

# Competition Alert

4 February 2010

## Safeway turns on its price fixing employees

*This Alert highlights the important implications of the recent English High Court decision in Safeway Stores Limited v Simon Twigger & Ors [2010] EHC 11 (the "Safeway Decision"). The High Court dismissed an attempt to strike out a claim for damages by Safeway to recover price fixing fines and damages from some of its own directors and employees allegedly responsible for the conduct. If such an approach were adopted in New Zealand it would have serious ramifications for the liability of directors and employees for competition law violations, Directors and Officers Liability Insurance ("D&O") policy implications and the operation of the Commerce Commission's leniency policy.*

### Background

In December 2007 Safeway, a British supermarket chain, admitted collusion involving increasing the price of dairy products with other UK supermarkets and dairy processors during 2002 and 2003. Safeway's admission came after the Office of Fair Trading ("OFT") served Safeway with a written notice, indicating their belief that Safeway had infringed Section 2(1) of the Competition Act 1998 ("**Competition Act**"). The admission formed part of an "early resolution" settlement agreement.

Under the agreement, Safeway accepted liability for involvement in the cartel and undertook to cooperate fully with the OFT's investigation. In return for the admission and ongoing cooperation, Safeway will receive a penalty reduction. No final decision as to the scope of the penalty has yet been reached by the OFT. Nevertheless, it is expected to be in excess of £10 million.

### The compensation proceedings

Following the settlement with the OFT, Safeway launched legal proceedings in the High Court against some ex-

employees and directors seeking an indemnity from them for the penalty that will be imposed by the OFT and compensation to cover legal costs incurred in responding to the OFT investigation. It seems, however, that the real targets of the claim are the insurance companies, as the Defendants' D&O liability insurance may well have to pay out if the claim is successful.

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Safeway's claim is based on alleged breaches of the employees' contracts and/or fiduciary duties owed as directors of the company by:

- » Participating in and facilitating the cartel; and
- » Not reporting the initiatives to their respective superiors and/or to the board of directors.

Alternatively, the Defendants are said to have been negligent in their conduct.

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**The strike out application**

The Defendants responded to the proceedings by asking the High Court to strike out the claim on the basis that:

- » It breaches a basic legal principle, 'ex turpi causa': this principle of public policy says that a person who does something unlawful cannot bring an action to recover damages that result from their own wrong doing; and
- » It is inconsistent with competition law: the UK competition law regime targets corporate entities and does not impose direct civil liability on directors or employees for conduct which leads to a company infringing the Competition Act. Accordingly, the objectives of the Competition Act's penalty regime would be frustrated if companies could pass on fines to employees and directors.

The High Court, however, rejected the strike out application on both limbs.

**Ex turpi causa**

The Court held that the wrongful acts in this case could not be said to be those of the Safeway companies for the purposes of the ex turpi causa rule. Instead, the Court said that the conduct in breach of the Competition Act were acts of the Defendants as directors and/or employees acting as agents for the companies.

The Court held that a breach of Part I of the Competition Act was not something for which a Company was itself primarily liable, unless the conduct concerned had either been approved by the board or shareholders or had been undertaken by the company's 'controlling mind' or 'alter ego'.

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**Consistency with competition law**

The High Court also rejected the second limb of the Defendants' argument. The Court did not accept that the legislation was intended to preclude individuals owing duties to ensure that a company complies with its competition law obligations. The Court was of the opinion that, had Parliament intended to limit the scope of individuals' duties to companies and liabilities under competition law, it would have done so expressly in legislation.

**Implications for New Zealand**

The *Safeway Decision* cannot yet be taken to be settled law in the UK, as it is likely to be appealed. However, if it stands,

the result raises some very important implications for competition authorities, employees, directors and insurance companies, not only in the UK but in other common law countries such as New Zealand. These implications are as follows:

*Undermining the deterrent objectives of the Commerce Act*

The Commerce Commission ("**Commission**"), and similar UK competition authorities, will be concerned that the possibility that companies could seek to recover any penalties through individual employees' and directors' D&O policies will significantly undermine the deterrent objectives of competition legislation. This is because, if companies can recover compensation damages for competition law penalties, their incentives to fully monitor the conduct of their employees would be reduced. Companies would stand to gain the benefits of cartel conduct, in terms of an ability to pass on an overcharge to consumers, without the downside risk of financial loss.

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*Directors and employees may incur personal liability even if not pursued by the Commission*

Prior to the *Safeway Decision* it was thought that the actions of the employees or directors could not be separated from those of the firm even if they were acting outside the scope of their authority. This is currently the case in New Zealand.<sup>1</sup> However, if the approach in the *Safeway Decision* gains traction, directors and employees may incur liability even if not pursued for individual penalties by the Commission. This is particularly significant given that the level of pecuniary penalties applying to companies under the Commerce Act 1986 ("**Commerce Act**") are much higher than those applying to individuals.

*Scope of D&O policies*

The *Safeway Decision* is likely to have an impact on the scope of D&O policies. The position of D&O policies in regard to compensatory damages is unclear, and compensatory damages may constitute a new form of liability for insurers to consider and address.

To the extent that this type of claim is recoverable, insurers may respond by seeking to increase D&O premiums or excluding this type of liability from their policies altogether. Given the large potential scale of compensation claims, directors and senior employees would be advised to consider their insurance arrangements, including whether they possess a D&O policy covering this form of liability.

Furthermore, directors and employees will need to consider whether they may need to meet at least some of the costs of their insurance arrangements personally, as section 80A of the Commerce Act voids any indemnification of pecuniary penalties by the company for breaches of section 30 of the Commerce Act. Consequently, directors and senior employees may have to meet a percentage of their premium in order to cover the portion of the premium applicable to risks the company cannot indemnify. As a result of the potential scale of *Safeway* style claims, this percentage may need to be increased to reflect the magnitude of claims that may need to be covered by D&O insurance.

*Negotiation of directors' releases on sale of a business*

The conduct in question in the *Safeway Decision* occurred prior to the purchase of Safeway by Wm Morrison Supermarkets plc in 2004.

In order to avoid the potential for companies to seek compensatory damages subsequent to the sale of a company, directors may seek to include the release from any company-initiated action in respect of this type of liability in sale and purchase agreements.

*Problems for the Commission's leniency policy*

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This is because, if a company wishes to make a leniency application or even assess the legality of its conduct, it requires full cooperation and open dialogue with its employees and directors. It will also materially diminish the

incentive for an individual to seek leniency, for fear of later being turned on by the company.

If employees and directors perceive they are at risk of being sued at a later date, they may be more reticent to disclose their activities, placing their incentives at odds with those of the company. It is for this reason that companies, when rolling out compliance training, typically advise employees that no employment action will be taken against them, provided they make early disclosure of any competition law breaches to the employer as soon as the employee appreciates that his or her conduct may have resulted in a competition law infringement.

The position of employees is complicated by the potential existence of criminal penalties, such as imprisonment, for competition law breaches. 'Hard-core' cartel conduct is currently subject to criminal penalties in the UK and a similar regime is likely to be introduced in New Zealand in the near future.<sup>2</sup> Employees participating in cartel conduct may find themselves squeezed between their employer and competition enforcers, as an early admission of culpability may be necessary to avoid criminal sanctions but would potentially result in stiff financial penalties. The effect of this squeeze may be to reduce the *incidence* of cartel conduct, but to stabilize those cartels that do emerge, making detection more difficult.

**Conclusion**

If the *Safeway Decision* stands it will have serious consequences for effective competition law enforcement.

An unsuccessful appeal to the Court's decision at first instance may lead to legislative changes in the UK to prevent such compensation proceedings against directors and employees and to prevent D&O insurance being used to cover price fixing penalties.

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1. Provided the individuals were acting for the company and not on their own account. *Meridian Global Funds Management Asia Ltd v Securities Commission* [1994] 2 NZLR 291 (CA).  
 2. See Russell McVeagh Competition Alert, "Criminalisation", 28 January 2010, accessible at [http://www.russellmveagh.com/docs/CompetitionAlertJan2010\\_275.pdf](http://www.russellmveagh.com/docs/CompetitionAlertJan2010_275.pdf).

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