Essay: Why do we have per se offences and should market allocation be per se illegal/criminalised? (25)

Introduction

Section 30 of the Commerce Act 1986 (CA) is a prohibition on cartel provisions. Section 30A defines this as a horizontal agreement fixing, controlling, or maintaining price, restricting output, or allocating the market. This prohibition is per se, meaning that the law conclusively presumes that the anticompetitive effect outweighs the procompetitive effect.

Per Se Defined

Bork identified two ways in which agreements between parties can harm competition. The parties can agree to remove some or all competition between them or can agree to injure competitors and thereby injure the competitive process itself. *Northern Pacific Railway* stated "there are certain agreements of practices which, because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use". *BMI v CBS* held that such agreements almost always "restrict competition and decrease output".

Economic Reliability

In *Chicago Board of Trade,* a price fixing agreement was upheld as legal because the price fixed was a reasonable one. The Madison Oil case overruled this and held that per se illegality applies whether or not the fixed price is reasonable. It held that price fixing is outright banned because of the potential or actual harm threat to the economy. These decisions, and the rationales of American jurisprudence such as *Northern Pacific Railway* and *BMI* form the basis for the New Zealand legislation.

A cartel is worse than a monopoly from a consumer rights perspective. A cartel will price fix at a rate which enables the least efficient conspirator to make a profit. This means that the price is higher than other conspirators would charge in a competitive market. Cartels therefore never produce a beneficial productive efficiency and always restrict output and increase price, meaning they deserve their per se illegal status.

The economic reliability argument is demonstrated in Thurgood Marshall J's comments in *Container Corp of America*; "[Per se rules] are justified on the assumption that the gains from the imposition of the rule will far outweigh the losses and that significant administrative advantages will result". As the US Supreme Court said in *Continental TV Inc* "per se rules tend to provide guidance to the business community and to minimise the burdens on litigants and the judicial system of the more complex rule of reason trials…". Trials under s 27 are usually long, complex and expensive. Counsel must argue over market definition, substantial market power, effect, and purpose. These factors are eliminated with a per se offence, the only issue is whether the parties fixed the price. This leads to significantly shorter and cheaper trials.

Benefits of Per Se Rules

In addition to the economic reliability arguments, per se offences are clear and unambiguous. Business are easily guided by the rules with a straightforward rule of "thou shall not price fix". There is no difficulty for businesses to get advice whether the measures are reasonable or whether they substantially lessen competition. It is a simple matter to avoid liability.

There is a significant deterrent value in the per se rules. *Container Corp. of America* stated that "per se rules always contain a degree of arbitrariness". This degree of arbitrariness deters businesses from

trying to beat the system and establish a cartel just out of reach of s 30. Because the per se provisions are so strict, businesses are deterred from anticompetitive behaviour.

Conclusion

Economic reliability, practical convenience, and the fact that price fixing agreements are almost always anticompetitive are all reasons supporting competition law having per se offences.

Should Price Fixing be Criminalised? (If this is 25 marks, include arguments for q 1).

Introduction

Price fixing is a horizontal restraint where parties agree to restrict competition by setting fixed or minimum prices below which they will not sell. It is per se illegal under s 30 of the Commerce Act. A price fixer cannot escape liability by arguing the fixed price was reasonable or even low (*Trenton Potteries*). This is because the market fixes prices, not firms within it.

Arguments for Criminalisation

There are significant harms to price-fixing. Price fixers cartel to act like a single monopoly, leading to increased price and decreased efficiency and output. However, cartels are worse than monopolies, as Prof Trebilcock said "[cartels] will almost never exhibit offsetting productive efficiency gains". Furthermore, cartel activity is directly damaging to consumers. As Sir John Vickers said "cartels are like theft, criminalisation makes the punishment fit what is a crime". There is misallocation of resources, goods which consumers would like are not produced or overpriced. There are significant harms to price fixing and no benefit.

It is not possible to know the current overall level of cartel activity. Overseas estimates state the average lifespan of a cartel is 5 years and there is a 10 – 20% chance the cartel will be detected. However 2008/09 studies have suggested cartels could last between 7 – 8 years. The major factors causing cartels to collapse is the incentive to cheat. However due to New Zealand's small market size it is easier for cartels to detect cheating which may extent their lifespans.

Current Sanctions are Insufficient

A 2010 Cabinet Committee Paper concluded that current cartel prohibitions are insufficient and led to the proposal of an amendment to the Commerce Act. If price fixing is not criminalised, the penalties are only financial. The maximum financial penalty has never been imposed in New Zealand. It is possible that potential cartels would not be disincentivised by the current penalties, especially given the chance of detection is low.

The current regime enables potential price fixers to weigh up the likelihood of profit and detection and make a rational choice to price fix. This is enforced by Bentham's punishment theory, which argues that penalty must be increased if probability of conviction is low. Furthermore, personal financial penalties for conspirators ignore the reality of the current global financial situation where a conspirator could conceal significant wealth through trusts and offshore accounts, potentially neutering personal financial penalties. The current regime may not act as a satisfactory deterrent to price-fixers.

Deterrent of Prison

Imprisonment is a significant deterrent to illegal activity. Unlike financial penalties, imprisonment is not a penalty which can be weighed up economically. The social, personal, emotional, and reputational implications of incarceration are vastly more severe, especially for white collar offenders. A criminal conviction is a far heavier moral condemnation than a fine and will have a much more personal effect on the offender rather than a reduction in wealth. Because white collar crime is rational, the detrimental factors of incarceration would be a more substantial deterrent on offenders.

Leniency Programme

Most cartels are undetected. An effective way of detecting cartels is by incentivising whistle-blowing by extending immunity from prosecution to the first whistle-blower who gives evidence against their co-conspirators. When New Zealand introduced its leniency programme, seven new cartels were reported in the first month.

People report cartels due to cold feet and wanting to get out of the arrangement without being punished by either the law or their fellow conspirators. Again, this is largely a rational decision where the conspirator considers the benefits of reporting outweigh the benefits or risk of remaining in the cartel. Potential imprisonment increases the risk of remaining in the cartel and immunity from jail time increases the incentive to report. Therefore, as seen in the US, a clear leniency policy backed up by the direct application of severe criminal sanctions incentivise reporting and therefore decrease cartel behaviour.

Arguments against Criminalisation

Cost and Efficiency

Criminal trials have higher standards of proof and more stringent rules of evidence than civil proceedings. Consequently, they have a much lower rate of conviction. Furthermore, imprisoning people is a costly exercise for the state and thus the taxpayer. Given that the crime being punished is costing consumers money, punishing that harm through a method which costs everyone money through tax appears contradictory. There may also be issues with lack of evidence and BORA breaches. The Commerce Commission currently has the powers to compulsorily interview people under oath, if this was used and the sanctions were criminal, this could breach BORA by removing the right to avoid self-incrimination.

Chilling Entrepreneurial Activity

This practice risks chilling entrepreneurial activity through businesses being too apprehensive of criminal consequences to embark in procompetitive collaboration. However, this could be refuted by including a clear list of “exempted” activity, such as working in partnership and joint ventures. Furthermore, the criminal standard of proof makes it unlikely that directors will accidently stumble into liability.

Unnecessary

The Commerce Commission’s current enforcement and leniency programme already operate effectively as a deterrent and incentive to report respectively. There is no need to criminalise the conduct when the same issue could be addressed simply by increasing the financial penalties associated with the crime.

Conclusion

Price-fixing should be subject to criminalisation, but the legislation requires careful drafting to ensure the maximum possible degree of clarity is achieved. It is important to clarify the scope of s 30 to avoid a chilling effect. Ultimately, white collar crime is rational, therefore deterrence is a significant factor in considering criminalisation.

Should Market Allocation be Per Se Illegal?

Introduction

Market allocation or division refers to the splitting of the market by cartels in order to eliminate or severely reduce competition in a particular market. As Paul Scott explored, market division can come in a variety of different forms. There can be customer, product, or functional market division, where competitors agree not to compete for the business of particular customers, in the sale of particular products, or in particular levels of distribution respectively. There is also time of sale market division, where competitors agree not to compete at certain times. Finally there is territorial market division where competitors agree not to compete in particular geographical territories.

Current Law

As discussed above, any cartel agreement which fixes, controls, or maintains price is per se illegal under s 30. However this may not cover geographic market division. *Caltex* stated that geographic market division is not price fixing as there is no agreement on price, however *CC (NSW) Pty* stated that it is.

A proposed amendment to s 30 would have explicitly included geographic market division as a per se offence, however the government at the time refused stating that it was already included. This indicates Parliamentary purpose includes market allocation within s 30.

Harms of Market Allocation

Market allocation typically takes place through hard core cartel activity to price fix and restrict competition. Cartel members behave as a single monopolist. This leads to allocative inefficiency (misallocation of resources resulting in reduced output and higher prices). This practice can manifest as price fixing or market division in other ways.

Territorial market division has arguably the worst effect. Product or customer market division still enables competition on non-price areas such as service, quality, and customer service. A territorial market division eliminates all choice, the consumer must use whichever conspirator is allocated to their area. This eliminates all forms of both price and non-price competition. An example of this is *Palmer v B R G of Georgia*, where following a territorial market division prices increased over 200%.

Market division can increase the life of price fixing cartels by increasing stability. By granting each conspirator a monopoly over their area of the market, there is less incentive to cheat and an increased likelihood of cheaters being caught. This is especially true of territorial cartels where a conspirator can easily detect competitor's products entering the market. Posner J commented in *Blue Cross & Blue Shield United* that "It would be a strange interpretation of antitrust law that forbade competitors to agree on what price to charge, thus eliminating price competition among them, but allowed them to divide markets, thus eliminating all competition between them".

Finally, clear rules around market allocation have the same positive effects as the per se rules around price fixing. They are unambiguous, businesses are able to know whether action is or isn't illegal. Trials are reduced in time and the deterrent factor is increased.

Reasons against per se illegality

Not all market division is anticompetitive. As Paul Scott notes in his lengthy but well written article, joint ventures and franchises are all examples of market division, but these practices are procompetitive. *BMI v CBS* is a case regarding price fixing for blanket licences for music. The blanket licence had five positive or procompetitive effects, including reducing transaction cost, increased allocative and time efficiency, the creation of a new product, and an increase in the overall competitiveness in the market. For those reasons, Byron White J held that this was not a case which deserved per se condemnation.

This is especially pertinent in a small market like New Zealand where organisations often compete at multiple levels of the supply chain to achieve the necessary scale. The law should be careful not to punish organisations for entering into procompetitive arrangements just because the organisation is vertically integrated.

These concerns can be neutralised by recognising, as was recognised in *BMI,* that "not all arrangements among actual or potential competitors that have an impact on price are per se violations… or even unreasonable restraints… literalness is overly simplistic and often overly broad". Not every case of literal price fixing violates the Sherman Act, nor would it violate an NZ equivalent. This definition allows for the Court to consider the nature of the price-fixing or market allocation in deciding whether it is per se illegal under s 30.

Joint ventures can create a freeriding problem, where one distributor profits unfairly from the efforts of another. Territorial market division can address this problem and prevent freeriding altogether. This shows that territorial market allocation can have a procompetitive effect.

Conclusion

Overall, the harms of market allocation outweigh the potential negatives of per se illegalisation. Approaches like the court in *BMI* show that not every case of price-fixing or market allocation is necessary per se illegal which allows for procompetitive conduct to continue. It is suffice for s 30 to be subject to the rule of reason, market allocation should be per se illegal.