merits of the matter with the investigator.

This is seen as preferable to guidelines whether issued by the investigator or the prosecutor. The reliability of guidelines was clearly demonstrated by the Commerce Commission in the recent litigation concerning market definition in the air cargo industry. The Commission argued a market definition in direct conflict with the definition in their own guidelines.

The frequently encountered mindset of an investigator is not objective. Rather it is along the lines of "where there is smoke there is fire and I am here to find the fire". To equip investigators with the power to threaten prosecution for an offence involving imprisonment risks unsound confession and testimony with consequent injustice for others. If interviewees know their evidence will be independently reviewed before any prosecution decision there is a better chance of the truth being revealed.

Improvements in Competition Law

The second question we noted for consideration is; "leaving aside criminalisation, do other aspects of the Bill represent an appropriate improvement in the regulation of competition law in New Zealand?"

"Conduct" basis

We are encouraged by the appearance of Option 2 in the draft Regulatory Impact Statement. Clarifying the prohibited conduct along the lines proposed is in our view a positive development subject to the caveat of leaving a "substantial lessening of competition" effect as part of the test.

Exemptions and Clearances

The exemption regime would allow businesses more scope for self determination of the compliance or otherwise of a business opportunity. Without the shadow of criminalisation, this assessment is more likely to be made and businesses will be more comfortable approaching regulators. The move to more self assessment has we believe, been successful in the European Union both for business and in reducing the burden on regulatory resources.

Related to this we see value in a clearance regime. To avoid a flood of applications we recommend some financial thresholds as "safe harbours" such as where the combined turnover expected from the proposed enterprise is below a specified level. This is consistent with other regimes such as applied by the Federal Trade Commission in USA and previously adopted by the European Commission.

International Dimension

There are three areas of concern which we would like to see considered, all of which have proved to be considerable difficulties in the air cargo proceedings by way of example.

The High Court recently spent 5 weeks devoted to the issue of whether in-bound cargo constitutes a "market in New Zealand". With 22 lawyers in Court (and many more behind the scenes) and 6 highly qualified international economists, the costs of the exercise will have run to millions of dollars.

This is an outcome of a regulator attempting to over-extend its jurisdiction and interfere with overseas markets, regulators and sovereignty – something that even the globally minded USA has progressively resiled from over the years.

The cartel provision offences do not appear to be constrained by any definition of "market". The only reference appears in the context of persons who, but for a cartel provision would be in competition in a market; the same does not apply to the agreeing competitors. It is important that this is clarified for a number of reasons including limiting the consideration of effects to the market in which the parties compete; that is where "competition" is harmed. Allowing consideration of effects in upstream or downstream markets creates a regulatory over-reach and potentially destroys economic value in those other markets.

Market definition is also important for jurisdiction and legal certainty, especially where possible criminal penalties or substantial regulatory fines are involved. There is an obvious lack of fairness in prosecuting in one jurisdiction, conduct in another jurisdiction which is legal in that other jurisdiction.

In increasingly international commerce it is important that legal obligations of each jurisdiction are clear and that businesses are not placed in the impossible position of compulsion in one state to conduct that is illegal in another with both states' regimes having jurisdiction. This is the reality of current proceedings. It is for this reason and others that the concept of international comity exists in the law to give due recognition to the sovereign right of states to determine and apply their own laws. An overly expansive or uncertain definition of "market" will run counter to international comity.

In similar vein, the legislature must have regard to the existence of international treaties which mutually recognise national sovereignty. Competition law reach into territory the subject of treaties risks breaching the principle of comity.

Conclusion

Fundamental Harm is Overcharging

Air New Zealand fully supports the need for competition to be appropriately regulated. There is undoubted harm in overcharging consumers. The fixation with the criminalisation debate however detracts from many other areas where our competition law can be improved, not the least of which is bringing the monopoly businesses in our economy and their acknowledged overcharging, under effective regulatory control. Businesses that have extracted many millions of dollars of overcharges from consumers seem to continue to escape the rigorous examination that those in truly competitive businesses incur.

The Bill presents a constructive approach to defining the conduct of concern and a regime for allowing businesses some scope for self assessment and an opportunity to gain certainty through

clearance. These benefits to commerce and to our economy will be undermined if overlaid with the spectre of criminal liability for making a wrong call in a notoriously complex area of business law.

This is not the time for Government to make wrong calls by placidly following the inclinations of our trading partners. We need a commercial environment where initiative is rewarded – not placed in a category of being "too high a risk". We have an opportunity to demonstrate an enlightened and creative approach which others will follow.

Yours sincerely

John Blair
General Counsel
Air New Zealand Limited