

10 June 2014

Your Ref:
Our Ref: KBE

Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir

Submission to Competition Policy Review

Please find enclosed for your consideration our submission to the Competition Policy Review.

Yours faithfully
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Legal and Regulatory Advisers to the New Economy

LIABILITY LIMITED BY A SCHEME APPROVED UNDER
PROFESSIONAL STANDARDS LEGISLATION

Submission
to the
Competition Policy
Review Panel

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1. Executive summary

- 1.1 This submission focuses on the narrow, but important question of whether corporations should be able to indemnify their officers against civil penalties and legal costs incurred as a result of breaches of the *Competition and Consumer Act 2010 (CCA)*. This question is raised in the context of a consideration of whether *“the enforcement powers, penalties and remedies, including for private enforcement [are] effective in furthering the objectives of the CCA?”*¹
- 1.2 At present, sections 77A and 77B of the CCA (**anti-indemnity provisions**) prohibit companies from indemnifying their officers against any civil liabilities incurred in their capacity as an officer of a corporation, and the legal costs of defending proceedings against them, where the officer is found to have such a liability. Importantly, the provisions make no distinction between claims for which no liability is found and claims for which liability is found in the same proceedings – it is enough for an individual to be found liable on one claim in a proceeding for the prohibition on indemnification for all legal costs to be triggered, even those incurred in respect of claims for which no liability was found.
- 1.3 We submit that these anti-indemnity provisions can operate as a disincentive to the defence of such proceedings by individual officers, with the consequence that important matters which touch on the competitive process and the involvement of individuals in that process may not receive the full scope of judicial review which they merit. Given the usually complex and costly nature of litigation involving breaches of the anti-competitive conduct provisions of Part IV of the CCA in particular, these provisions may operate harshly and unfairly for the individuals concerned, by effectively denying them access to justice in circumstances where the potential financial risk of defending proceedings may weigh in favour of an early settlement with the regulator (with consequent admissions).
- 1.4 This submission also considers the position of the law in other key jurisdictions in relation to indemnification and concludes that there is little international support for a regime that prohibits companies from indemnifying their officers.

¹ *Competition Policy Review Issues Paper*, 14 April 2014, Chapter 5, Competition Laws, p.41.

- 1.5 For the reasons set out in this submission, we submit that the current anti-indemnity provisions should either be:
- (a) removed from the CCA altogether, with express reference to the fact that the general anti-indemnity provisions in section 199A of the *Corporations Act 2010* (Cth) shall not apply to breaches of the CCA; or
 - (b) as a minimum, amended to permit indemnification in respect of legal costs which are incurred in respect of claims which the individual officer successfully defends, together with a discretion for the court to overturn the prohibition on indemnification for civil liability and legal costs for claims for which the individual is found liable where the court determines that the matter is one which warrants the exercise of its discretion.

2. Background

- 2.1 The *Dawson Review 2003* recommended the introduction of provisions that would prohibit corporations from indemnifying, directly or indirectly, officers, employees, or agents against the imposition of a pecuniary penalty.² This recommendation did not extend to legal fees. Following this recommendation, sections 77A and 77B of the CCA were introduced on 1 January 2007.
- 2.2 Section 77A of the CCA provides, relevantly, that:
- (1) A body corporate (the first body), or a body corporate related to the first body, must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against any of the following liabilities incurred as an officer of the first body:*
- (a) a civil liability;*
 - (b) legal costs incurred in defending or resisting proceedings in which the person is found to have such a liability.*
- Penalty: 25 penalty units*
- 2.3 Section 77B of the CCA provides, relevantly, that:
- (1) Section 77A does not authorise anything that would otherwise be unlawful.*
- (2) Anything that purports to indemnify a person against a liability is void to the extent that it contravenes section 77A.*

² *Trade Practices Act Review*, 161-165.

- 2.4 The Explanatory Memorandum that accompanied the Bill that introduced the anti-indemnity provisions (the *Trade Practices Legislation Amendment Bill (No. 1)* 2006 (Cth)), stated:

*For the purposes of subsection 77A(1), a corporation is not considered to be indemnifying an officer if, for example, it advances monies or makes a loan to an officer to enable that person to defend or resist legal proceedings, but only if the monies advanced, or loan made, must be repaid if the officer is found to have contravened Part IV of the TP Act and is liable to pay a pecuniary penalty of **any size** pursuant to section 76 of the TP Act.*

- 2.5 The prohibition on indemnification of legal costs is not expressed to be only in respect of those legal costs which are incurred in defence of those claims of contravention of the CCA for which the officer is found liable in any proceedings.
- 2.6 The failure to expressly limit the prohibition to indemnification of such legal costs almost certainly means that an individual officer who incurs legal costs in defence of multiple claims in proceedings for which he or she is found liable on some claims and not liable on others will not be able to be indemnified for the legal costs which he or she incurs in respect of claims for which no liability is found. There is almost no case law on the provisions and none at all on the question of whether an officer can be indemnified for legal costs in respect of claims on which he or she is not found liable. This may be unsurprising given that few individuals would be likely to be able to afford the costs of mounting such a case and few corporations would be likely to have the incentive to do so.

3. International position

- 3.1 Australia followed the lead of New Zealand by introducing the anti-indemnity provisions. Indeed, the Dawson Review Committee cited New Zealand's position on indemnification in its argument for introducing anti-indemnity provision into the CCA.³ However, New Zealand appears to have been the first and only other country to have implemented provisions similar to sections 77A and 77B of the CCA. In turn, this aspect of Australian competition law is inconsistent with the law in most other jurisdictions. The approach taken by other countries is considered below:

³ *Trade Practices Act Review*, 161-165.

New Zealand

- 3.2 Section 80A of the *Commerce Act 1986* (New Zealand) prohibits a corporation from indemnifying a director, servant or agent of the corporation against liability for payment of a pecuniary penalty imposed for price fixing. Under s 80B of the *Commerce Act 1986*, a corporation may face a pecuniary penalty if it is found to have contravened s 80A.

European Position

European Union

- 3.3 Indemnification of officers or employees is not an issue at an EU level since *Regulation 1/2003* does not authorise the European Commission to impose fines on individuals for involvement in anti-competitive conduct.⁴ However, national competition bodies in EU countries may impose fines or criminal sanctions for competition law infringements. The approach taken by individual countries within the EU is considered below.

United Kingdom

- 3.4 There are no provisions in either the *Competition Act 1998* or *Enterprise Act 2002* that prohibit companies from indemnifying officers or employees against fines arising out of breaches of competition law.
- 3.5 Under provisions amending the *Companies Act 1985*, which were introduced in April 2005 and are now reflected in sections 232- 239 of the *Companies Act 2006*, companies are expressly permitted to indemnify directors in respect of civil proceedings brought by third parties for both legal costs and liabilities incurred. This indemnity does not extend to the payment of the costs of an unsuccessful defence to criminal proceedings or criminal fines or penalties imposed by regulators, however, it does extend to successful defences.
- 3.6 Section 206 of the *Companies Act 2006* allows funds to be advanced to a director to fund defence costs of criminal and civil proceedings so long as the loans are conditional on repayment on conviction or judgment against the director. Loans can also be advanced to a director to meet the defence costs of any regulatory investigation or action but these loans do not have to be conditional on repayment.

⁴ Barry Rodger, Angus MacCulloch and Jonathan Galloway, *Cases and Materials on UK and EC Competition Law* (Oxford University Press, 2nd edition, 2009) 55.

France and Germany

- 3.7 France and Germany also allow for individuals to be fined in relation to anti-competitive conduct;⁵ however, neither French nor German law appears to prevent companies indemnifying employees.⁶

United States of America

- 3.8 Neither the *Sherman Act* nor any other Federal legislation prevents indemnification of officers or employees against civil fines for breaches of antitrust law. The ability of a corporation to indemnify an employee or officers for criminal fines depends on state law.⁷ Specifically, Federal law requires individuals to bear the cost of the fines imposed upon them unless payment by their employer “is expressly permissible under applicable State law”: 18 *United States Code* § 3572(f). Many state statutes do expressly permit indemnification.⁸

4 Arguments for removing or at least amending the anti-indemnity provisions

Inconsistent with international position

- 4.1 As noted in section 3 above, there is little international support for the anti-indemnity provisions. Indeed, New Zealand appears to be the only other country that has implemented statutory provisions which are similar to ss 77A and 77B. This aspect of Australian competition law is, therefore, inconsistent with the law in most other jurisdictions.
- 4.2 In a world where competition increasingly takes place on a global basis, across jurisdictions, such inconsistent laws make little, if any sense. An individual officer facing liability for the same conduct in multiple jurisdictions may be able to be indemnified for the penalties and legal costs in Europe, the UK and the USA but not in Australia. If a principle rationale for the prohibition on indemnification is said to be its deterrent effect, such rationale will hold little water where it applies in one jurisdiction only.

⁵ OECD Reviews of Regulatory Reform – Review of France <http://www.oecd.org/daf/competition/sectors/31415943.pdf>, 21; OECD Reviews of Regulatory Reform – Review of Germany <http://www.oecd.org/daf/competition/sectors/33841373.pdf>, 25.

⁶ Ibid.

⁷ American Bar Association, *Criminal Antitrust Litigation* 2nd Edition (2006), 94.

⁸ Department of Justice, “Deterrence and Detection of Cartels: Using All the Tools and Sanctions” (March 1, 2012), 6, <http://www.justice.gov/atr/public/speeches/283738.pdf>

A disincentive to access to justice and a harsh and unfair prohibition

- 4.3 The anti-indemnity provisions apply to all contraventions of the CCA. In many proceedings, especially those involving claims of cartel conduct, misuse of market power or substantial lessening of competition in a market, the claims involved can be complex, proof of which may depend on lengthy legal and economic argument on matters such as the definition of the market or markets involved, who is a competitor and what is the effect of the impugned conduct on competition. These are complex matters for the experienced competition lawyers and judges involved, let alone for an individual officer faced with such claims.
- 4.4 It unfortunately follows that the more complex the issues involved in proceedings, the higher the legal costs involved. An individual officer faced with the prospect of incurring legal fees into the tens or hundreds of thousands of dollars for which he or she cannot be indemnified could not be blamed for viewing his or her defence of the claim through the prism of mere economic risk analysis, rather than on an assessment of its merits. For most individuals such costs will be way beyond their means. Put simply, the risk of having to potentially pay (or repay) such amounts in the event of a finding of liability, may be sufficient to persuade an individual not to take the risk of proceeding to trial and to settle the matter, without there being any judicial consideration of the matters which are the subject of the claim. As those who have negotiated a settlement of proceedings in which the Australian Competition and Consumer Commission (ACCC) is the Applicant will understand, such a settlement is almost always on the ACCC's terms and includes an admission of liability.
- 4.5 It is not only individual officers who are affected by the prohibition on indemnification, it is also the corporations of which they are officers who may be denied, or, at least, be limited in the opportunity to appropriately test the law when the officer through whom they act cannot afford to take the risk of the economic consequences which would flow from defence of proceedings in which there may ultimately be a finding of liability on any one claim.
- 4.6 It is submitted that justice is not well served and the vigorous and healthy competitive processes which competition law and policy are designed to protect can be left inappropriately defined in situations where proceedings are not determined by the courts but are left to be determined by reference to an individual's capacity to pay.
- 4.7 Sections 77A and 77B will also preclude indemnification where an officer was acting in good faith when they breached the CCA. While good faith may not be a defence to a breach of the CCA, there are situations where it would be harsh

and unfair to preclude indemnification of an officer who contravened the CCA such as “ *where he or she has acted in genuine reliance on legal advice, or on the basis of an honest mistake of fact.*”⁹

- 4.8 As Fisse has noted, one key issue with individual liability is “*the extent to which individual persons are subjected to enforcement action in test cases where the ACCC has sought to take the law to its outer limits. The humane approach in such situations is to proceed against the corporate defendant alone and to spare the sentient from the ordeals and cost of defending themselves.*”¹⁰ It is submitted that enforcing a test of an humane approach would be far more problematic than simply permitting indemnification of individuals in such cases.

The prohibition on indemnification is an ineffective deterrent to breach of the CCA

- 4.9 The anti-indemnity provisions have been justified on the basis that they will deter officers of companies from taking part in anti-competitive conduct by forcing officers to pay their own fines and legal costs. However, the assumption that this argument relies upon – that fines are an effective form of deterrent – is questionable. Indeed, just because officers of a company may be aware that they will have to pay a penalty, does not necessarily mean that they perceive the risk of being caught and having enforcement action against them as very high.¹¹
- 4.10 While criminal sanctions, such as those which may be imposed for breach of the cartel conduct provisions of the CCA may alone be generally sufficient to deter officers from engaging in anti-competitive conduct¹², such sanctions apply only in relation to cartel conduct, whereas the prohibition on indemnification applies to all breaches of the CCA. Where the deterrent factor relies solely on an economic risk analysis, it is submitted that few individuals will fully appreciate the risk involved unless and until that risk becomes a reality – that is, unless and until proceedings are commenced or imminent. By that time any effectiveness as a deterrent which the anti-indemnity provisions may have is illusory.

⁹ Brent Fisse, ‘The Dawson Review: Enforcement and Penalties,’ 26(1) *University of New South Wales Law Journal* 315, 319-320.

¹⁰ Brent Fisse, above n 8.

¹¹ Caron Beaton-Wells and Christine Parker, ‘Justifying criminal sanctions for cartel conduct: a hard case’ (2013), 1(1) *Journal of Antitrust Enforcement*, 205.

¹² Belinda A Bennett, ‘Criminalization of Cartel Conduct: The Changing Landscape’ [Joint Federal Court of Australia/Law Council of Australia (Business Law Section) Workshop, Adelaide, 3 April 2009] 1.

5 A proposal for reform

- 5.1 It is submitted that the most appropriate reform would be to remove the prohibition on indemnification in respect of both penalties and legal costs from the CCA altogether. Given that the provisions of section 199A of the *Corporations Act* would still apply it would also be necessary for any such amendment to expressly preclude the operation of section 199A in respect of breaches of the CCA.
- 5.2 In the event that it is decided that some form of prohibition on indemnification should remain, it is submitted that sections 77A and 77B of the CCA should be amended to permit indemnification for legal costs incurred in the defence of claims in any proceedings where no finding of liability is made and that there be a general discretion given to the court to permit the indemnification for legal costs in respect of claims for which a finding of liability is made where, in all the circumstances, the court is of the view that such indemnification is warranted. A non-exhaustive list of such circumstances might be included, which could include matters such as whether the law on the matter had been previously untested by the court, whether the individual acted in good faith and/or on reliance on legal advice.
- 5.3 It is submitted that if indemnification were permitted, not only would it prevent any limitation on access to justice to individuals and any undue harshness or unfairness to such individuals, corporations that did indemnify their employees would arguably have an added incentive to implement compliance programs to ensure that their officers did not breach the CCA in the first place.



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