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Price fixing is perhaps the best known of Australia's per se prohibitions: regardless of any impact on competition or the prices ultimately paid by consumers, competitors can't agree on prices. 'Competitors' is generally thought to be a straightforward term which does not encompass agents. But some recent cases highlight how agents and other commercial partners can find themselves in price fixing trouble. One of those cases, USA v Apple, also raises interesting issues regarding market power, market share and most favoured nation clauses.



Can Apple defend itself against price fixing claims?

the state of COMPETITION

Flights of fancy or hard core cartels?

When agents (allegedly) price fix

Price fixing arrangements – much like Tolstoy's happy families – can tend to have a degree of sameness about them: minor variations on a theme of smoky rooms (often in exotic locations), conspiratorial tones and inflated prices. The recent video by the Australian Competition and Consumer Commission (the ACCC) on the perils of price fixing (see 'Further Reading' for the link) plays into the stereotypes, with a dramatic flare that would make Elliot Perlman proud.

Sometimes, however, a price fixing scenario goes beyond the ordinary, involving parties who would not usually be considered competitors. For example, the ACCC is currently prosecuting Flight Centre, alleging that it attempted to induce various airlines to reduce online discounting. It also has a long-standing case against ANZ, in relation to the payment of rebates to mortgage brokers. And, in a case which has generated considerable publicity, the US Department of Justice (DOJ) has recently filed proceedings against Apple and various book publishers.

The Apple case is a relatively basic 'hub and spoke' allegation, which is a variation on the standard price fix. That said, it gives rise to some fascinating points of discussion, particularly on the issue of market power. With the Flight Centre case, however, the ACCC definitely appears to be trying to break new ground in the characterisation of the relationship between agents and their principals. Similarly, the ANZ case places an unusual spin on a commercial relationship.

USA v Apple

While some of the publishers have settled with the DOJ, Apple continues to fight claims that it was the ring-master of a 'hub and spoke' arrangement: an arrangement in which it – a customer, not a competitor, of the book publishers involved – co-ordinated a price fix between those competitors.

Much like the arrangement alleged in the *Superleague* case (discussed in a different context in our last issue), Apple is said to have designed and co-ordinated a scheme intended to lift prices for e-books above the \$9.99 which had become an industry standard. This standard price point is largely attributed to the dominance of Amazon, which – prior to Apple's

**Apple is alleged to
have been the ring-
master of a price
fixing conspiracy**

entry into the e-book market – accounted for nine of every ten sales. The \$9.99 price point is said to be well below what the publishers wanted as, according to the DOJ, they feared it would become a customer expectation which in turn would impact on their wholesale prices. Acting separately, however, the DOJ says they were powerless to do anything about it.

The conspiracy allegedly organised by Apple changed the market from a predominately wholesale/retail model to an agency model. Previously, publishers sold their titles to distributors – principally Amazon – who then onsold to consumers at a price of the distributor's choosing. Amazon took the early running in this market with the introduction of the first Kindle device in 2007, and since that time has been far and away the most significant retail presence.

Under their arrangements with Apple, however, the publishers were the principals, thereby retaining control over the pricing of e-books, with Apple their agent. Each of the five defendant publishers entered into separate agency arrangements with Apple, all of which were negotiated separately but simultaneously and which had the same commencement date.

Preceding these negotiations, there had been a number of meetings between the various publishers (ie without Apple), including several in the “private dining rooms of upscale Manhattan restaurants”. (The DOJ, in its pleadings, appears keen to point out that all the typical features of a price fix are present!) Apple's entrance to the e-book market then provided the publishers with the perfect means by which to implement their conspiracy.

After reaching their respective agreements with Apple, the publishers then (according to the DOJ):

quickly acted to complete the [conspiracy] by imposing agency agreements on all their other retailers. As a direct result, those retailers lost their ability to compete on price, including their ability to sell the most popular e-books for \$9.99 or for other low prices. Once in control of retail prices, the Publisher Defendants limited retail price competition among themselves.



The price fixing allegation in Apple is a basic 'hub and spoke', but it has several interesting twists

This, the DOJ describes as an “abrupt, contemporaneous shift from past behavior”.

Market power but zero market share?

There are many aspects of the DOJ's claim which raise interesting questions beyond whether there was indeed a conspiracy formulated in upscale Manhattan restaurants and then executed via Apple. For example, the DOJ's case theory rests on Apple's importance in a market in which – at the time of the alleged conduct – it had virtually no presence.

Indeed, the DOJ describes Apple as “perhaps the only company that could facilitate [the publishers'] goal of raising retail e-book prices across the industry”. If Apple were not a significant player, then any conspiracy between the publishers which was implemented through Apple would fail.

Apple had to be a sufficiently strong presence to enable the publishers to push the new agency model onto other retailers. If the publishers could not roll out the model broadly within the market, they would be in no better position and Apple would be substantially worse off, as it would be trying to compete with Amazon's \$9.99 price point without any control over its own pricing.

Unsurprisingly, Apple makes much of this fact in its defence: “here, Apple was a new entrant with zero share and no market power”. Yet the potential for market power – even if falling short of “substantial market power” – in such circumstances is intriguing.

There may well be scope to contend that a powerful player could, due to its position in one market, enter a related market with zero market share but some market power (although traditionally the US has been less inclined than other jurisdictions to accept leveraging arguments). Perhaps it is easiest to envisage this in terms of a move between geographic markets – the ‘brand’ power attaching to Krispy Kreme, for example, seemed to mean that it had considerable market presence in Australia before ever selling a doughnut here.

Similarly, if one considered online groceries to be a separate market, then it is not too difficult to imagine that Coles and Woolworths could start in that market with more power than their initial market share would suggest.

But here Apple's market position was as a retailer of a product (e-books) it had hardly ever sold before, using a new format that was completely untried (the iPad). That's a difficult starting point for the DOJ. Such a player would require a very strong reputation (as indeed Apple has) and there would need to be reasons to assume that that reputation could extend into the new market (in fact, here, two markets: the tablet market *and* e-books). In essence, Apple's brand and technological nous – and established distribution methods – had to be so well-regarded that its success in both markets would be considered virtually inevitable.

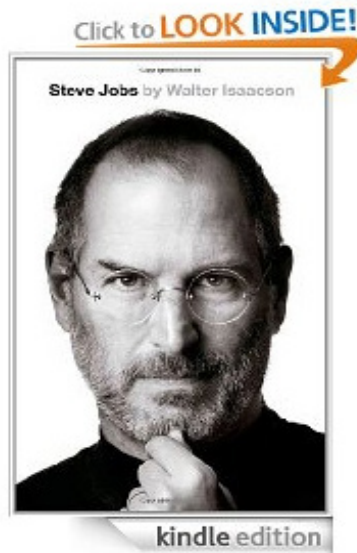
The “unusual” most favoured nation clause

The DOJ's case theory also needs to explain *why* Apple would engage in this sort of conspiracy – why would it engineer an outcome that, at first blush, mostly seems to benefit the publishers? Apple needed to be confident that the scheme would succeed (reiterating the need for some degree of market power), but it also required a clear benefit. After all, if prices are higher, but Apple is just an agent, then the biggest winners are the publishers.

Here, the DOJ places considerable emphasis on a 30% com-

“Apple was a new entrant with zero share and no market power”

In its complaint, the DOJ cites "evidence" from Steve Jobs' biography. Ironically, the e-book version is currently \$24 on Amazon



mission payable to Apple (calculated by reference to the retail price), combined with an "unusual" 'most favoured nation' (MFN) provision. This required each publisher to guarantee that the prices of e-books sold via Apple would match the lowest price for which that title was available through any other retailer.

The DOJ alleges that this departs from the norm, as it was not the sort of MFN that ensured Apple would receive the best available wholesale price, nor was it limited to using as benchmarks those websites in relation to which the publishers controlled retail prices. Thus the DOJ concludes that "instead of an MFN designed to protect Apple's ability to compete, this MFN was designed to protect Apple from having to compete on price at all...". Implicit in this statement, of course, is the notion that Apple is a competitor in the retail market for e-books – something which runs counter to common notions of agency.

Apple is defending the case vigorously on several fronts. In relation to the most favoured nation clause, it claims that:

If the MFN was not 'standard', this was because de novo entry into an alleged market controlled by a single dominant distributor is not a standard event. If the MFN was 'unusual' this is only because it was sought by a party with no market power, it applied to a minimal share of sales (starting from zero), and it served a procompetitive purpose: ie to allow Apple to enter eBook distribution assured that its iBookstore would be price competitive...

Indeed, on this point, the DOJ's claims seem a little vulnerable. Most favoured nation clauses are not bought 'off the shelf' – they tend to be highly tailored provisions, reflecting the very specific requirements of the parties involved.

Furthermore, the first of the DOJ's criticisms doesn't apply to agency agreements. Under the terms of its agency, Apple would not pay wholesale prices at all. A clause promising Apple the 'best' available wholesale price simply wouldn't make sense.

The DOJ's other specific concern was that, if the conduct was legitimate, then the publishers should have promised that Apple would be price-competitive only in relation to those sites which they controlled. But as they controlled very few sites, with Amazon having a market share in excess of 90%, such a promise would not be worth the paper it was written on.

Apple bites back

In other key aspects of its defence, Apple makes much of the fact that virtually its entire business is – and always has been – premised upon an agency/principal model. Indeed, returning to the issue of zero market share, this long-standing and very successful distribution model is one reason why it might be argued that Apple had a degree of market power.

Apple also explains the co-incidence of timing and the involvement of senior management in negotiations with the various publishers by reference to the commercial imperative created by the launch of the iPad. When viewed in that light, the simultaneous nature of much of the alleged conduct seems more explicable.

As for the fact that the most favoured nation clauses with each publisher were substantially the same, Apple might claim this was due to its very strong bargaining power (which is not necessarily the same as market power). Nonetheless, Apple faces an interesting conundrum, as some of its best defences are – it seems – premised upon conceding a degree of market power which Apple may not wish to admit.

Where's it at...

As mentioned earlier, some publishers have reached a settlement with the DOJ. Interestingly, they seem to have got off pretty lightly, so one can make a fair guess as to where the DOJ thinks the real game is.

The settling publishers have promised to allow their retailers to price without restriction for a minimum of two years. They have also agreed to terminate their agreements with Apple, and to refrain from entering into further agreements with most favoured nation provisions.

Apple unsuccessfully opposed this settlement. In the meantime, a trial has been set down for June 2013. One can only hope that it goes to a final judgment, as the issues certainly are interesting.

ACCC v Flight Centre

Meanwhile, the ACCC is fighting its own battle against Flight Centre, again for alleged price fixing. Flight Centre would traditionally be regarded as an agent (hence, the term 'travel agent'). But the ACCC alleges that, in attempting to stop its principals from undercutting its own prices, Flight Centre was in fact trying to fix prices with competitors.

Specifically, Flight Centre is said to have attempted to induce various international airlines (Singapore, Malaysian and Emirates) to agree to stop directly offering and booking their own international airfares (including via the internet) at prices less than Flight Centre offered. Allegedly, there were six such requests made between 2005 and 2009.

The ACCC took these requests as an attempt to get the airlines to raise their internet prices so Flight Centre could then match those prices. Via proceedings lodged in March this year, the ACCC claims that the purpose and likely effect of the arrangements sought by Flight Centre was to maintain the level of Flight Centre's commissions. The ACCC alleges that such arrangements – if actually made – would have amounted to price fixing in contravention of section 45 of the *Competition and Consumer Act 2010* (via the old *per se* deeming provision contained in the now-repealed section 45A).

It seems that the airlines did not accede to Flight Centre's requests. Consequently, the case is framed as an attempt only, with Flight Centre the sole respondent.

Why lawyers are confused by the Flight Centre case

[15-5] Meaning of 'agency' The traditional view of the term 'agency' connotes an authority or capacity in one person (the 'agent') to create legal relations between a person occupying the position of principal and third parties.¹

*Excerpts from
Halsbury's Laws of
Australia: in essence,
a true agent has a
duty not to compete
with its principal*

[15-175] Duty to avoid conflict of interest and duty not to profit from position The relationship of agency is generally viewed as having a fiduciary nature.¹ Accordingly, the agent is not permitted to put his or her duty in conflict with his or her interest unless the agent has first made to the principal full disclosure of the exact nature and extent of his or her interest and the principal has consented.² Depending on the nature of agency, it may also amount to a breach of fiduciary duty to act for more than one principal with competing interests, at least not without full disclosure to each principal.³

It's no good being an agent if your principal undercuts you

Flight Centre has publicly contended that the ACCC has misunderstood its business model as an agent for, rather than a competitor to, the airlines. If Flight Centre and the airlines are not competitors, then there could never have been an arrangement to fix prices.

Brian King, Professor of Tourism at Victoria University, wrote in *The Conversation* (16 March 2012):

Though the court may take years to determine any wrongdoing, it is timely to reflect on the travel industry's inter-firm relationships and their appropriateness in an online and fast changing business environment. Are consumers really getting the best deals, or is the "Lowest Airfare Guarantee" boast of Australia's most powerful travel retailer only possible because the cheapest POSSIBLE consumer prices have already been ruled out by an insistence on taking their cut?

(The effect of these sorts of price guarantees was considered in Issue 2 of *The State of Competition*: "Lowest prices are just the beginning...", available at <http://thestateofcompetition.com.au/newsletter-archive/>. That said, we can't agree with the notion that travel agents – who perform services for both customers and their principals – aren't entitled to compensation for those services.)

The Flight Centre case raises challenging issues about the appropriateness of the price related dealings which occur between travel 'principals' (for instance, airlines and hotels) and their 'agents' (eg, Flight Centre). In particular, if an agent doesn't like the terms upon which the principal is selling elsewhere (whether itself or via another agent), when will its protests over pricing tip over into an attempt to fix prices?

Interestingly, in some respects, attempts are harder to prove than actual arrangements, as substantial evidence is required as to the respondent's state of mind when engaging in the conduct. To this end, it is intriguing to consider whether a subjective assessment that parties are not competitors could form part of a reasonable defence.

Standing on the side-lines, it is hard to understand what

specifically has caught the ACCC's attention in this case. If it is price fixing when a principal responds to pressure from an agent and changes its pricing behaviour, why does the reverse not apply? Most true agents have no control over price – their pricing behaviour is completely determined by the principal. So wouldn't the same logic make this price fixing too?

Where's it at...

The case was heard before Justice Logan in October, with judgment reserved. It has gained some international publicity given the way the travel industry is generally structured. Indeed, the International Air Transport Association, IATA, lodged an *amicus curiae* application, which was rejected by the court. (The airlines involved are IATA members and Flight Centre is accredited with IATA.)

ACCC v ANZ

The Flight Centre case bears some similarities to another case which the ACCC commenced back in 2007 against ANZ.

In this case, the ACCC alleged that ANZ had engaged in price fixing conduct in its dealings with a mortgage broker known as Mortgage Refunds.

As a general rule, brokers sign up customers for, say, a home loan, and then receive a commission from the relevant bank. Mortgage Refunds tended to pass onto its customers part of that commission. The ACCC alleges that ANZ sought to reach an agreement with Mortgage Refunds to limit such payments to customers as a condition of ongoing relations with the bank.



The idea that agents are simply avatars of their respective principals is turned on its head in ACCC v Flight Centre

In defending a case which it describes as “ill conceived”, ANZ claims that the bank and mortgage broker were not competitors. Indeed, they operated in different markets, with the bank offering broad financial services and the broker being a so-called ‘vertical channel’ providing broking services.

After a long and circuitous route to court (which has involved several amendments to the pleadings), the ANZ case was heard in April with judgment reserved.

Conclusions

Clearly the ACCC is trying to push the boundaries of what constitutes a competitor. This is indeed an area in which there is limited case law, so some jurisprudence is to be welcomed.

Nonetheless, if it is found that agents and their principals should be considered competitors, there will need to be a huge overhaul of distribution systems throughout the country. Agency arrangements are put in place for numerous reasons (including to ensure price parity for particular brands), and given the breadth of the new cartel provisions – not to mention, the existence of criminal penalties – clarity is required as a matter of urgency.

Both the Australian cases we have discussed here are being run under the old law. Strictly speaking, therefore, they will not tell us when the “competition condition” in the cartel provisions (section 44ZZRD(4)) is satisfied. But it is hard to believe that findings by the Federal Court as to when parties are in fact competitors will not guide the ACCC in future enforcement action.

Meanwhile, assuming agents and principals are not competitors, our advice to agents would be to ensure you don’t put on the top hat and become the ring-master for your principals – that looks an awful lot more like the sorts of cartels we’re used to.

It’s perilously close to year’s end...

For our next edition, we’ll look back over the competition highlights of 2012. To make sure you don’t miss out, subscribe to The State of Competition via the “Newsletter Sign-up” button on [our website](#).

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Further reading

- The entire case book in the Apple case – including all public filings and interlocutory judgments – is available at: <http://www.justice.gov.au/cases/applebooks.html>. The complaint and Apple’s answer make for particularly entertaining reading
- Interestingly, the agency issue has been the subject of recent consideration (as opposed to litigation) in the UK – see the speech by the CEO of the Office of Fair Trading, “Principal agent relationships in competition policy”, available at: <http://www.offt.gov.uk/news-and-updates/speeches/2012/0112#.ULgBjqXraPM>
- The Apple and Flight Centre cases raise issues concerning the online retailing environment and potential anti- and pro-competitive conduct by ‘bricks and mortar’ retailers and their suppliers. Alexandra has just presented a research paper on this issue, *Facing up to (virtual) reality: meeting the online retail challenge*. The paper can be found at: http://www.ipria.org/events/conf/Competition_Conference/Online_retail.pdf
- For a detailed discussion of most favoured nation clauses, see Rhonda Smith and Alexandra Merrett, “Playing favourites: the competition effects of preferred customer arrangements” (2011) 7 *European Competition Journal* 179
- The ACCC’s video on the tragic downfall of Martin the Price Fixer can be found at: http://www.youtube.com/watch?v=mcc6O_pdpE