

Competition and co-operation

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1. Beware co-operation between competitors?

- **In the simple model of perfect competition there are lots of buyers and sellers, only one product, and no risk or uncertainty**
 - Atomistic behaviour involving many agents
 - Emergent equilibria with desirable characteristics
- **In such a world there is no valid reason for co-operation between firms**
- **Worse than that, a group of sellers can collectively mimic a monopolist by all agreeing to charge higher prices**
 - A single seller in a perfect market cannot profitably increase price above marginal cost
 - If the sellers collude, they can mimic a monopoly (higher price and lower output than perfect competition)

- **As a result we see a natural suspicion of co-operation between competitors:**
- *People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices ... Adam Smith*
- **Similarly the US Supreme Court has explained that concerted behaviour justifies more scrutiny than unilateral behaviour because "concerted activity inherently is fraught with anticompetitive risk" insofar as it "deprives the marketplace of independent centers of decisionmaking that competition assumes and demands" (*Copperweld*, 1984)**

2. In the real world, however ...

Lots of good reasons for competing firms to co-operate

1. Share costs, resources and risk

- Dairy co-ops
- Irrigation schemes
- Oil and gas exploration
- Fighting a common threat eg fire, crop disease
- etc

2. Set standards

- Interoperability - eg Blu-ray, HDMI
- Customer switching rules (eg NZ electricity market)
- etc

3. Create new products

- through R&D
- by combining existing products eg multi-field ski passes
- by creating an event eg Toast Martinborough
- by agreeing the rules and schedules for a sports league (eg salary caps to ensure even matches)
- etc

4. Create larger networks

- telephones
- bank ATMs
- instant messaging services
- etc

5. Create a market

- NZ electricity market

6. Procurement arrangements #1 -- joint buying

- Foodstuffs co-operative (Four Square co-operative buying group since 1922)

7. Procurement arrangements #2 -- avoiding winner's curse

- Meat packers' case -- information exchange may have reduced risk without lessening competition

8. For public service reasons

- medical rosters for emergency care
- search and rescue coverage

3. Competition and co-operation: A complex relationship

While co-operation (collusion) can hinder or remove competition, it can also increase competition.

It may even be a pre-requisite to competition:

"All exchanges regulate in great detail the activities of those who trade in these markets (the times at which transactions can be made, what can be traded, the responsibilities of the parties, the terms of settlement, etc.), and they all provide machinery for the settlement of disputes and impose sanctions against those who infringe the rules of the exchange. It is not without significance that these exchanges, often used by economists as examples of a perfect market and perfect competition, are markets in which transactions are highly regulated (and this is quite apart from any government regulation that there may be). It suggests, I think correctly, that for anything approaching perfect competition to exist, an intricate system of rules and regulations would normally be needed." Ronald Coase

- **However, it may be hard to distinguish good collusion from bad collusion.**
- **Many of the examples discussed above can be tweaked so that they reduce competition. For example:**
 - Agreeing a common standard may kill off a competing technology
 - Shared costs could be artificially inflated
 - A competitor excluded from a new market may not survive

4. How does the law distinguish good collusion from bad collusion?

United States

- Sherman Act (1890) prohibited contracts in restraint of trade
- Limited to contracts which are unreasonable and anticompetitive (*Standard Oil*, 1911)
- Distinction between per se offences and rule of reason developed:
 - Conduct is a "per se" breach if economic effects are self-evident and no redeeming features eg price fixing or marketing sharing between competitors.
 - Otherwise, a full "rule of reason" competition assessment is carried out

- **But since the 1960s, concern over the potential overreach of per se rules has meant that:**
 - Onus on plaintiff to show that a rule of reason analysis should be departed from (*Sylvania*, 1977)
 - Subsequently, an agreement by engineers not to participate in competitive tenders (*National Society of Professional Engineers*, 1978) and an agreement between music copyright holders as to licence fees (*BMI*, 1979) were assessed under the rule of reason
 - Others exceptions to the per se rules emerged, eg activity which is ancillary to (ie a necessary part of) a joint venture (*Dagher*, 2006)
- **Today, role of per se rules is limited and full economic analysis typically required**

New Zealand

- **General prohibition against contracts which substantially lessen competition in a market (s27)**
- **Price fixing is deemed to breach s27 (s30)**
- **Exceptions to s30: joint ventures (s31), price recommendations involving more than 50 participants (s32), and joint buying (s33)**
- **Exceptions from s27 etc for partnerships (s 44(1)(a)), terms of employment (s 44(1)(f)), export (s 44(1)(g)), civil aviation agreements (Part 9, CAA), etc**
- **Agreements which breach s27, but which nonetheless have a net public benefit, can be authorised**

5. The prohibitions in the Commerce Act are complex

Moving beyond the paradigm of a smoke-filled room cartel, price fixing is a complex issue ...

1. Hard to describe the moral injunction given the "Swiss cheese" nature of the prohibition. For example:

- You cannot collude on price if you are two barristers sole, but you could if you formed a partnership
- You cannot collude on prices in New Zealand, but export is different
- You cannot collude on the price of goods or services, unless it relates to wages and working conditions
- You cannot collude on price, unless you are an airline and have the approval of the Ministry of Transport
- Two lemonade sellers at the beach cannot collude about the price of lemonade, but they can collude over the purchase of lemons
- Two lemonade sellers at the beach cannot collude, but if there's only one they can charge as much as they like
- Two lemonade sellers at the beach cannot collude, unless they merge

2. The prohibitions are open-textured and require a lot of judgment and expertise to apply in interesting cases

Section 27 requires a determination of the relevant market and an assessment of whether any adverse effect on competition is likely to be substantial. Both are essentially questions for economists.

Although s30 is a per se prohibition, it is not a simple prohibition

Provisions which fix, control or maintain prices are unlawful. How does this apply to:

- rose growers who want to set up an online market
- rose growers who want to share a flower drying factory
- rose growers who jointly agree a price for fertiliser, but separately acquire it
- setting of interchange fees in a four party credit card scheme

Advice in competition cases is typically in terms of probabilities not certainties. Competition law deals with a boundary between right and wrong which is quite different to most other legal prohibitions.

6. Criminalisation

Recently introduced in the UK (2002) and Australia (2009)

Proposed by MED in January 2010 Discussion Paper on the basis that there is currently under-deterrence of hardcore cartel behaviour

Thoughts:

- 1. Section 30 is much more complex than it looks, so turning it into a criminal offence would create a broad and uncertain criminal prohibition (ie much more complex than smoke-filled rooms):**
 - Rule of law issues: People should be able to tell in advance whether they are breaking the law with a reasonable degree of certainty (and ideally without needing to instruct an economist)
 - Uncertainty + risk of imprisonment
 - > increases the cost of co-operative behaviour
 - > risk averse behaviour (lots of advice will be sought, authorisation applications, avoidance of potentially beneficial arrangements, and acquisitions rather than co-operation)

- 2. Any criminal offence should carefully define the prohibition and should probably only apply to covert and/or dishonest behaviour (ie follow the UK rather than Australia)**

- 3. Such an offence would not be objectionable in principle, but requires weighing up the costs and benefits (Is there a problem to be solved? What are the costs in terms of risk averse behaviour and administration?)**