

UNJUSTIFIED PER SE CRIMINAL AND CIVIL LIABILITY UNDER THE *TRADE PRACTICES ACT 1974 (Cth)* FOR SUPPLY AGREEMENTS BETWEEN COMPETITORS

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I INTRODUCTION

Supply agreements between competitors are part of the life-blood of commerce. The competition laws in most countries do not subject such agreements to per se liability for price fixing or other cartel conduct, except for some rare and controversial exceptions.¹ That is not the position in Australia. Under the *Trade Practices Act 1974 (Cth)* ('*TPA*') and the Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2008 (Cth) ('*Bill*'), pro-competitive or harmless supply agreements between competitors may often involve a breach of the per se prohibitions against price fixing and other cartel conduct. The introduction of criminal liability for price fixing and other cartel conduct under the *Bill* accentuates the significance of this flaw in the legislation. Exposure to the risk of criminal liability for pro-competitive or harmless commercial conduct is doubly absurd and repugnant.

The exposure of supply agreements between competitors to per se liability for price fixing or other cartel conduct is reduced to some extent by the exception for exclusive dealing conduct under section 45(6) of the *TPA* and section 44ZZRS of the *Bill*. However, as illustrated in Part II below, some everyday kinds of pro-competitive or harmless supply agreements between competitors are not excepted from per se liability by section 45(6) of the *TPA* or section 44ZZRS of the *Bill*. Nor are they excepted by any other provision. Authorisation by the Australian Competition and Consumer Commission ('*ACCC*') could be sought, but in most situations, authorisation is impractical given the cost, delay, publicity and uncertainty of the authorisation process and the limited scope or period of immunity where authorisation is granted.

* Brent Fisse Lawyers, Sydney. This commentary is based on section 4 of a submission made to the Senate Economics Committee on the Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2008 (Cth). The full submission is available at: <http://www.brentfisse.com/images/Brent_Fisse_Submission_to_Senate_Economics_Committee_on_Cartel_Bill_20_January_2009.pdf>. The Senate Economics Committee report does not discuss the issue of supply agreements between competitors: Senate Standing Committee on Economics, *Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2008 [Provisions]* (2009).

1 See Robert Bork, *The Antitrust Paradox* (1978) 274–8; Jonathan Faull and Ali Nikpay, *The EC Law of Competition* (2nd ed, 2007) [3.116].

It is difficult to explain the aberrational treatment of supply agreements between competitors in Australia. Provisions such as section 45(6) of the *TPA* and section 44ZZRS of the Bill often have been referred to as ‘anti-overlap’ provisions, a term also used in the Explanatory Memorandum accompanying the Bill.² As explained in Part III below, the focus on overlap seems to have diverted attention away from the fundamental policy issue that needs to be addressed. The fundamental policy issue is not whether section 45 should overlap with section 47, or whether sections 44ZZRG and 44ZZRH, or sections 44ZZRJ and 44ZZRK, should overlap with section 47. The issue is whether vertical supply agreements between competitors should be subject to per se liability for price fixing or other cartel conduct. Sections 45(6) and 44ZZRS do not address that issue squarely, nor does any other provision in the *TPA*. There is a significant gap in the law.

The straight-forward solution recommended in Part IV below is to insert an additional exception in Part IV of the *TPA* that excludes per se liability for price fixing or other cartel conduct where the relevant provision in a supply agreement between competitors does not have the purpose or likely effect of substantially lessening competition *between those competitors*.

The unsatisfactory treatment of supply agreements between competitors under the *TPA* and the Bill should be rectified by means of an amendment to Part IV of the *TPA* of the kind indicated in Part IV below.

II EXAMPLES OF PRO-COMPETITIVE OR HARMLESS COMMERCIAL SUPPLY AGREEMENTS SUBJECT TO PER SE LIABILITY UNDER THE *TPA* AND THE BILL

A Example A

ACO, an Australian manufacturer of Product A, supplies Product A on reasonable commercial terms and conditions to BCO, CCO and numerous other companies with which ACO competes downstream in the Australian wholesale market for Product A and competing products. These supply arrangements are pro-competitive given that: (a) BCO, CCO and other companies are able to compete as wholesalers against ACO in relation to ACO’s Australian-made Product A; (b) BCO, CCO and other companies are able to compete against each other in relation to ACO’s Australian-made Product A and to compete more effectively against companies supplying imported similar products; and (c) the agreements do not include an exclusive dealing condition, a resale price maintenance restriction or any other condition on the freedom of BCO, CCO and the other companies to sell ACO’s Product A however and wherever they wish.

The price charged by ACO for Product A obviously is a major input cost of the wholesale price to be charged for Product A by BCO, CCO and the other companies in competition with ACO. The supply price provision therefore

2 Explanatory Memorandum, Trade Practices Amendment (Cartel Conduct and Other Measures) Bill 2008 (Cth) [4.4].

‘controls’ that wholesale price.³ Accordingly, the supply price provision is a price fixing provision, as defined in section 45A(1) of the *TPA*. It is possible that the provision may not control the price to be charged for Product X by ACO. However, that is irrelevant: the provision does control the price to be charged for Product X by BCO, CCO and other customers, and it is sufficient that the competitors agree that the price to be charged by one of them will be controlled.⁴

The supply price provision is also a cartel provision, as defined by section 44ZZRD(2)(a), (2)(c) and (4) of the Bill. The reasoning parallels that set out above for price fixing under sections 45(2) and 45A(1) of the *TPA*.

The Explanatory Memorandum states that section 44ZZRD(2) is not intended to apply where a price is only ‘incidentally affected’ and ‘where the price is otherwise established independently’ and gives this example:

Company A, having a shortage of inputs for its manufacture of a good, seeks to source the inputs from Company B, a competitor in the market for the good. B agrees to produce the additional inputs and to provide them to A, at an agreed price. Provided there is no agreement between A and B regarding the price at which A sells the good concerned, the purpose/effect condition would not be met merely because of the reflection of the input price in the price of the good.⁵

Example A does not involve the supply of an input for use in the manufacture of a product, but the supply of a product that is to be re-supplied by a competitor. The price charged by ACO has an indirect effect on the price to be charged by BCO, CCO and other customers but it is difficult or impossible to say that the effect is merely ‘incidental’. The definition of a ‘cartel provision’ in section 44ZZRD(2)(e) explicitly covers situations where a provision has the purpose or likely effect of controlling the price for ‘goods or services re-supplied, or likely to be re-supplied, by persons or classes of persons to whom those goods or services were supplied by any or all of the parties to the contract, arrangement or understanding’.

Apart from the limited scope of the exception stated and the example given in the Explanatory Memorandum, the extent to which supply agreements between

3 *Australian Competition and Consumer Commission v CC (NSW) Pty Ltd (No 8)* (1999) 165 ALR 468, [164]–[202].

4 This is consistent with the wording of s 45A(1) and s 44ZZRD(2)(a) and the apparent legislative intention to avoid creating a loophole in situations where, eg, a price fixing agreement between two competitors relates only to the price to be charged by one competitor or where it may be difficult to prove that the price fixing provision controls the price to be charged by both parties. Assume that GCO competes with HCO in relation to Type G products. GCO threatens to expand its production of Type G products if HCO discounts the price it charges for Type G products. HCO agrees not to discount its price for Type G products and GCO agrees not to expand production of Type G products. In such a case it may be difficult or impossible to prove that the agreement is likely to control the price to be charged for Type G products by GCO. Such proof is unnecessary under the s 45A(1) definition of price fixing. The contrary has been suggested by Ian Tonking, on the basis that the words ‘in competition with each other’ that succeed the wording ‘by any of them’ in s 45A(1) indicate that the earlier words should be read as if they said ‘or by any two or more of them’, since there must be at least two competitors for there to be competition: Ian Tonking SC, ‘Competition at Risk? New Forms of Business Cooperation’ (2002) 10 *Competition and Consumer Law Journal* 169, 186. However, it is difficult to reconcile that interpretation with the wording of s 45A(1), and the requirement that there be two or more competitors requires only that there be two or more competitors, not that the price fixing agreement must control the price to be charged by two or more competitors.

5 Explanatory Memorandum, above n 2, 13.

competitors are subject to per se liability should not depend on the vague notion of an ‘incidental effect’, the obscure distinction between indirect and incidental effects, or the opaque qualification ‘where the price is otherwise established independently’. The position should be governed by a clearly drafted statutory provision, not a makeshift rescue attempt in an explanatory memorandum.

The anti-overlap provisions do not exclude Example A from per se liability. The supply price provision in ACO’s supply agreements is not excepted by section 45(6) from per se liability for price fixing under section 45(2)(a)(ii): it is not an exclusive dealing condition. Nor is the supply price provision excepted by section 44ZZRS from per se liability for a cartel offence under sections 44ZZRG or 44ZZRH or for breach of the civil penalty prohibitions under sections 44ZZRJ or 44ZZRK: there is no exclusive dealing condition in the supply agreements.

Nor is there any other escape route short of the unrealistic possibility of applying for an authorisation. For example, the resale price maintenance exception under section 45(5)(c) of the *TPA* and section 44ZZRR of the Bill does not apply: the supply price provision is not a resale price maintenance provision. Nor is there a way out under the joint venture provisions in sections 44ZZRO(1) and 44ZZRP(1): there is no joint venture between ACO and BCO or any of the other companies to which ACO supplies Product A.

B Example B

XCO, an Australian manufacturer, agrees to supply Product D to YCO on condition that YCO agrees to supply Product E to XCO. YCO agrees to supply Product E to XCO on condition that XCO agrees to supply Product D to YCO. XCO and YCO compete against each other in the market for Product D, Product E and competing products. The reciprocal supply provisions are pro-competitive because they increase the ability of XCO and YCO to compete against major competitors in the market. Neither XCO nor YCO are prevented from deciding to acquire Product D or Product E from alternative sources at any time.

The reciprocal supply provisions are exclusionary provisions as defined by section 4D of the *TPA*. XCO and YCO compete with each other in relation to the relevant competing products. A substantial purpose of each reciprocal supply provision is to restrict the supply of a relevant competing product unless the condition of reciprocity is satisfied. It is irrelevant that the exclusionary purpose is conditional: an exclusionary purpose under section 4D may be conditional or unconditional. Nor can it be maintained that the ‘real purpose’ of each reciprocal supply provision is an exclusionary purpose but a purpose to ‘act in the best interests of the market’ or to ‘improve competition’: if the purpose of a provision is to restrict the supply or acquisition of goods or services in the way prescribed by section 4D it is irrelevant whether or not the defendant believes that the restriction is in the best interests of the market or a way of improving competition. The dictum of Lockhart J in *Radio 2 UE Sydney Pty Ltd v Stereo FM Pty Ltd*,⁶ that conduct that ‘improves competition’ is not price fixing under section 45A(1) of the *TPA*, is obiter, was not endorsed by the Full Federal Court,

6 (1982) 44 ALR 557, 566.

does not extend to competitively neutral as well as competitively positive conduct, and does not provide any legal or commercial certainty about the meaning and scope of section 4D.

Each reciprocal supply provision is also a cartel provision, as defined by section 44ZZRD(3)(a)(iii) and (4) of the Bill. A substantial purpose of the provision, as outlined in section 44ZZRD(3)(a)(iii) is to restrict or limit the supply or likely supply of goods or services to a person (YCO or XCO) by a party to the contract (XCO or YCO).

The reciprocal supply provisions are not excepted by section 45(6) from per se liability for making a contract containing an exclusionary provision under section 45(2)(a)(i): they are not exclusive dealing conditions. Nor are the reciprocal supply provisions excepted by section 44ZZRS from per se liability for a cartel offence under sections 44ZZRG or 44ZZRH, or for breach of the civil penalty prohibitions under sections 44ZZRJ or 44ZZRK: they are not exclusive dealing conditions.

Nor is there any other escape route short of the unrealistic possibility of applying for an authorisation. For example, the resale price maintenance exception under section 45(5)(c) and section 44ZZRR does not apply: the reciprocal supply provisions are not resale price maintenance provisions. Nor is there a way out under the joint venture provisions in sections 44ZZRO(1) and 44ZZRP(1): there is no joint venture between XCO and YCO but merely a reciprocal supply agreement.

C The Implications of Example A and Example B

These examples of supply agreements between competitors are hardly atypical or contrived. They relate to many possible kinds of products. The price fixing provision in Example A is a feature of many supply agreements between competitors. The exclusionary provision in Example B is far from unusual – supply agreements between competitors often contain restrictions on supply or acquisition that do not amount to exclusive dealing conditions. Yet, as explained above, conduct of the kind illustrated by Example A and Example B is subject to per se civil liability under the current provisions of the *TPA* and to per se criminal and civil liability under the amendments proposed in the Bill.

Exposing competitors to per se civil liability in pro-competitive or harmless commercial supply situations of the kind illustrated by Example A and Example B is absurd. The exposure to criminal as well as civil liability under the Bill is doubly absurd and repugnant.

Example A and Example B are impossible to reconcile with the statement of legislative intention in the Explanatory Memorandum that ‘exceptions are included in the Bill to ensure that the prohibitions do not prohibit legitimate business activities that are beneficial to the economy or in the public interest’.⁷

Some possible kinds of restriction in supply agreements between competitors will raise the vexed question of whether or not there is an exclusionary purpose, given the ‘real’ commercial purpose facilitated by the restriction.

7 Explanatory Memorandum, above n 2, [4.8].

Consider the following example. RCO, an Australian manufacturer of Product R, supplies Product R to SCO, TCO and numerous other companies with which RCO competes downstream in the Australian wholesale market for Product R and competing products. RCO is concerned about the economic downturn and the increasing risk of non-payment. Accordingly, RCO's supply agreement includes a *Romalpa* clause that title to the products supplied will not pass to the customer unless and until payment is received. Is the *Romalpa* clause in this example an exclusionary provision as defined by section 4D of the *TPA*? RCO competes in the wholesale market for Product R and similar products with SCO, TCO and the other companies to whom it supplies Product R. The predominant and immediate purpose of the *Romalpa* clause is to restrict the supply of a service (the transfer of title in Product R) to SCO, TCO and other customers unless and until payment is made for the relevant supply of Product R. On one possible view, that purpose is an exclusionary purpose as defined by section 4D:

- the economically rational purpose to help ensure payment does not negate or override the immediate exclusionary purpose: where a provision has multiple purposes it is sufficient that one substantial purpose is an exclusionary purpose (section 4F(1) of the *TPA*);
- it is irrelevant that the exclusionary purpose is conditional on non-payment: an exclusionary purpose under section 4D may be conditional or unconditional;
- the purpose is a substantial purpose within the meaning of section 4D and section 4F(1): it is considerable and looms large in the objectives being pursued by RCO.

On another possible view, however, the situation is on all fours with that in *News Ltd v South Sydney District Rugby League Football Club Ltd*,⁸ where a majority of the High Court decided that the 14 team term of the rugby league arrangements proposed was not an exclusionary provision. On that view, there is no exclusionary purpose in the *Romalpa* clause example because, looking at the supply agreement as a whole and not the *Romalpa* clause alone, the 'real' purpose is not to restrict supply but to help ensure payment for supply.

In cases such as that where *Romalpa* clauses are used in supply agreements between competitors, it is unfortunate that companies and their advisers are forced to go beyond the wording of section 4D and to try to divine guidance from the sophisticated reasoning of the majority of the High Court in *News Ltd v South Sydney District Rugby*.⁹ This uncertainty can and should be avoided by means of a straightforward amendment to Part IV of the *TPA*, as discussed in Part IV below.

8 (2003) 215 CLR 563 ('*News Ltd v South Sydney District Rugby*').

9 See also Ian Stuart Wylie, 'What is an Exclusionary Provision? Newspapers, Rugby League, Liquor and Beyond' (2007) 35 *Australian Business Law Review* 33, 42.

III ADDRESSING THE FUNDAMENTAL ISSUE AND AVOIDING PREOCCUPATION WITH ‘ANTI-OVERLAP’ PROVISIONS

The fundamental issue that needs to be addressed is whether or not, or when, supply agreements between competitors warrant per se liability under prohibitions against price fixing and other forms of cartel conduct.

Whether or not section 45, sections 44ZZRF–44ZZRG, or sections 44ZZRJ–44ZZRK should overlap with section 47 is a different and secondary issue. Yet the discussion of supply agreements between competitors in Australia to date appears to have been preoccupied with ‘anti-overlap’. That preoccupation lives on in the Explanatory Memorandum.¹⁰ The Explanatory Memorandum does not address problems of the kind illustrated by Example A and Example B in Part II above but seems to assume, wrongly, that section 45(6) of the *TPA* and section 44ZZRS of the Bill deal adequately with the scope of per se liability for price fixing and other forms of cartel conduct in such situations.

Orthodox competition policy opposes the imposition of per se liability for price fixing or other forms of cartel conduct where the agreement between competitors is a vertical supply agreement and where there is no underlying horizontal agreement not to compete against each other. A leading statement of that orthodoxy is provided in Phillip Areeda and Herbert Hovenkamp’s *Antitrust Law*:

We saw in ¶1402 (2d) two overlapping policy reasons for being concerned with horizontal ‘agreements’. Neither reason applies in the same way to vertical agreements. *First*, agreements concern us because cooperative action creates a restraint that is not otherwise possible. In the horizontal context, one competitive firm alone cannot fix prices or exclude rivals from the market without rival participation in that exercise. In one sense, the same is true in the vertical area, where a manufacturer obviously cannot fix a dealer’s resale price or force a tied product upon the dealer without the dealer’s cooperation (although a manufacturer retailing its product can lawfully charge any retail price it wishes). Nevertheless, a purely vertical agreement does not fix market-wide prices unless the parties control the market.

Second, horizontal agreements concern us because they may create market power that did not previously exist. The ordinary cartel agreement creates market power by consolidating the price–output choices of firms that otherwise lack power over output or price. Of course, not every agreement between two or more rivals creates significant or even measurable power – such as, for example, in the case of two farmers agreeing to share an expensive piece of equipment or two solo practicing lawyers who agree to share an office.

As a general matter, a purely vertical agreement does not increase anyone’s market power, although it may reflect the preexisting power of one party. Indeed, most litigated vertical agreements involve not so much consent or coordination but are a response to the manufacturer’s unilateral power to substitute another dealer. ...¹¹

The same policy explains the exclusion of vertical supply agreements from the application of the cartel offence under sections 188–9 of the *Enterprise Act*

10 See Explanatory Memorandum, above n 2, [4.4], [4.8].

11 Phillip E Areeda and Herbert Hovenkamp, *Antitrust Law* (2nd ed, 2001) [1437a].

2002 (UK) ('*Enterprise Act*'). Sections 188–9 reflect the policy position set out in the Office of Fair Trading Report:

We understand that the view of those who are experts in the field of competition law is that the criminal offence should only be applicable to horizontal agreements between individuals representing 'competing' undertakings operating at the same level of the supply-chain for the purposes of the agreement in question. It should not apply to vertical agreements, many of which are considered to have pro-competitive or other beneficial effects and consequently are currently excluded from the application of Chapter I of the Competition Act 1998 or alternatively benefit from exemptions under European competition law.¹²

The policy position that a cartel offence should not apply to vertical agreements between competitors was expressed by the ACCC in its submission to the Dawson Committee in 2002:

Market sharing may also be vertical. Market sharing between manufacturers and distributors or franchisors and franchisees may be in the best interests of consumers. It may increase rather than decrease output. In the US these arrangements are treated in accordance with the rule of reason. They are not characterised as unlawful per se. The Commission has indicated that it does not seek to criminalise vertical agreements. They are not currently covered by s 4D of the Act.¹³

The assertion in the ACCC submission that vertical agreements are 'not currently covered by section 4D of the Act' is not explained and, as shown by Example B in Part II above, does not appear to be correct. Moreover, the majority of the High Court in *Visy Paper Pty Ltd v Australian Competition and Consumer Commission*¹⁴ pronounced that the application of section 4D depends on the application of the wording of the provision, not the categorisation of an agreement as being horizontal rather than vertical.

IV SOLUTION FOR AVOIDING UNJUSTIFIED PER SE LIABILITY FOR SUPPLY AGREEMENTS BETWEEN COMPETITORS

Sensible limits on the scope of per se liability could be imposed if the courts were to read down the statutory prohibitions against price fixing and other forms of cartel conduct, and to confine them to horizontal agreements between competitors. However, that solution is most unlikely to occur, especially given the approach to the interpretation of section 45(6) taken by the High Court in *Visy v ACCC*. In any event, a solution is needed now and the cost and uncertain outcome of test cases should be avoided.

Sections 188–189 of the *Enterprise Act* provide one possible statutory model. These provisions limit liability for cartel conduct to cases where the cartel conduct is reciprocal (for example, competitor A agrees to fix the price it is to

12 Sir Anthony Hammond KCB QC and Roy Penrose OBE QPM, *Proposed Criminalisation of Cartels in the UK*, Report Prepared for the Office of Fair Trading (2001) [1.12].

13 Australian Competition and Consumer Commission, *Submission to the Trade Practices Act Review* (June 2002) [2.4.4.3].

14 (2003) 216 CLR 1, [23]–[27] ('*Visy*').

charge and competitor B agrees to fix the price it is to charge). However, the requirement of reciprocal cartel conduct goes beyond excluding vertical agreements from the scope of the cartel offence, and is highly questionable given that a serious interference with the competitive process may exist where a cartel agreement fixes the price to be charged by one competitor.¹⁵ Moreover, sections 188–9 are very complex provisions that defy ready communication to jurors.¹⁶

A straightforward solution is to insert in Part IV of the *TPA* an additional exception that excludes per se liability for cartel provisions and exclusionary provisions in supply agreements between competitors if the provision does not have the purpose or likely effect of substantially lessening competition *between those competitors*.¹⁷ The focus of this solution is on whether or not competitors agree that one or more of them will not compete against another competitor; it does not require an evaluation of competition in a market as a whole, nor of whether the restriction of supply or acquisition had the purpose, effect or likely effect of substantially lessening competition in a market.

The rationale is simple and directly reflects orthodox economic principle: there is no justification for imposing per se liability for price fixing or other cartel conduct unless the competitors agree that at least one of them will not compete against another competitor.

This approach would exclude per se liability in Example A and Example B in Part II above. By contrast, it would not exclude liability for an exclusionary provision on the facts in *Visy* (where competitor A agreed not to compete for competitor B's customers).

15 Assume that GCO competes with HCO in relation to Type G products. GCO threatens to expand its production of Type G products if HCO discounts the price it charges for Type G products. HCO agrees not to discount its price for Type G products and GCO agrees not to expand production of Type G products. In such a case, it may be difficult or impossible to prove that the agreement is likely to control the price to be charged for Type G products by GCO. Yet there is an obvious and serious interference with the competitive process. There is no compelling policy justification for excluding liability for price fixing in such a case, which does involve price fixing as defined under s 45A(1) of the *TPA*.

16 As criticised by Julian Joshua, '[the cartel offences] are drafted with all the user-friendliness of a schedule to VAT regulations': Julian Joshua, 'Norris v United States: A Stalking Horse for the Cartel Offence' (2008) *Competition Law Insight* 11, 13.

17 See Bork, above n 1, ch 1, 262. An essential feature of conduct justifying per se liability for price fixing and market sharing is the elimination of rivalry between competitors.

V CONCLUSION ON SUPPLY AGREEMENTS BETWEEN COMPETITORS UNDER THE *TPA* AND THE BILL

The unsatisfactory treatment of supply agreements between competitors under the *TPA* and the Bill should be rectified by means of an amendment to Part IV of the *TPA* of the kind indicated in Part IV above.

The recent Senate Economics Committee Report on the Bill failed to discuss the issues raised by supply agreements between competitors. However, political spin and a superficial and incomplete report will hardly make these (or other) issues go away.