

**Serious cartel conduct, criminalisation and evidentiary standards: Lessons from
the Coal Vend Case of 1911 in Australia**

Martin P. Shanahan and David K. Round*

*Centre for Regulation and Market Analysis
University of South Australia*

Draft Version - Please do not cite without permission from the authors

Paper presented to the
European Business History Association Conference,
Bergen, 2008.

* David Round is a Member of the Australian Competition Tribunal. The opinions and analyses presented in this paper should be treated as private assessments, and not those of the Tribunal.

Abstract

Competition is the *sine qua non* of a well-performing market. The undesirable social effects of departures from the free interplay of market forces, whereby individual firms get together to fix prices, restrict output, divide markets or otherwise act to hobble the competitive process and thus inflict harm on rivals, suppliers or customers, has led to some jurisdictions passing laws to criminalise such behaviour, while others have imposed civil sanctions.

In recent years in Australia, with major price-fixing cases coming to court, and guilt having been found, pressure has been building from lawyers, judges, economists and politicians to criminalise price-fixing. Currently there is a Bill before the Australian Parliament to make price-fixing a criminal offence. Price-fixing has been illegal per se in Australia since the 1977 amendments to the *Trade Practices Act 1974*, Australia's competition statute. The criminalisation of such conduct is not new; it dates back to the Sherman Act of 1890 in the United States, and some European countries have introduced criminal penalties for price-fixing in recent years.

In this paper we assess a 1911 High Court of Australia determination of Australia's first price-fixing case, known as the Coal Vend case. We argue that the judge's reasoning and decision constituted an analytical tour-de-force, displaying an economic sophistication well ahead of its time. Although decided almost a century ago, this decision addressed many of the issues currently facing competition agencies prosecuting cartels. Unfortunately, the decision was subsequently overturned twice on appeal, leading to a neglect of its masterful analysis. The appeals were upheld largely on the basis of the difficulties associated with proving dishonesty, or intention to harm, which was a feature of the legislation under which the case was tried. We conclude that there is much that could be learnt by current policy makers – and indeed by judges – if they examined more carefully the decisions of earlier cartel cases.

Keywords: competition, cartels, price-fixing, intent, public interest

Introduction

Whether serious cartel conduct, price-fixing in particular, should be penalised by criminal sanctions, or whether civil penalties are sufficient to deter such behaviour, has proved to be a difficult issue in many countries. Opinion is divided as to the most appropriate response to such conduct, with some arguing that criminal penalties are the only effective way to deter such behaviour,¹ while others argue that civil penalties, mixed with incentives to be the first to declare such behaviour (known as leniency for whistleblowers) are ultimately more effective.²

One issue that is hotly debated in these discussions is the requisite standards of proof required in civil and criminal cases. Anglo- and Euro-centric jurisdictions have until the last decade or so favoured civil penalties for price-fixing, thereby requiring proof of a standard ‘on the balance of probabilities’. Further, civil cases frequently do not require proof of the intention of the perpetrators in order to find them guilty of an offence (ie if harm is caused, a penalty may be imposed even when the harm was ‘unintentional’ – in other words, an effects test is used rather than a purpose test). Criminal cases however, require both a higher standard of proof ‘beyond reasonable doubt’ and that the mental element of the offence (the perpetrator intended the harm) to be proved. This means that in cases of serious cartel conduct it will often be difficult to attain the required level of proof or to demonstrate the necessary mental element – intention to harm (and not just that the conduct resulted in harm). Clearly, the criminal prosecution of serious cartel conduct will be more difficult in those jurisdictions requiring criminal standards of proof.

In 1906, influenced by the *Sherman Act* that had been passed in the US in 1890, the Australian Commonwealth Parliament passed the *Australian Industries Preservation Act 1906* (*AIPA* hereafter), which was designed to prevent the formation of ‘trusts’ that operated against the public interest.³ It differed from the *Sherman Act* in two major ways: it did not criminalise cartel behaviour, but such conduct was only illegal if it were carried out with “intent to restrain trade to the detriment of the public”.

While the *AIPA* was to a large extent designed to protect Australian companies from the threat of predatory conduct by the giant American combines of the time, it nevertheless was soon put to effect against what a century later would be regarded as a classic and pernicious textbook cartel that had horizontal (coal miners) and vertical (shipping companies) dimensions, and applied to an essential commodity, coal, that at the time had no effective substitutes for many of its uses. A better case for the first application of the *AIPA* could hardly be imagined. Its precedential value was immense.⁴

In what has rightly been described as “one of the most farsighted and enlightened antitrust opinions ever written”,⁵ the decision in the High Court of Australia of Mr

¹ Amongst the countries with criminal sanctions for price-fixing are Austria, Brazil, Canada, Chile, France, Germany, Ireland, Israel, Italy, Japan, Mexico, Norway, South Korea, Switzerland, the UK and the US. Many of these laws have only been in existence for the last decade.

² See, for example, Harding (2006) p. 181; Riley (2007) p.1 and Vann and Letwin (2007).

³ The full name of the statute was *An Act for the Preservation of Australian Industries, and for the Repression of Destructive Monopolies*.

⁴ As it turned out, the eventual loss by the Government in the Privy Council (at the time the final court of appeal for decisions made by High Court of Australia) set the cause of competition back badly in Australia. No further price-fixing cases were mounted by the Commonwealth Government until well after the *Trade Practices Act 1974* had come into operation.

⁵ Ransom (1981) p.331.

Justice Isaacs, in what has become known as the *Coal Vend* case,⁶ upheld the power of the new Commonwealth Government to act against trusts, vends and attempts by businesses to enter into anti-competitive arrangements. In his insightful decision, Justice Isaacs examined and discussed the economic and evidentiary material necessary to demonstrate issues such as intention; intention and effect; the inferences that could be drawn from silence; and the definition of a reasonable price and the public interest. On appeal, the respondents did not deny that they had committed to a restraint of trade, but argued that they did not do it with the requisite intent. The *AIPA* had been amended before the writs were issued in 1910, the effect of the amendments being to take out the need to prove intent to injure the public. The opportunity to amend the writs (and thereby, presumably, to increase the probability of a successful prosecution) was not taken, possibly because the then-current but new Attorney-General who had taken over the case from his predecessor had scant regard for the statute.⁷ In the protracted hearing of this matter, the critical factor was to become interpretation by the appellate courts of the firms' intentions when they had engaged in price fixing and bid rigging.⁸

In this paper we look at the current debate in Australia on the criminalisation of serious cartel conduct in the form of price-fixing, and we then explore these issues through the lens of the *Coal Vend* case. In short, we apply the lessons from history to inform current debates on the criminalisation of serious cartel conduct. In doing so, we hope to bring to the attention of researchers a brilliant dissection and analysis of cartel conduct that was cutting edge, and whose methods pre-dated many of the analytical tools used by economists and judges today to assess co-ordinated firm behaviour. We conclude that Australian competition law and enforcement policy would do well to learn from this history.

The current debate

In 2003 the *Review of the Competition Provisions of the Trade Practices Act 1974* (the Dawson Review) recommended the introduction of criminal penalties for serious cartel conduct in Australia.⁹ Much debate followed, but finally in January 2008 the Australian Government released an exposure draft of the *Trade Practices Amendment (Cartel Conduct and Other Measures) Bill* for consultation and public discussion.¹⁰ It is expected that the *Bill* will be presented in the next session of the Australian Parliament later in 2008.

The draft *Bill* creates two criminal offences in Part IV of the *Trade Practices Act*. An offence is committed if a person makes, or gives effect to, a contract, arrangement or understanding that contains a cartel provision with the intention of "dishonestly obtaining a benefit". A civil offence is committed if the same two types of conduct occur, but without the requisite intent.

In the draft a cartel provision is defined as one that relates to price-fixing; restricting outputs in the production and supply chain; allocating customers, suppliers or territories;

⁶ *Attorney-General of the Commonwealth of Australia v The Associated Northern Collieries and Others* (1911) 14 CLR 387

⁷ See Walker (1967).

⁸ This in part explains why the first instance decision has been ignored, and also partly contributes to the long-term highly concentrated structure of Australia's industrial markets, and the penchant of executives to collude with equanimity. The appeal decisions are, respectively, *Adelaide Steamship Co Ltd v The King and the Attorney-General* (1912) 15 CLR 65 (Full Bench of the High Court of Australia) and *Attorney-General of the Commonwealth of Australia v Adelaide Steamship Co Ltd* [1913] AC 781 (Privy Council).

⁹ Trade Practices Committee of Review (2003).

¹⁰ This section relies on the Commonwealth Discussion Paper (2007).

or bid-rigging by parties that are, or would otherwise be in competition with each other. Maximum proposed penalties for committing a criminal offence include five years imprisonment or a fine of \$220,000 for an individual, and for a corporation a fine of \$10 million per offence, or three times the benefit of the cartel, or ten percent of annual turnover if the benefit of the cartel cannot be determined. The current civil penalty for corporations is identical to this, and will remain, but strangely, the current maximum penalty for an individual is \$500,000, more than double the proposed criminal penalty. The reasons for this have not been articulated, but presumably allow for the fact that a criminal conviction carries a social stigma with it – such as being disqualified from holding certain positions, or being branded a criminal.¹¹

Critical to the Australian *Bill* currently under discussion, is how to distinguish between a criminal and civil offence. Unlike in the United States, where there is no distinguishing element, the proposed Bill makes dishonesty the key element. Dishonestly is defined in the *Commonwealth Criminal Code Act 1995* (Criminal Code) and the *Corporations Act 2001*. The Exposure Draft takes the same approach, defining dishonesty to mean “dishonest according to the standards of ordinary people; and . . . known by the defendant to be dishonest according to the standards of ordinary people.”¹² Alternatively, fraud (which includes dishonesty) or secrecy (which also has an element of dishonesty) have been suggested as alternative key elements to distinguish between a civil or criminal offence.¹³

In determining whether or not dishonesty should be the critical element, the question of what would be required to establish dishonesty, and so establish criminal culpability, has been subject to considerable discussion.¹⁴ Criminal law requires proof, beyond reasonable doubt, of two elements - the action itself (*actus reus*) and the mental element (*mens rea*) – the intention. Dishonesty as an element of intention requires proof that the person prosecuted *knew* what was being done was dishonest (to the standard of ordinary people). Indeed, one argument for the US approach (that dishonesty is not a trigger element to make serious cartel conduct criminal) relates to the difficulty in proving the mental element of dishonesty. This is not the place to engage in an extensive discussion of this issue.

However, in its submission to the Australian Treasury on the Exposure Draft of the *Trade Practices Amendment (Cartel Conduct and Other Measures) Bill* the International Bar Association provides an example of how difficult it may be to prove the subjective element of the offence, i.e. that the accused knew that the act was dishonest and the intention was to act dishonestly:

¹¹ The decision to prosecute for a criminal offence will not be one for the Australian Competition and Consumer Commission, Australia’s antitrust agency, to take. The ACCC is responsible for investigating cartel conduct and gathering evidence, and then for referring what it assesses to be serious cartel conduct to the Director of Public Prosecutions for consideration for prosecution. In deciding whether to refer conduct to the DPP, the ACCC will concentrate on behaviour that can cause large scale or serious economic harm, has been longstanding, especially if the alleged offender has previously been found by a court to have engaged in cartel conduct, either civil or criminal, and if the combined value of the affected commerce over all participants exceeds \$1 million within a 12 month period. The DPP will make its decision to prosecute based on similar factors.

¹² This approach is virtually equivalent to the UK provision of the *Enterprise Act, 2002* (UK) section 188.

¹³ Fraud is an element contributing to the criminal cartel offence in France, while secrecy is the element required to commit a criminal cartel offence, particularly with respect to bid-rigging, in Canada, Austria and Germany.

¹⁴ See in particular, the submissions to the Commonwealth Treasury (2007).

For example, while establishing the subjective element of the test may be relatively straightforward in cases in which the defendants clearly acted in a covert manner, the evidential burden may be more problematic in cases where the factual background does not clearly support a subjective finding of ‘dishonesty’, or where the defendant claims that in fact he acted with an altruistic purpose (such as a need to maintain profitability in light of aggressive competition from overseas competitors) and was not, in his view, acting ‘dishonestly’.¹⁵

Before considering the facts of the *Coal Vend* case, it is appropriate to recall the economic and evidentiary factors that will likely indicate the operation of a cartel. Economic theory, backed up by decades of empirical research, point to a number of structural and behavioural market variables that are likely to be linked with co-ordinated behaviour. Among these are highly concentrated markets; the presence of one or two very large firms, or otherwise equality of firm size; similar cost conditions and technology; high barriers to entry; homogeneous products; inelastic demand; stable or declining demand; low buyer concentration, with relatively small, regular and frequent orders; sales take place by open rather than closed bids; a low ratio of fixed to variable costs; managers have substantial ownership links; the presence of a communication mechanism such as industry or trade associations, or some other facilitating practices that permit the signalling of pricing information or the co-ordination of output decisions. Of course, the presence of these factors does not, without more, prove the existence of collusion. For that, market outcomes must be examined.

Empirical economic evidence of collusion may be found in increased prices moving together by all firms, with no innocent or ordinary commercial explanation possible, lower outputs, shared territories, or increased profits that cannot be explained other than by way of co-ordinated action. But short of outright admissions, or what is known as ‘smoking gun’ or ‘hot document’ evidence, or taped conversations, or solid ‘whistle blowing’ evidence, then collusion must be inferred from market evidence. Judges, at least in Australia, are prepared (and permitted by the statute) to make a finding of collusion if no convincing case can be made by the alleged conspirators that the prices alleged to have been set in collusion were the product of market forces.

Such inference, of course, is acceptable when the civil test of ‘on the balance of probabilities’ is used. But it is a different matter when the criminal test of ‘beyond reasonable doubt’ is to be used to assess economic evidence that does not contain admissions. Clearly, any given price or output outcome in a market is a product of many factors. Collusion could be one explanation of co-extensive price changes, but many other innocent possibilities also exist, including the notoriously-difficult-to-assess phenomenon known as conscious parallelism, whereby prices move together without any noticeable communication between the parties. Even if all innocent commercial explanations for a lock-step price increase could be eliminated, would a judge (or jury) be confident that some other market-related explanation might not exist? While the burden of proof lies on the prosecution, and it could be expected to exhaust all of the possible innocent explanations, one would expect some doubts to be created by the defendants, such that the ‘beyond reasonable doubt’ test might be interpreted very strictly by a judge or jury, given the personal consequences for executives of a guilty finding.

¹⁵ International Bar Association, (2008) 2.9(a) p.3.

This problem could be overcome by the increasing practice of encouraging whistleblowers to come forward with direct and usable evidence of a conspiracy, by promising them indemnity from prosecution, the only caveat being that they themselves were not the ring leader in organising or maintaining the cartel. Such witnesses then, of course, will face a torrid time in the witness box.

These comments only cover the situation where the fact of the collusion must be proved. If an intent clause is included in the statute, then it becomes even harder to provide proof at the criminal standard of evidence. What provides evidence of intent to harm the public or to dishonestly obtain a benefit? All executives seek to obtain benefits for their firms – where, and how, does one objectively draw the dividing line between ‘good hard play’ and ‘dirty tricks’ such that it can be claimed beyond reasonable doubt that the behaviour of the executives has infringed the law?

Questions such as these form part of the debate around criminal prosecution for serious cartel conduct. This paper contributes to the debate by examining the insights used in the long overlooked *Coal Vend* case – a case that was decided almost a century ago, but which still provides guidance and instruction today.

The Coal Vend facts

At the beginning of the twentieth century, Australia was producing around five million tons of black coal each year, and the northern collieries of New South Wales (primarily in the regions of Newcastle and Maitland) were responsible for around half of that production. Annual coal consumption in Australia was around 31cwt (or 1.57 tonne) per person, with coal used for railway locomotion, manufacturing, smelting, gas production, and in ships, as well as for domestic purposes.¹⁶ Substitutes consisted mostly of firewood for domestic (and some transport) purposes, and horses and animals for transportation.

The owners of the majority of the coal mines in the Newcastle and Maitland fields of New South Wales formed a vend agreement around 1906 which assigned to each member a certain proportion of the coal business originating from these fields. The parties to this agreement supplied over 90 percent of the coal sold interstate from these coal fields.¹⁷ Not only was the output divided between each member of the Vend, but the agreement also provided that each member could not open any new coal fields unless it could otherwise not maintain its allocated share of the total interstate trade in coal. Penalties were imposed if a given shaft or mine exceeded its allocated output. According to the tendered evidence, the reason for the formation of the Vend was the belief of the coal mine owners that the prosperity of the district and their own individual commercial viabilities were in danger because of ruinous competition and the resulting low prices for coal. The agreement was, in fact, a cartel which had the effect of increasing price and restricting output. There was also a vertical component to the agreement. The coal miners entered into an agreement with a number of large shipowners who carried most of the coal interstate and who were also the main coal merchants in the other states. The coal mine owners agreed to sell all the coal required for the interstate trade to the shipowners and to no one else. In turn, the shipowners

¹⁶ Fleming (2000) p.51.

¹⁷ According to evidence given in the case (p633), in 1905 over 1.3 million tons of coal was transported interstate from N.S.W. (excluding trade with Tasmania). Only about 3,000 tons was carried by shipping companies outside the agreement, giving the Vend 99.75% of the interstate coal trade. This fell to 93.65% in 1906 when a competitor (Scott & Fell) won contracts to ship coal. Scott & Fell later went bankrupt, allegedly because of the Vend’s ability to deny it coal. Fleming and Terwiel (1999) Table 1, show the Vend’s share of trade did not fall below 85% until after the agreement collapsed in 1911/12.

agreed to buy all the coal necessary for the interstate business from the coal mine owners and not to carry or deal in coal coming from any other mines in New South Wales. They also agreed not to resell the coal at a price greater than fixed under the agreement as constituted by the coal mine owners. The case involved 22 collieries, 4 shipping companies, 16 individuals and 2 commercial trusts.

The Legislation

The defendants were charged with almost thirty offences collectively and individually under the *AIPA*.

Part II of the Act, headed Repression of Monopolies, proscribed the following offences in relation to trade or commerce with other countries or among the states:

4(1)(a)) Entering into a contact or engaging in any combination with intent to restrain trade or commerce to the detriment of the public;

4(1)(b)) Entering into a contract or engaging in any combination with intent to destroy or injure by means of unfair competition any Australian industry the preservation of which is advantageous to the Commonwealth having due regard to the interests of producers, workers and consumers;

7(1)) Monopolizing or attempting to monopolize or combining or conspiring to monopolize any part of trade or commerce with intent to control, to the detriment of the public, the supply or price of any service, merchandise or commodity;

9) Whoever aides, abets, counsels, or procures, or by act or omission, is in any way, directly or indirectly, knowingly concerned in or privy to (a) the commission of any offence against this Part of the Act.... shall be deemed to have committed the offence.

This legislation, although modelled on the *Sherman Act*, differed from it in one important aspect. Section 4(1)(a) included the phrase “with intent to restrain trade or commerce to the detriment to the public”. The parallel sections of the *Sherman Act*, by contrast, contained no such reference to an intention to cause detriment. Despite this phrase being deleted when the *AIPA* was amended in 1910, and the *Coal Vend* decision itself being subsequently overruled, the contemporary resonance of the case in many ways derives from this phrase. As the presiding judge, Mr Justice Isaacs (who had been the Attorney-General responsible for bringing the *AIPA* into existence, prior to his elevation to the High Court) was required to examine the intention of the defendants, the writ being issued under the unamended version of the *AIPA*, as mentioned earlier, and whether the public suffered detriment, he was also required to examine the reasonableness of their prices and outline in details how he reached his conclusions.¹⁸

We turn now to a detailed discussion of the facts and the way in which they were analysed by Isaacs J, and then consider the reasoning of the two superior courts that upheld the appeals of the collieries and the shipping companies.

The Coal Vend case: Attorney-General of the Commonwealth of Australia v The Associated Northern Collieries and Others (1911).

It was not an exaggeration when it was written by an academic lawyer (a visiting American one, at that!) over 25 years ago that “[t]he *Coal Vend* judgment written by Isaacs J. in 1911 is one of the world’s outstanding expositions of modern antitrust theory.”¹⁹ As the reader will see by the end of the paper, we strongly concur with this

¹⁸ Ransom (1981). p. 330. The clause “with intent to restrain trade and commerce to the detriment of the public” was included because of the criminal charges associated with the bill. Commonwealth Parliamentary Debates (1906) Vol XXXI p 381.

¹⁹ Ransom (1981) p. 343.

assessment, based not only on social equity grounds but also on the analytical rigour with which the judge single-handedly dissected a myriad of statistical and documentary evidence to produce a damning indictment of behaviour that was put into effect through horizontal and vertical co-ordination. This conduct resulted in increased coal prices and supply conditions that could not be challenged by coal buyers or rival shippers, who had no viable energy alternatives to which they could turn. The price consequences of the cartel must surely have impacted on every business in almost every Australian state, and ultimately must have flowed through to every member of the public. The detriment to the public must have been palpable. Had it not been necessary to make a finding on intent, the outcome of the case would have been clear cut. By the time of the appeals, even the parties were freely admitting a restraint of trade had occurred, but they denied the necessary intent to harm the public. The restraints were, of course, necessary in their view to save bankruptcy of the collieries and to protect the capital of their owners, and to protect the wages and employment of the workers in the coal mines.

The decision of Isaacs J is a gold mine for economic analysis. He came to the case very well prepared. He was no neophyte in this area of the law. As already noted, he was the Attorney General who introduced the *AIPA* into the Commonwealth Parliament and who debated its content line-by-line. If ever a judge understood the intent and background to the legislation under consideration, this was such a situation. Because of this background, he may have taken a more inquisitorial approach at trial than would have been customary at the time. It has been observed that the trial was ‘bitterly contested’, with the defendants ‘taking issue on every point and advancing legal arguments even against hopeless odds’. There was so much material presented to the Court, and such a judicial willingness to examine every piece of it in great detail, that the final judgement was 271 pages long.²⁰ It was, alas, dealt with on appeal by very short judgments whose brevity was strongly correlated with the singular lack of concern by the appeal judges for the broad public interest, and the proper (in terms of broad social welfare, rather than narrow sectional interest) interpretation, from a policy perspective, of the term ‘detriment to the public interest’.

We turn now to assess, as economists, and with an eye to the evidentiary standards required for criminal prosecutions of price-fixing, the approach taken by Isaacs J. with the intention of demonstrating why his judgment could stand even today if confronted with all the advances that have been made by economists in cartel theory.

By necessity Isaacs J’s decision dealt with a large range of social, economic and legal issues. The decision is organised into eight main sections germane to the legal requirements of the case,²¹ but for the purposes of this analysis the focus is on those aspects of his decision that required economic insights. Thus the discussion that follows uses, in part, the structure-conduct-performance categorisation of markets and their operation. In addition, we discuss Isaacs J’s comments regarding the extent to which the firms’ conduct gave rise to allocative inefficiencies and productive efficiencies. Finally, as a third organising schema, we pay attention to his analyses of the firms’ strategic behaviour, both unilateral and co-ordinated, applying particular emphasis to their strategic behaviour in seeking to enhance their market power after others (frequently newcomers) challenged them in the market. The fact that Isaacs’ judgment has

²⁰ Donald and Heydon (1978), p.152. The same authors also state that the defendants behaved quite differently at the subsequent Full Court hearing, conceding the existence of a combination, and that, at law, the combination resulted in a ‘restraint of trade’. Both points were heavily contested in the first trial.

²¹ These were: Common law rules of evidence as to combination; Distinction between contract and combination ; Intent; Test of offence; Test of reasonableness; Public detriment; Monopoly; Penalties.

something to say about all these issues is testament to his insights, especially given that at the time economic theory had not yet advanced to the modelling of such behaviour.

Defining Monopoly

The mischief to be prevented in the law against monopolies was, according to Justice Isaacs, clear. ‘It is injury to the public that is to be prevented’ [652]. Beginning with the Oxford Dictionary definition, he noted:

“Monopoly is a kind of commerce in buying, selling, changing or bartering usurped by a few, and sometimes but by one person, and forestalled from all others, to the gaine [sic] of the monopolist, and to the detriment of other men.” There we have all the main elements of the law, including detriment which obviously must include excessive price . . . the legislation is not aimed at the share or proportion of trade which any person whether individual or corporation may acquire in the ordinary course of business. If by superiority of service or commodity, by lower prices, more desirable terms or any of the arts and inducements known to active rivalry, always consistent with healthy competition, and free from force or fraud, a trader attracts to himself the whole of the trade in any particular direction he does not offend against the law of monopoly. The field of opportunity is open to all; he has fairly used it and has succeeded. He has succeeded, not because he has silenced, but because he has outstripped his competitors, and because the public find it to their advantage to voluntarily accept his service in preference to that of others they might have; and should he abuse his opportunity by asking unduly high prices, or restricting facilities or otherwise, the field is as open as ever for competitors to offer and for the public to accept. At all events, up to that point, he has neither done nor intended any harm to the community. But if not content with serving the public to the best of his ability, and letting consequences take care of themselves, he so acts as to purposely concentrate in himself the existing means of public satisfaction in such a way and to such an extent as in the circumstances to prevent or destroy all reasonably effective competition, he does, within the meaning of the Statute, monopolise or attempt to monopolise.

Competition itself connotes attraction of trade, and so long as it remains legitimate the law, as I read it, does not reprove it simply because it attains its necessary object.

When however a trader forsakes his quality of competitor, and becomes an engrosser, when he sets himself to stifle or strike down effective competition which stands as a commercial protection between himself and the community at large, and so substantially to gather into his own hands the power of dictating the terms upon which the public needs may be satisfied he offends against the enactment. Nor is the offence less that two or even twenty traders combine to effect this object [652-54].²²

This statement reveals a sophisticated appreciation, years ahead of its time, of the implications of monopoly, market power, the operation of the competitive process, strategic conduct, the dynamics of market interaction, and consumer choice. It also presents a compelling recognition, one that the economics profession took a long time to accept, that a consideration of market structure is not sufficient to discover the ‘truth’ about market outcomes. Further, it pays attention to both the means by which a monopoly position is attained and the conduct of the monopolist once in the position of

²² Throughout [] refers to page numbers in the case.

market control. It also suggests an economist's appreciation of the benefits of competition as a process, foreshadowing by many decades the acceptance of this approach in Australian courts dating from the late 1970s. Thus the natural commercial safeguard of the public, according to Isaacs J., was reasonable and effective competition and the mischief the *AIPA* was designed to defeat were acts designed to prevent or destroy such competition.

Structure

- Evidence of membership

In evidentiary terms, there existed several 'smoking guns' that established the existence, structure, membership and aims of the cartel.

Associated Northern Collieries (the Vend) appeared before the court as an entity; it was acknowledged as such by its membership and it produced records with minute-books and a secretary [405]. The books included the names of nineteen of the defendant coal companies and thirteen individual directors. The second group, Associated Steamship Companies, comprised four shipping companies and their managing directors. Further evidence included a written agreement regarding a tender called by the South Australian Government Railways, reciting the contemplated formation of the Vend and a separate bank account [407]. The existence of receipts and payments into this account was accepted as strong evidence of an individual company's membership of the singular structure. Signatures and names on cheques tied individual directors and company secretaries to this agreement. Other evidence included copies of correspondence, telegrams and general communications. Similarly, the shipping companies' correspondence when organising guarantee arrangements and accepting tenders revealed companies' membership of the Vend.²³ Again foreshadowing contemporary approaches, Isaacs J. looked for, but was unable to find, any 'innocent explanations' for this behaviour.²⁴

- Vertical integration

The terms in the agreement also made it clear that the coal companies determined the conditions of the agreement. For example, while clause 5 bound the collieries not to sell for interstate trade except through the shipping companies that were party to the agreement, clause 6 bound the shipping companies not to buy coal for interstate trade except from the collieries in the agreement. The collieries, however, were free to determine among themselves who would supply the coal (regardless of what the shipping company had contracted with the final buyer). Further, clause 6 bound the shipping companies to pay whatever price the collieries set as the f.o.b. price in Newcastle, but clause 8 specified the maximum prices to be charged by the shipping companies to the public. These charges were set in reference to the Newcastle price, and thus meant the shipping companies were not 'squeezed' should the Newcastle price increase [477-482]. The agreement also included a one-sided set of penalties whereby if the final sale price to the public was not pre-agreed between a designated colliery and a shipping company, the collieries received the whole of the excess.²⁵

²³ That such evidence existed was perhaps a little surprising given contemporary accounts of shipowners' behaviour. "Trip after trip between the shipping offices and the ships lying in port was made by senior personnel who struggled down greasy ladders clutching bundles of documents which they personally consigned to the devouring flames". Buckley and Wheelwright (1998) p.228.

²⁴ Isaacs J. explicitly considered the possibility that individual directors, particular those who linked the shipping companies with the Vend, may possibly have been acting fraudulently, negligently, in error or in some other way wholly unexplained by their companies' participation in a combination. He rejected such a defence as incredible and unbelievable [p420].

²⁵ Isaacs J concluded:

.... even if the document ... [the draft agreement] ... and its modifications are by any technical process of reasoning or rule of law to be taken, as not constituting a formal

There was some tension in the agreement. For their part, the shipping companies tended to try and 'select' which coal companies they would deal with, going so far as to 'transfer' coal companies between themselves [448]. Nonetheless collieries determined who produced, and how much, and at what price it would be supplied, each year.

Evidence of collusion

There was considerable evidence, including correspondence, and unsigned agreements setting out the parties' collective 'agreements', 'arrangements', 'resolutions' and 'understandings'[p.416-418]. (There were even minutes of solicitors' advice warning against signing such agreements in light of the *AIPA*). The evidence against the firms who were members of the Vend was strong. In the end, Isaacs J found that an agreement was made around September 1906 that ran, with minor modifications, to the end of 1907 and which was subsequently renewed in 1908, 1909 and 1910 [434].²⁶

- The essence of collusion: 'Arrangements'

Proving collusion is difficult. Even with a 'smoking gun' agreement the law hesitates to deem the intentions ascribed to one member of a group to all the members of that group. Guilt must be proved separately for each alleged conspirator, although, in the judgment of Isaacs J, it can be provided by inference:

Community of purpose may be proved by independent facts, but it need not be. If the other defendant is shown to be committing other acts, tending to the same end then though primarily each set of acts is attributable to the person whose acts they are, and to him alone, there may be *such a concurrence of time, character, direction and result* as naturally to lead to the inference that these separate acts were the outcome of pre-concert, or some mutual contemporaneous engagement, or that they were themselves the manifestations of mutual consent to carry out a common purpose, thus forming as well as evidencing a combination to effect the one object towards which the separate acts are found to converge [400, emphasis added].

In evidentiary terms this statement represented a significant step forward, as it represents an important bridge between theories of collusion and the practical

contract, they do, as I find, constitute the bond of union and the basis of common action between the Vend and every member of it for the time being, on the one hand, and the shipping Association and every member of it for the time being on the other [458].

The agreement, while linking collieries and shipping interests, also contained some companies that did both. In these instances, companies could be members of the Vend, and still retain the right to ship other coal independent of the agreement. This required special terms, terms which were agreed but never disclosed by the parties.

²⁶ The duration of the Vend was also contested, as the initial agreement included clauses to permit members to renegotiate prices each year. While there was written evidence for some years, not every year's new agreed prices were recorded. The Court held, however, that "The offence a person commits, who, 'is or continues to be a member or engaged in any combination' has no definite stopping place short of the termination of the combination itself, or his connection with it" [413]. The first defections from the Vend also provided evidence of the participants' views of their actions. In late 1909, when a member company refused to give up an exclusive contract to supply coal to McIlwraith's Metropolitan Gas Company, it wrote "[it]... would be no party to any understanding or agreement which in any way restricted trade or was in contravention of the Antitrust Act"[453]. The cartel arrangements, however, remained in place for another year. But the end of the cartel was nigh, when the defections began, as happens in all cartel arrangements.

evidentiary step of ‘how to detect’ the existence of collusive behaviour.²⁷ In focusing on “a concurrence of time, character, direction and result”, Isaacs J. once again anticipated his fellow judges by several decades.

To illustrate this point further, he noted that when the Vend excluded a competing shipping firm (Scott & Fell) from the interstate coal trade, that company wrote three times to it asking “We also understand you to say that on no consideration would you supply us for the interstate trade. Please inform us whether we are correct in this assumption” [446]. There was no answer to these letters, leading Isaacs J to the conclusion “the inference of absolute refusal is therefore irresistible” [446].

Isaacs J. found that the 1906 Vend agreement was created as a response to increased competition,²⁸ while the collieries’ procedure of bargaining collectively with the ship companies was directly aimed at overcoming the ‘weak spot’ in their arrangements for price maintenance, which was “the internal competition among themselves for the business with shipowners” [438]. Similarly he concluded that in September 1906, the shipowners ceased to act independently and in competition with each other [440]. By such reasoning, he indicated that he understood well the idea that cartels cannot work in the presence of a cheater, and that what had been done here was to eliminate that possibility.

-Intent

The version of the *AIPA* that applied in this case included the express words that the intent of the agreement had to be (i) to restrain trade and commerce and (2) to do this with the intent of causing detriment of the public. Just what constitutes a detriment to the public has been a hotly debated issue by economists and lawyers over the years, as indeed has been the more basic issue as to how far the term ‘public’ should be extended – does it include only consumers, or are all members and groups in society part of the group whose interests should be considered? Isaacs J. was clear on this issue:

The aim of the legislature, as is apparent from the ordinary natural meaning of the words of the Statute, as well as the reason of the matter was to protect the public at large. ... This is the mischief the Statute was designed to meet, by giving the public the power to prevent injury to the body politic by individual members of the community...the reasonableness that is essential to the validity of a contract, which is in fact in restraint of trade, is reasonableness as regards both the private interests of the parties, and the interests of the public outside those private interests, but affected by their individual arrangements. [465]

In effect, this is the ‘total welfare standard’ adopted by many economists, and endorsed by the Australian Competition Tribunal in 2005 as the proper goal for assessing the impact of a firm’s actions on the public.²⁹

Isaacs J found

²⁷ See commentary on this point by Donald and Heydon (1978) pp. 132-133. This also meant that terms such as combination, arrangement, conspiracy and understanding were used interchangeably throughout the judgment.

²⁸ The only period that appears can be relied on as one of really competitive Vend prices was that beginning 1904 and ending in the early part of 1906. The present Vend was proposed in the beginning of 1906 [436].

²⁹ Qantas Airways Limited (2005) ATPR 42-065 at paras163-191.

... for the plain guiding principle of the combination was to sweep away by artificial arrangements whatever protection the public might have against the terms of price, choice, and other conditions of supply, which the will of the combination might at any moment think opportune to dictate[649-50].

The intent to restrain trade was found. By recognising the impact of the combination on the availability of substitutes as well as simply price, Isaacs J. demonstrated an understanding of competitive processes not generally associated with the judiciary at this time. The next step in legal reasoning was to determine whether the impact of the Vend's actions was to the detriment of the public.³⁰

'Detriment' carries its own meaning upon its face. Whatever is its loss or disadvantage, or prejudice, whatever puts it in a worse position is to the detriment of the public. A higher price, a worse quality, a restriction in choice, a more precarious supply, delay in delivery, are instances. [474]

This statement again reveals a well-rounded understanding of the effect that non-competitive market structures have on consumers and on the market place generally. Isaacs J was also clear that merely increasing prices or decreasing quantity were not, in themselves, conclusive evidence of non-competitive behaviour – but rather they were possible symptoms of efforts to injure competitive outcomes. He recognised, again in a pioneering manner, that collusion usually comes in a package of conduct – it is not generally one-dimensional. One modern antitrust development that he did not appear to anticipate was to ask specifically whether if, in the absence of a collusive agreement, what each firm did would have been profit-maximising if they had engaged in this conduct independently, that is, not in tandem with their rivals. Had he done so, we suspect his answer would have been an unequivocal no, suggesting that the observed market outcomes were not the product of the intensive rivalry that is a feature of the competitive process.

Conduct

The Court found 'wonderful unanimity' [452] between the collieries and shipping companies regarding the partition of supply and quoted prices to customers. For example, over the course of 1909 the Court saw evidence from five 'different' tenders involving five coal companies and shipping agents tendering to supply from between 2,000 to 750 tons coal to the Melbourne and Metropolitan Board of Works. Each tender, regardless of supplier or quantity required, quoted a price of exactly 22s 6d per ton. Multiple examples of tenders were also provided in evidence for a wide range of contracts entered into in 1910, with quotes varying 'not one farthing between the tenderers' [456].

Isaacs J examined a number of instances when the documents revealed the Vend members coordinated their individual responses to tenders. Such coordination, however, was not enough to reveal a breach of the law. What was also required was that such actions resulted in public detriment. He thus examined coal prices before and after the formation of the Vend (in a predecessor to the 'with and without' test that is used as a main analytical tool today in Australian antitrust cases, especially for estimating the net effect of mergers and assessing the impact of arrangements between firms). He did this for each state and for each major customer within each state. Over the time period of the Vend he found coal prices, depending on quality and size, had increased, in some

³⁰ It is on this issue that the case frequently resonates most strongly for contemporary discussants examining trade practices law from a modern, consumer interest perspective.

instances by more than 6s per ton per year – or by more than 50 percent in a year. In almost all markets coal prices had risen by over 30 percent in under five years. He concluded, on the basis of the evidence before him, that the price rises, coming either shortly after or shortly before the formal commencement of the Vend, resulted in a ‘heavy detriment to the public’ [509]. Their prolonged continuance and progression over 3.5 years excluded the possibility of temporary shocks or extraordinary causes. In estimating the size of this effect, Isaacs J estimated that

...if only one penny per ton were added all round to the prices of interstate coal – 1,500,000 tons – it would give an aggregate return of £6250. There is therefore a wide margin between the 1906 price and subsequent prices on the coal dealt with in the evidence to be accounted for by the mere restoration of fair and reasonable competition, and the necessity of avoiding impending ruination [510].

To determine whether such coordination was done to stave off financial ruin, the Court also examined the minutes of the Vend to find references to such commercial pressures. It found no such evidence.³¹ The judge also examined the aggregate quantities of coal sold interstate and overseas for several years, both preceding the Vend and after. Evidence from annual reports, local banks, and the chamber of commerce all suggested a steady upward increase in quantities sold.

Quantity and Price control

Coal, depending on its source, varies in quality. Purchasers, depending on their purpose, have varying demands for different qualities of coal. Both the quality, quantity and the price of the supplied coal were determined in the agreement.³² Clause 7 set a scale of prices for the purchasers (shipping companies) outlining a scale that varied by location and coal type, and which varied in line with prices in Newcastle. Discretion to sell above these prices to single customers was also allowed in special situations up to a maximum of 10,000 tones per year. Cognisance was also given to the fact that insurance and freight charges were set by f.o.b. prices in Newcastle, and so final prices needed to be adjusted so as to prevent shipping companies being squeezed. Other charges in shipping, including ‘lighterage’, wharfage, cartage, bagging, and screening, were set per ton. Government dues were not specified. There was also flexibility given to allow the parties to agree to different prices for large contracts.³³

³¹ The judge was not convinced when the defendants offered incomplete profit and loss accounts from a single colliery to support their case. (*cf* the Privy Council’s view).

³² An unsigned version of the agreement was tendered in evidence. Clause 2 (c) stated “The vendors ... will so far as practicable forward to the purchasing agents the coal from the particular colliery required by the purchasing agents and, failing that, then coal from one or other of the collieries of the same class.... Provided however that in no case shall the Vendors be called upon to deliver coal from any colliery that has reached the limit of output assigned to it by the Vendors under any agreement existing between the collieries”. [424] Clause 4 stated “All coal shall be delivered by the Vendors to the purchasing agents f.o.b. at the usual place of loading coal from such colliery. And the prices to be paid for the various classes of coal shall be fixed by the Vendors annually in the month of November in each year during the currency of this agreement, such prices to take effect from the first day of January following for the then ensuing year. The prices so fixed shall be communicated to the purchasing agents as hereinbefore mentioned. The Government weights at Newcastle shall be taken as final and conclusive and no allowance shall be made for wastage”. [425]

³³ The degree of flexibility allowed in the agreement, while doubtless a reflection of the inexactness of business, and the need to give members ‘room to move’, also serves to underline the view of Stigler (1964) that detecting patterns of collusion in a ‘noisy’ commercial environment is likely to be difficult, contrary to the simpler economic models of oligopoly and monopoly that suggest the agreement facilitated a range of prices and qualities of coal. Consideration was also given to unusual circumstances. Changes in home or foreign demand, accidents, strikes or war were specifically cited as factors that might

Formal arrangements between the collieries and the shipping companies and between the shipping companies and final purchasers contained clauses preventing resale, redelivery or any other ‘on-sale’ of the coal. Contracts with final purchasers frequently contained an ‘all or none’ clause, the ultimate requirements contract, directly aimed at preventing purchasers from sourcing coal from other mines and suppliers. While admitting that purchasers did not have to sign such contracts, the Court found Vend members employed both ‘force and fraud’ to ensure that they signed [648].

Performance

- Reasonable verses unreasonable price.

Isaacs J concluded that the price charged by the combination was between 6d and 1s a ton higher than it would have been but for the combination [547]. He viewed such an increase in prices as unreasonable.³⁴ Nevertheless he struggled with defining what a ‘reasonable’ price for coal would be. There was no ‘specific standard of detriment’ and no ‘specific standard of excessiveness of price’ [544] to help the Court. In attempting to make such a judgement Isaacs J initially appeared to favour a ‘cost plus’ approach – the costs being the ‘expense’ of the carrier varied in accord with the ‘trouble, expense and responsibility attending the receipt, carriage and delivery of the different articles’³⁵ [544]. He also concluded that the defendants, having argued pre-existing prices were leading to ‘ruination’ had, in effect, invited him to consider whether the price rise was indeed a ‘detriment to the public’ having regard to the price rises and the costs of production. He thus looked to estimate the counterfactual price, a price that would

have represented the reasonably competitive price, which the collieries would have charged f.o.b. at Newcastle, and which would have allowed them a fair profit after allowing for full cost of production and transit to Newcastle?

Importantly, he added:

Profit is ... one practical consideration that in one form or other enters into the calculation of a reasonable price, but it is by no means the sole or even governing test. It is not sufficient to ask what profit a given price affords,

require a reconsideration of the price regime. This framework approach required the court to look at the arrangements ‘as a whole’, and when linked to the restrictions on transportation, were seen to constitute a ‘ring fence’ [477] regarding the supply of coal.

Again contrary to simple comparative static models, the Vend found itself adjusting its penalties for breaches, when rising demand meant that all the collieries found themselves under pressure to sell more than originally agreed. As Isaacs J., noted

...I think that they would naturally try to some extent to remove the prohibition against meeting public requirements without entirely abandoning their scheme...In November 1907 they determined... to meet the difficulty they were in by the danger of public outcry on the one hand, and the risk of collieries overselling on the other, by what they called ‘a scientific basis of allotment for an extended period after 1908’. [526]

Evidence was tendered that over the period, several thousands of pounds worth of ‘penalties’ were paid by Vend members for transgressing the terms of their agreement. That they continued to remain members is itself suggestive of the profitability of the arrangements.

³⁴ The question of whether a price is ‘reasonable’ is in effect an invitation to consider whether the price is above marginal cost, or given possible differences in production methods between firms, whether it is above a price that would be set under competitive conditions in the market. Rather than calculate what constituted a ‘reasonable price’, Isaacs J examined whether the price charged was unreasonable. It should also be remembered that there exists no objective standard by which to measure whether a price is reasonable. In addition, what is reasonable to one member of society may well be thought unreasonable by another person.

³⁵ Quoting Barron Parke and Lord Collins in (1896) 1 QB 260 at 265.

when we are seeking to discover whether it is a reasonable competitive rate. The nature and extent of the competition, actual and possible, are for instance, material factors in the problem [545-6].

In effect, Isaacs J. was examining the question in terms of a normal or competitive rate of return in all the circumstances, especially considering market conditions.

In undertaking this exercise Isaacs J did not consider interstate trade in isolation. He also examined the export market and its potential for delivering higher prices to producers.³⁶ Here again the decision is sophisticated in its understanding of markets. He suggested not only that the quoted prices were misleading (deliberately excluding wastage and other factors that lowered export receipts) but that transaction costs, strategic considerations, and familiarity with local conditions effectively raised the producers' entry costs into export markets and made this less lucrative than presented. Any significant entry into export markets could have attracted other suppliers to Australia, thereby increasing competition, while the impact of exporting over 1.5 million tons of coal each year was likely to lower the returns earned by exporters. For these reasons Isaacs J. found that the interstate and export markets were separate and unlikely to bring price pressures to bear on each other.

Isaacs J's analysis of the longer term profitability of the collieries also paid attention to the business cycle and its impact on company viability. Having rejected arguments that the collieries had been unprofitable for many years or had paid unreasonably low wages for years, so that increases post-Vend were merely designed to recoup previous low prices, he concluded:

...I see no reason for hesitating to believe that prices, prevailing before the Vend formation, were not only not ruinous in themselves, but were, to some extent, profitable prices, and that, then and since, they were not lower than the foreign prices obtainable for the same coal. They were in my opinion higher, though of course not so much higher as to attract in ordinary circumstances an influx of foreign coal into Australia [541-542].

The information supplied by the shipping companies regarding their transportation costs, wharfage, and screening costs, together with their yard, cartage and other costs enabled the Court to deduce that the prices they supplied as to costs were 'unreliable'. Again unusually for the time, Isaacs calculated the 'full' costs of freight as supplied by the companies, concluding that the consequent profit margins were 'absurd' - in some cases demonstrating they made a significant losses (by which can be implied, losses leading to immediate shutdown). In effect, the figures supplied by the companies were misleading and unrepresentative of 'normal' profits. Isaacs J also identified that storing coal on the wharf, an argument used to justify increases in prices to customers based on the costs of storage, was in fact rarely done by the shipping companies. He further found that the need to store any coal in the slack season was a direct outcome of the Vend allotments and not variation in customer demand. This was one element of strategic behaviour undertaken by firms to make life 'difficult' for other suppliers.

One technique used by Isaacs J to identify 'inaccuracies' in the figures presented to him by the shipping companies, was to contract their costs and methods against those of a competitor (Kethel & Co.); a counter-factual case. This company, which was 'outside'

³⁶The defendants suggested that the existence of an export market demonstrated there was no cartel, because if local prices fell too low they could have switched to exporting. Thus local prices, rather than being 'high', were only sufficient to maintain production.

the Vend, had supplied details of its costs of production, and normal logistics supply chain costs. He used the figures supplied by Kethel to examine whether the data supplied by the Vend were in fact reasonable and believable. After making a number of allowances ‘in favour of the defendants’ he concluded that many of the claimed costs that were used to explain price rises were either fictitious or overstated.

After an exhaustive review of freight charges, Isaacs J estimated the amount of possible overcharging that had occurred. Exclusive of estimates for inflated freight costs, and using the figure of 1s a ton from his colliery cost estimates, he estimated value of the overcharge resulting from the collieries’ agreement just for 1908 was over £105,500 [565-602].

By undertaking such a forensic examination of costs, Isaacs J was proceeding not only further than most judges of his era – he was adopting approaches that are used only occasionally nine decades later (due to the fact that such a rich cornucopia of data rarely comes before the courts in evidence). This is another link between his approach and the modern era in jurisprudence when complex pricing and costing issues are a more standard part of the evidence heard by courts. Of course, he had the luxury of a mountain of data in the form of invoices and other evidence. In addition, to avoid the considerable costs of defending an action in court, many of the big price-fixing cases launched in Australia by the ACCC are now settled administratively by the firms involved, with negotiated penalties that are presented to the Federal Court for ratification. No judicial assessment occurs, and no jurisprudence enters the record.

- Restraint of trade

Clauses 5 and 6 of the agreement identified five states as subject to the agreement and specified that only the members to the agreement would supply or carry coal for this trade.³⁷ There were financial penalties if the purchasing agents broke the specified price ceilings. The agreement included an undertaking to allow accountants from the collieries full access to the shipping companies’ books if such accusations were raised, a typical cartel control device. For their part, the shipping companies agreed to ship nothing but Vend coal interstate under the terms and conditions specified. The enforcement mechanisms for violations of the cartel agreement were quite clear. While there was some evidence that variations to this agreement occurred over time, and various minor changes inserted, none materially affected the agreement. The consequences of these restraints were presented in evidence, and included the following outcomes. It should be noted that these outcomes are typical of what economists have for a long time argued can be the result of a cartel coming into operation.

- Restriction of Choice

The shipping companies repeatedly refused to specify the pits from which their coal came, or to meet tender requirements asking for coal from particular pits. The Court held that the words used to ‘explain’ such deficiencies were consistently fraudulent and misleading, suggesting as they did that the companies simply ‘couldn’t specify’ the pits, as they had done in the past - or that the coal supplies were ‘from those shipping from

³⁷ According to clause 5 “The Vendors agree not to supply any coal for consumption in any of the States mentioned in clause One ... [Victoria, South Australia, Western Australia and Queensland]...except to the said purchasing agents or their nominees in terms of this agreement.”. Clause 6 outlines the exclusivity of the arrangements stating the purchasing agents: “shall not purchase, sell or deal in, directly or indirectly or engage directly or indirectly in, or share the profits of the carriage of any coal other than that purchased by the purchasing agents from the Vendors”. [425-426]

Specific exceptions to these arrangements were spelt out to allow the parties to the agreement to purchase coal for their own use on other terms, up to a specified maximum beyond which penalty price premiums applied.

Newcastle' as they were unable to contract for particular classes and of coal. Such statements all reflected the agreement (unknown to the final customer) between the collieries and the shipping companies.

- Shortage of Supply

By organising a cartel with horizontal and vertical dimensions, giving them the ability to either exclude other firms outright or to apply a 'vertical squeeze' to them, the collieries were insulated from the possibility of outside competition supplying their market. It also meant that customers were at much higher risk of supply shortages. In somewhat dramatic language, Isaacs J noted:

But where each group for its own subjects makes and adheres to a compact of mutual exclusiveness, they form, so to speak, the corresponding blades of huge commercial shears that cut off all approach to relief from despotic prices of the Vend as well as those of the Shipping Companies [Emphasis in original, 611].

Clause 21 expressly prohibited the opening of new shafts by any party to the agreement. The result was that when foreign ships happened to take coal in excess of earlier estimates, or in quantities unplanned for by the Vend, local purchasers were not supplied. The result was heightened fear of shortage of supply and occasional real shortages. As the final customers were frequently large public utilities such as the Melbourne Metropolitan Board of Works, the Melbourne Gas Co., South Australian Railways, and large public companies such as Australian Paper Mills and Broken Hill Proprietary Co. Ltd., such shortages had the potential for a significant impact to move through to the community at large.

When faced with imminent shortages, the shipping companies told customers supply was short 'owing to the disturbed conditions now existing in the coal trade at Newcastle' or the 'unsettled state of affairs with the miners in the Newcastle district' – neither of which reflected the true reason for the shortfall [610]. Isaacs J was particularly scathing of one instance when the Vend provided assurances 'to do everything possible to assist the Shippers [to supply customers]. Notwithstanding this assurance the allotment system [was] not abandoned and the exclusiveness continue[d]"[615].

-Inferior quality

The Court also examined the general impact of substituting inferior quality coal. For example, it was observed that South Australia's dependence on interstate coal, and the supply of poorer quality coal had resulted in interruptions and delays in its rail system. The impact on BHP of poorer quality roasting coal and on coastal shippers unable to obtain small coal was also noted. By restricting the shipping companies from supplying coal other than from the Vend, the agreement also forced customers in some instances to use coal which for their specific purposes was inferior, even though supplied by the Vend.³⁸

-Misleading conduct

There were also accounts of misleading conduct by the Vend. For example, after agreeing between themselves to supply the South Australian Railways with New South Wales Coal, the Vend members would not supply coal to Scott Fell & Co, a non-Vend member, so as to prevent its tendering for the contract. Two Vend members (Huddart

³⁸ For example, for coastal shipping coal from other pits was, in some cases superior; yet inferior coal was supplied by the Vend to these customers.

Parker & Adelaide Shipping) then tendered at 11s9d per ton while Howard Smith (a fellow Vend member) tendered for the same contract at prices ranging from 14s to 21s per ton. The clear intent was to give the impression to the market that competition was occurring in the market when it was not [631-34].

- Co-ordinated misuse of market power to eliminate a rival

In July 1908 the rival shipping company that was not part of the Vend, Scott Fell & Co, went into liquidation. While not discounting other issues, Isaacs J found that

Whatever other causes assisted, there cannot be any doubt that the defendants tried to crush them, and at all events contributed to their downfall. The defendants gathered to themselves a giant's strength, and used it as a giant; they have used it not only on the public but on all that has stood or has endeavoured to stand between them and the public [636].

With the disappearance of Scott Fell & Co, the quantity of coal that was carried by companies other than those within the Vend fell from over 130,000 tons in 1907 to under 38,000 in 1908. The Vend's control over the market was tightening.

- Separation of Markets

Isaacs J found that the Vend arbitrarily discriminated between customers. While

In one sense discrimination by reason of purchasers' special opportunities is perfectly legitimate, but when the heavy end of discrimination owes its weight to combination, there is a distinct lawful cause of complaint for those who have to carry it, while their neighbours escape [626].

Thus the Melbourne Gas Company, having a potentially more elastic demand for coal than the Footscray Gas Company (by hinting it was looking to purchase Cessnock land for a coal mine) was able to negotiate a better price. Indeed the Vend's minutes suggested the lower price would be 'prudent'. Customers with less elastic demand (ie all companies in South Australia which at this time had no known coal reserves) were charged higher prices. While such separation of markets is not unusual in markets with limited competition in supply, and is indeed a common pricing practice used by many firms in different temporal or geographic markets, the Court found the Vend went further, tendering 'low' when faced by competition from wood supplies, and then supplying coal inferior to that originally contracted. When this was challenged by the customer, the Vend members initially considered lowering the final price, but owing to the Vend's control of supply, ultimately forced the customer to choose between inferior coal or a higher priced standard quality coal – the competition from wood having diminished.

In summary, the Court held that in respect to the performance of the cartel in the market for coal, the following categories of detriment had been proved:

- excessive prices had been charged that were “governed not by legitimate business considerations, but dictated by the necessities of consumers, their artificiality increased difficulties in obtaining other supplies and by favouritism or other erratic causes” [475]
- restriction upon choice of transportation by the pits;
- restriction of the total quantity from permitted pits;
- restriction upon the quantity of small coal produced and sold;
- short deliveries of coal;

- substitution of other coal types of coal, sometimes inferior. [475]

Allocative efficiency vs. productive efficiency

It is possible to interpret the actions of the coal and shipping owners as actions designed more to enhance productive efficiency than to distort allocative efficiency. On this basis, the proper social question is not so much whether their actions improved productive efficiency, but rather, did the cost to allocative efficiency outweigh the benefits derived from increasing productive efficiency. This approach, which is less mechanical than the structure-conduct-performance method, has the advantage of highlighting the need to find a balance between ‘commercial realities’ (ie less than full competition) and ‘excessive market control’ (where market power is abused).

The evidence that many of the actions undertaken by the shipping companies and mine owners were aimed at improving productive efficiency is not unsubstantial. The Northern collieries had acted in concert for 20 or 30 years prior to the case. For example, their collectively determined selling price allowed them to regulate the hewing price paid to miners. At various times they had more formally organised their affairs, with an 1891 Vend agreement establishing a fixed price, agreed quantity and penalties and compensation for variation. According to the defence, such arrangements did not, however, remove companies’ individual control or result in a restriction of trade. This loose coordination had evaporated by the turn of the century, and by 1903 some collieries gave rebates to purchasers, undermining the agreement [435]. Isaacs J determined, consistent with modern knowledge of cartel operations, that the existence of declared prices did not by themselves reveal a lack of competition between collieries, as rebates and other forms of competition existed simultaneously.

At several points the Court held that ‘some degree’ of restriction on competition was permissible; simply colluding on quantity and price was, in itself, not illegal.³⁹ The critical issue for the case was whether the restraint afforded ‘fair’ protection and was “not so large as to interfere with the interests of the public”[467]. The issue is of one of balancing the costs to allocative efficiency against the gains from productive efficiency. As Isaacs J said,

It could not in my opinion be disputed that some cases of prevention of competition between the contractors, and some cases of keeping up prices would not be objectionable. Competition though stayed as between the parties might still be open to others....The prices that are kept up by an agreement might be quite fair and reasonable, and nothing more than would exist under healthy competitive conditions [466].

The test of whether the balance between productive and allocative efficiency was met, was found in an earlier English case,⁴⁰ where it was stated as follows:

³⁹ When examining the association of shipping companies, for example, Isaacs J noted that their relationship, over a number of years prior to the Vend, was cordial and even ‘amicable’. Indeed ...there is no doubt that for some purpose, or purposes, compatible with that free competition, they were, for some time before in friendly association and were called the Steamship Owners Association. Traders who are in actual competition with each other are not infrequently and quite consistently members of the same Association for general mutual advantage.

It was not mere cooperation that caused the creation of a cartel but the behaviour of the members that shifted the nature of the association from one of friendly but competitive behaviour to one where combined intent to stifle competition emerged. Early cooperative behaviour also undermined the argument that pre-Vend competition was ruinous, with individual firms behaving recklessly.

⁴⁰ *Horner v Graves* 7 Bing 735 131 Eng. Rep. 284 (C.P. 1831),

We do not see how a better test can be applied to the question, whether-reasonable or not, than by considering whether the restraint is such only as to afford a fair protection to the interests of the party in favour to whom it is given, and not so large as to interfere with the interests of the public. Whatever restraint is larger than the necessary protection of the party can be of no benefit to either; it can only be oppressive, and, if oppressive, it is in the eye of the law, unreasonable [467].

After citing a number of cases, Isaacs J held that “Even at common law therefore, the Court is bound to consider whether the contract is reasonable from the standpoint of the public” [469]. In his opinion, a long-run perspective was required (a position that would resonate with modern-day economists) to assist in making this judgment. Thus, he found that

An apparent advantage may, when properly examined, be seen to merely temporary and the prelude to severe public loss. Competition unrestrained may drive fair-minded and useful servants of the public off the field, bringing disorganisation of labour in its train and leaving the community at the mercy of those who risk a passing concession for a permanent control.

The Court then is bound to look beyond the surface, and investigate causes and effects; it must regard not merely one or more isolated incidents, but the combined circumstances of the situation as far as they are ascertainable before it pronounces whether the intention to which the law attaches culpability was present in the minds of those charged with contravention. [474].

The defendants argued their agreement enhanced productive efficiency. Isaacs J noted that there were downsides to this position from the perspective of some buyers:

the combination was beneficial because it promoted concentration of supplies, in other words, having the whole of the production available for the service of the trade. That means...if ships load whatever coal is brought to them the loading takes place quicker and with less possibility of delays than if coal from particular pits were selected for the cargo. The bare fact may be so, but that is not guarantee of advantage from the combination for it is little satisfaction to a consumer to know that he can be the more speedily supplied with coal that he would rather not have, in return for not getting at all the coal he prefers [484-5].

In other words, the Vend was denying consumers the ability to choose what they thought would be in their own best interests. Yet the defendants argued that should their acts be seen as contravening the *AIPA* such an outcome was unintentional and certainly secondary to the primary aim of preserving a sinking industry. This argument, though theoretically plausible, was rejected by the Court as being inconsistent with the defendants’ behaviour and intent. If the industry was declining, then it would have been in both the individual and collective interests of each firm to ensure that buyers got what they wanted, and when they wanted the supplies of coal.

Strategic conduct

A third economic approach to examining market outcomes is to examine the strategic conduct of the parties.⁴¹ The question then becomes whether, through their behaviour and actions, the parties aimed to stifle competition. Of particular interest is if their efforts could be seen as attempting to stifle competition in ‘advance’ of it occurring, by restricting opportunities to competitors and potential entrants.

The notion of strategic conduct has been a relatively recent advance in economic theory, coming to economics via the business school literature. Arguments concerning strategic behaviour by firms, especially in the form of strategic entry deterrence or in moves designed to protect market shares from smaller rivals, are now commonly found in antitrust cases. Isaacs J recognised the behaviour of the Vend companies as being in this league:

The detriment to the public which is alleged to have arisen and to have been intended, as a result of the matters complained of, consists in the practical and persistent annihilation of competition on land and sea, excessive, arbitrary and capricious prices charged to consumers, restriction of their opportunities of choice, difficulties in obtaining particular classes or grade of coal desired, substitution really compulsory of other coal for coal preferred and delays in obtaining delivery [399].

One element of the strategic conduct of the parties was their attempt to conceal the fact of combination. This included varying the collieries who dealt with particular shipping companies (to give an impression of competition), and giving false excuses to companies outside the agreement (who were trying to enter into interstate business in coal) as to why prices could only be quoted c.i.f. (cost including freight) and not f.o.b. (full on board) [442-443]. In this instance the object of concealing the freight costs was held by Isaacs J to be to deter a potential new competitor from trading coal interstate by denying competitors information about cost differences between transporters and reducing the chance of one being ‘played off’ against another.

In one example, it was revealed that all of the collieries were aware of an ‘outsider’s’ request for coal (to supply a tender in South Australia) and had organised their response to this in concert. [445]. Indeed this company had sent a ‘circular’ letter indicating that it knew of the Vend and, it can be inferred, it was attempting to cause a ‘crack’ in the agreement by getting one of the companies to respond individually and outside the terms of the Vend. The evidence presented to the Court revealed that each coal company gave responses ranging from outright refusal to deal; conditional agreement to mine and supply coal only to ‘non Commonwealth’ ports; to claims that their entire year’s coal supplies were already committed. Similarly coordinated responses came from the shipping companies when asked their transport charges, and in several cases requests for quotations simply went unanswered.

A further justification given for the price arrangements was the need to ensure that miners received a fair wage. It was argued that the standard practice in Newcastle was to regulate miners’ wages via the selling price, with every 1s increase in the selling price resulting in a 4d increase in the hewing rate (in modern terms, a ‘pass through’ of benefits to other stakeholders). Such a policy not only distributed revenue transparently within the collieries, but ensured worker loyalty and gave existing companies an advantage over rivals whose wage setting processes differed. The problem, as Isaacs J

⁴¹ In essence, converting a threat or promise into a commitment, Church and Ware, (2000), p 461). See also Smith, Round and Trindade 2007.

correctly noted, was not the arrangement itself (variations of which had occurred over some years), but that the argument assumed the 1s was 'legitimately' obtained.

To give effect to the defendants' argument as to this point would be to sanction a misuse of the custom by admitting the right of the collieries to decline to recognise the admittedly just claims of the employees except at the cost of working a gross injustice to the community. From that injustice the public have some sort of protection while competition prevails, but by combination that protection is annihilated and the colliery proprietors are then in a position in which they are able to make any increase of wages to the miners dependent on their also obtaining, however unnecessary it may be, an almost corresponding bonus for themselves. [535]

Taking a general, as opposed to partial equilibrium approach to the question of public interest, and clearly recognising the difference between productive and allocative efficiency, Isaacs J noted:

... the reduction of the [coal] price to what is reasonable would be much more likely to enable other employers to pay better wages to their work people. And the law either is, or may be made, strong enough to secure justice at the same time to the miners without imposing an undue burden on the rest of the community, and I do not believe any injustice will accrue to the miners [536].

The strategic behaviour of the shipping companies was an important element in the success of the Vend. Prior to the formation of the Vend, in the presence of a competitive market environment, the shipping companies had played off one colliery against another, attempting to obtain the lowest price. This behaviour, or even a fear of such behaviour, "would have been a wholesome corrective to the cupidity of the Vend" [549]. In contrast

The Shipping Companies watched the progress of the Vend's growth, they awaited its completion, they agreed to make the observance of part of its regulations a condition of their own compact, they undertook to aid the Vend by refusing to carry for public consumption any other coal with negligible exceptions which were for their own benefit - in short they consented to allow the Vend to raise its price to any desired height, stipulating only that no Vend coal should reach the public except through them, so that the exorbitancy of f.o.b price up to the limit of necessity became a matter of perfect indifference to them - it must all be refunded by the consumers [548-9].

The Court also found the shipping companies then used their position to raise coal prices further - on top of those increases imposed by the collieries. Having examined the increase in colliery prices, Isaacs J then examined what would constitute a 'fair' freight price.

In addition to their pricing behaviour, the shipping companies participated in strategic supply behaviour by storing coal in the slack season when demand was low. This, however, added to their costs. Such a supply system was against their own interests, by raising their costs, and they expressed a strong desire not to undertake such storage. Isaacs J. concluded that the main reason storage was undertaken was

...so as to repress certain shipping competitors who were then struggling to share the interstate trade, and so as to make other competition practically impossible [572- emphasis in original].

He thus identified a key practical step undertaken by members of the Vend to block entry into the market. The process raised the shipping companies' immediate costs but also increased the barriers to entry for potential competitors by helping maintain the shipping companies' exclusive arrangements with the collieries and the collieries' practices of allocating coal by pre-determined fiat. A better example of strategic entry deterrence by raising rivals' costs, and through the creation of a stockpile in the form of excess capacity that permits immediate reaction to a threat of entry, is hard to imagine.

Isaacs J was highly aware of the possibility of strategic behaviour on the part of the shipping companies. In the course of determining that 1904 and 1905 were years (pre-Vend) when there was reasonable competition between the companies, he observed:

Therefore, unless they were in 1905 deliberately losing money in order to smother Scott Fell & Co [a competitor shipping company] - which of course they do not admit- and people do not usually throw away money unnecessarily - it is difficult - too difficult for me at all events - to accept their suggestion on the materials they have left me [Emphasis in original 606].

Specific examples were also cited where the Vend had denied coal to 'possible future competitors'. Citing the example of the decision to exclude Scott Fell & Co from the coal trade, Isaacs J noted that at the time this occurred Scott Fell owned only one steamer but "Evidently the advent of Scott Fell & Co into the interstate coal trade was a disturbing element to the previously unchallenged control enjoyed by the shipping companies" [633]. It was obviously the intention of the Vend members to create insurmountable barriers to the expansion of this rival.

The strategic behaviour of the Vend went well beyond direct use of market power, and included efforts to manipulate public opinion. Evidence was produced that revealed the Vend had paid the proprietor and editor of a Sydney journal to write a piece in the *Adelaide Advertiser* in support of the Vend.⁴²

Finally, where competitors could not be squeezed out, they were sometimes invited to join the Vend, a classic cartel control mechanism. New mines, for example, did open over the period the Vend operated, and some were invited in, provided they could agree to terms limiting their total annual output. Again the Court held that such behaviour was strategic. Through 1907 and 1908 the increase in prices meant "the combination was safe and strong.....What then was the necessity for inducing the mines to join? It was not necessity, it was not self-protection, but the desire for complete control" [649].

⁴² This piece, ('a telegram from Sydney') appeared in November 1908 and was written with the "appearance of a vigorous, fearless and timely word of caution from a source independent but well informed, friendly to the people of that State [SA]... and stating the opinion generally entertained not only among the collieries but in the commercial circles" [638]. In it the author expressed astonishment at the South Australian Government's possible intention to open a State coal mine, and laid out in considerable detail the benefits of the highly competitive coal market and coal supply arrangements that had been operating for some time. While legal counsel indicated that payment for the piece was purely altruistic behaviour on behalf of the Vend to prevent the SA government making a costly blunder, the Court was not convinced.

Ultimately Isaacs J found against the defendants. They successfully appealed. While previous writers have focused on the legal aspects of these decisions, we will briefly examine the difference in economic approaches adopted by the two appellant courts.

Appeal to the Full High Court:

Adelaide Steamship Co Ltd v The King and the Attorney General (1912)

The defendants appealed to the Full Bench of the High Court. The crux of their appeal was that the *AIPA* required not only entering into a combination to restrain trade or monopolise some part of trade or commerce between the states, but also the *intention* to cause detriment to the public. They were successful in their appeal.

A number of elements explain this decision. First, the Full Court determined that the term ‘public’ in this legislation had been narrowly construed by Isaacs. The term included more than ‘consumers’ but also included producers and workers. This was in effect a total welfare approach – but without applying differential weights to particular (and additional) sectors of the community. Indeed, it could be argued that the Full Bench did not look beyond the coal mining industry in its assessment of the impact of the Vend on the public. Second, while older English authorities were strongly against arrangements that led to the restraint of trade, a more ‘modern’ (ie nineteenth century) trend had emerged that gave primacy to the individual and an individual’s freedom to enter contracts.

Cut-throat competition is not now regarded by a large portion of mankind as necessarily beneficial to the public. ...The Trade Union Acts in effect authorize combinations.... The Wages Board Acts of the Australian States...are based on the same notion.... The mere fact that the effect of such combinations may be to raise the price of commodities to the consumer is not regarded. It is recognized that consumers of a commodity are a part, not the whole, of the public, and that in considering the question whether a contract in restraint of trade is detrimental to the public regard must be had to the public at large. It may be that the detriment, if it be one, of enhancement of price to the consumer is compensated for by other advantages to other members of the community, which may, indeed include the establishment or continuance of an industry which otherwise could not be established or would come to an end [76-77].

In essence, the economic underpinning of this approach is one of weighing productive efficiency against allocative efficiency in coming to a final conclusion on the overall impact on the public. As economists, we find nothing wrong with this template as such - the problem is in the misapplication of it, by limiting the boundaries of examination to only the market immediately in question, rather than going beyond to all other markets (and all their stakeholders) in which coal was an input. Unfortunately the Full Bench did not exhibit the same sophisticated understanding of economic issues as displayed by Isaacs J, and indeed it did, on occasion, demonstrate a complete lack of appreciation of some basic economic concepts.

The Full Bench’s view on the dangers of excessive competition meant it turned its attention to the issue of intent to cause detriment. The defendants’ intent to combine and intent to raise prices were considered proven.⁴³ Whereas Isaacs J’s decision presented a

⁴³ As the Sherman Act did not contain reference to intention to cause detriment, the court felt unable to follow its precedents any distance.

clear view of monopoly, and the consequences of this for reasonable prices and the public at large, the Full Court's dismissive view of the term suggests they did not think it necessary to consider the implications of the presence of monopoly (in terms of raising prices above marginal cost). In particular it paid little heed to the potential for a combination to have an incentive to raise prices.⁴⁴

The Full Bench was also persuaded to keep a narrow focus by the testimony of the manager of the local Union Bank and a manager of a non-Vend mine that prior to 1906 (but after around 1902) things had been difficult in Newcastle owing to competition from newly emerging mines and minefields.⁴⁵

The Full Bench held that those collieries and shipping owners who formed the Vend had

...honestly believed - and believed on grounds which were not only reasonable but very substantial - that the prosperity of the Newcastle and Maitland Districts was in danger, as well as their own individual interest, by reason of the excessive competition and unremunerative prices obtained for coal [85].

Such a judicial response to cut-throat competition still may be found on occasion in modern antitrust cases, where judges who are inexperienced in economic analysis seem perplexed by the issue of how an industry faced with cut-throat competition can ever get itself back to 'normal' trading conditions through the operation of regular market forces, and without one or more firms 'going to the wall'. The need for exit and the consequent loss of jobs and private capital, does not have much appeal to such judges. Thus the Full Bench found:

In our opinion [the agreement] was under the circumstances a lawful and even laudable transaction, which was intended to operate and did operate to the advantage and not to the detriment of the public at large, notwithstanding that it was intended to operate and did operate to raise the price of coal ...

... In our opinion the fair inference to be drawn from the tenor of the Vend agreement itself is that the intention of the parties was to put the Newcastle coal trade on a satisfactory basis, which would enable them to pay adequate wages to their men and to sell their coal at a price remunerative to themselves, having regard to the capital and risk involved in the enterprise. It

⁴⁴ For example they cite as 'confused' Isaacs J's use of the term monopoly:

The word 'monopoly' has been used in the various senses of 'complete control of a trade', 'dominating influence in a trade', 'practical control of a substantial part of a trade', 'securing the greater part of a trade by keeping others out, whether by ordinary means of competition or otherwise' and 'retaining possession of a trade actually enjoyed' [79-80].

Despite the dismissive tone, these different aspects to its meaning are quite defensible, and are used frequently in modern economics and antitrust law. The Court seemed totally 'blind-sided' to the possibility that monopoly could result in anything other than fully competitive market prices.

⁴⁵ This was despite the court's own observation that

We are unable to find any evidence to show that the real state of things in Newcastle was not as disclosed by these witnesses. Indeed the only case suggested was that as the coal mines were actually worked, and the coals sold at a low price, it must be assumed that they were in fact worked at that selling price at a profit [84].

Not only did the Full Bench did not undertake the extensive examination of prices, costs and quantities undertaken by Isaacs J (although it would not be usual, at least in modern times, to revisit the facts found by the first instance judge, absent arguments as to error having been made in finding them) it seemed unwilling to consider that the continued operation of the mines and shipping companies was itself evidence of some degree of commercial viability.

may also, we think, be fairly inferred that they intended to ask as high a price as they could get in the market without running the risk of being underbid by other competitors in Australia or abroad and so losing the trade. This is not, in our opinion, an intention to cause detriment to the public [91].

In our opinion, the Full Bench never properly argued the nexus between the alleged advantage to the public as it should have been defined and the increase in the price of coal. Similarly with regard to that component of the arrangements regarding shipping the coal, it held that despite the agreement including penalties for breach of the agreement, and inducements to ship exclusively for the collieries and at specified prices, there was no revealed intention to restrict trade or monopolise interstate trade to the public's detriment. Having reached this view, the Full Bench held that it was not necessary to see if the powers conferred by the agreement had indeed been used to the detriment of the public – an examination of effects. Nonetheless, as it was possible that unintended detriment may have occurred, it reviewed whether the prices charged had been 'unreasonable'- this being the only medium through which detriment could be transmitted.

In considering whether the price set was unreasonable the Full Bench outlined the assumptions it felt Isaacs J had adopted in his analysis:

- i the price at which a commodity sells in any year is *prima facie* a price actually remunerative to the producer;
- ii. that price is 'reasonably' remunerative;
- iii. any higher price is unreasonable;
- iv. all conditions affecting prices remain constant until otherwise shown;
- v. any rise of prices is *prima facie* unreasonable.

Having established that the first assumption was not substantiated, it held that the observed price rises were not unreasonable.

In assessing whether the formation of the Vend had resulted in short supply which caused detriment to particular companies, the Full Bench held that 'possible error of human foresight' and 'unusual congestion' at ports was mainly to blame. Further it found no connection between the Vend and any individual member's refusal to supply to non-Vend ship-carriers. Nor was the monopoly control of interstate coal shipping unreasonable.

Appeal to the Privy Council:

Attorney-General of the Commonwealth of Australia v Adelaide Steamship Co Ltd (1913).

After the decision of the Full Court, the Commonwealth had one avenue left - an appeal to the Privy Council.⁴⁶ This Court upheld the Full Court decision – so confirming the reversal of Isaacs J.'s original decision. In addition to examining why the Privy Council decided this way, there are a number of aspects of further interest to this case that must be addressed.

In effect the Privy Council held that contracts to restrain trade or commerce, or agreements to combine, even if unenforceable at common law, were not necessarily of

⁴⁶ Appeals to the Privy Council were allowed from Australia until the *Privy Council (Limitation of Appeals) Act 1968* (Cth); *Privy Council (Appeals from the High Court) Act 1975* (Cth). and finally the *Australia Act 1986* (Cth), s 11.

detriment to the public. Without explicitly stating so, it agreed with the Full Court's view that the term 'the public' was not mostly weighted by the interests of coal consumers, but gave considerable weighting to the producers and workers in the industry involved. The decision was very much one that supported the status quo and protected capital rather than consumers.

Monopoly and restraint of trade

In delivering its decision the Privy Council made it clear that it was aware of the costs and benefits of monopoly. It began from the common law position that everyone is entitled to carry on trade or business as they choose, and no one can lawfully interfere with another's trade or business unless there is just cause. Such 'just cause' may be in fact be the consequence of inadvertent impacts of another undertaking their own business, or because of rights from the Crown (letters patents, or a 'monopoly') or by contract (restraint of trade). The 'social detriment' caused by a monopoly, which necessarily means a lessening of freedom of trade, necessarily requires that some consideration passes in exchange (a benefit to match the cost). Thus patents rights were developed because these 'encouraged inventive ingenuity,' while sole trading rights in foreign parts encouraged 'new countries being opened to trade' [32]. The evils of monopoly included an 'increase in the price of ...wares... and second...deterioration of the wares themselves' [33].⁴⁷

Primacy of individual contracts

Contracts to restrain trade were initially viewed as void as being against public policy. As with the Full Court, however, the Privy Council noted that 'yet under certain circumstances it may be to the interest of the individual to contract in restraint of this freedom and the community if interested to maintain freedom trade is equally interested in maintaining freedom of contract within reasonable limits' [33]. The onus of proof lies with the party alleging that the evil of monopoly (unreasonable prices) is a consequence of a contract to restrain trade. Thus, citing dicta from the *Mogul* case, the Privy Council held that

The right of the individual to carry on his trade or business in the manner he considers best in his own interests involves the right of combining with others in a common course of action, provided such common course of action is undertaken with a single view to the interests of the combining parties and not with a view to injure others⁴⁸ [35].

It is important for economists to note that the focus of the Privy Council is not really on economics, but on contract. Although the discussion covers the "right to carry on ...trade or business", what is being weighed is the freedom to contract against the restraints of doing so. This view of the true nature of the 'dispute' between the appellants and the respondents is fundamental in explaining the outcome from this appeal hearing.

Atiyah (1979) identifies these interpretations as a consequence of English judges' inability to understand the contemporary reality of cartels and monopolisation, and their (then) old-fashioned beliefs in the instability of pure competition. Institutions were different then, as were social standings and recognition of economic rights. Furthermore, their faith in the primacy of contracts was founded on the belief that free

⁴⁷ It was also noted that while Crown grants such as letters patent and sole trading rights were monopolies in the 'strict legal sense', the *AIPA* used the term monopolies in the 'popular sense' of being equivalent to destructive or pernicious monopolies, whose actions could include raising prices.

⁴⁸ *Mogul Steamship Co v. Mc Gregor, Gow & Co.* 66 *Law Times* 1 (1892).

trade and the freedom to trade could only be protected by rigorously upholding the freedom of individuals to contract in any manner they deemed fit. Thus, provided the agreement did not constitute an illegal arrangement between the parties to the contract, the courts were hesitant to declare it invalid due to its impact on parties outside the contract. (pp 616-620; 697-703)

The Privy Council also found that the term ‘public’ included producers and consumers, noting however that this distinction mattered little as

...in considering the interests of consumers it is impossible to disregard the interests of those who are engaged in such production and distribution. It can never be in the interests of the consumers that any article of consumption should cease to be produced and distributed, as it certainly would be unless those engaged in its production or distribution obtained a fair remuneration for the capital employed and the labour expended [39].⁴⁹

This sentiment, while true as a matter of commercial necessity, was narrowly construed in terms of the issue at hand, and in fact begs the real question - does conduct designed to line one’s own pockets and also of those who are part of one’s own business environment cause detriment to the broader public interest? This is a balancing test that required a broader set of scales than the ones that were sitting on their Lordships’ judicial bench.

In examining the intended consequences of the agreement between the collieries, and between the collieries and the shipping agents, the Privy Council decided to examine whether there was an intention to injure the public via price rises or annihilating competition. Inducing shortages or causing delays were dismissed as unintentional, having no benefit to the parties to the Vend.

According to one academic commentator, the *mens rea* behind the Privy Council decision was its attitude to upholding the primacy of contracts over broader public implications.

The Lords interpreted the statute in light of the principles established in *Mogul* and *Nordenfeldt*.⁵⁰ They rejected the argument that the Australian Parliament had intended that all contracts in restraint of trade were always either void or unenforceable, since such a holding threatened the existence of “trade unions, the economic advantage of which has often been recognised in modern legislation”... [The] Committee linked the price stability the cartel agreements facilitated to the collier’s ability to employ workers and pay satisfactory wages, an outcome “eminently reasonable and well calculated to prevent labour troubles.” ... Ultimately, the issue was whether these considerations established sufficient “intent” to violate the statute. The court held that the cartel agreements raised no “legitimate inference that any of the

⁴⁹ While such a comment is certainly true in the short-run, it does suggest a lack of awareness of the long run outcomes from markets.

⁵⁰ *Mogul Steamship Co v. Mc Gregor, Gow & Co.* 59 *Law Times* 514 (1888); *Mogul Steamship Co v. Mc Gregor, Gow & Co.* 62 *Law Times* 820 (1889); *Mogul Steamship Co v. Mc Gregor, Gow & Co.* 66 *Law Times* 1 (1892); and *Maxim Nordenfeldt Guns and Ammunition Co v. Nordenfeldt*, 67 *Law Times* 469 (1892); *Maxim Nordenfeldt Guns and Ammunition Co v. Nordenfeldt*, 68 *Law Times* 833 (1892); *Maxim Nordenfeldt Guns and Ammunition Co v. Nordenfeldt*, 69 *Law Times* 471 (1893); *Nordenfeldt v. Maxim Nordenfeldt Guns*, 1894 AC 535.

parties concerned, whether colliery proprietors or shipping companies, acted otherwise that with a single view to their own advantage, or had had any intention of raising prices or annihilating competition to the detriment of the public.⁵¹

Another commentator on this decision was more dismissive. "... the Privy Council decision...[was] ...little more than [an] expression of the personal philosophies of its members."⁵²

Allocative efficiency vs. productive efficiency

There is an alternative economic explanation for the decision of the Full Bench of the High Court and that of the Privy Council - their view of what constituted the benefits of productive efficiency and the costs to allocative efficiency. Isaacs J's decision looked closely at the impact of price rises on a basic commodity and (indirectly) on the general equilibrium impact this had (viz his discussion on BHP, SA Railways and the costs of doing business generally). The Full Court and the Privy Council, by contrast, emphasised the need to ensure productive efficiency in the industry. This was relatively easy when the counterfactual was 'ruinous competition'. The Privy Court summarised the situation thus:

The collieries in the Newcastle coalfield were ceasing to pay dividends ...[prior to the agreement]... and falling into the hands of the banks who financed them: the miners had little chance of an advance in wages, though there had been a general advance in prices; and the prosperity of Newcastle which is dependent on the coal industry and the shipping industry in connection therewith, was seriously threatened [41].

Similarly

The shipping companies were already suffering from the low prices at which J & A. Brown & Co sold their coal.... Moreover, some of the shipping companies had controlling interests in companies owning collieries in the Newcastle and Maitland fields, and were suffering from the reduction due to competition... [42].

The Privy Council actually considered the dynamic consequences of competition; describing the possible consequences correctly, but then reaching the wrong conclusion:

It can never, in their Lordships' opinion, be of real benefit to the consumers of coal that colliery proprietors should carry on their business at a loss, or that any profit they make should depend on the miners' wages being reduced to a minimum. Where these conditions prevail, the less remunerative collieries will be closed down, there will be great loss of capital, miners will be thrown out of employment, less coal will be produced, and prices will consequently rise until it becomes possible to reopen the closed collieries or open other seams. The consumers of coal will lose in the long run if the colliery proprietors do not make fair profits or the miners do not receive fair wages. There is in this respect a solidarity of interest between all members of the public [48].

⁵¹ Freyer, (1992), pp.130-31.

⁵² Ramson (1981) p.331.

Their Lordships concluded that as the Vend did not control 100 percent of the collieries, nor had it eliminated competition in the home trade, interstate trade or foreign trade completely, it could not have raised prices unreasonably. To the extent that this might reflect their understanding that competition can work at the margin, they were correct. But they did not take into account the package of strategic behaviour engaged in by the companies. Their view was far too structural, short run and simplistic, in comparison with the approach taken by Isaacs J at first instance. The Privy Council thus concluded that the agreement between the collieries to raise prices was not done with the intent of acting to the detriment of the public, and was thus not illegal.

With regard to the agreement to transport coal by the shipping companies, the Privy Council held that the terms requiring exclusivity in dealings, and the setting of maximum prices, were not particularly unusual or injurious to the public. Indeed they considered such arrangements may have been to the benefit of consumers by ensuring reasonably steady supply:

If, as their Lordships think, there was justification for a combination of colliery proprietors to raise the price of coal, it was obviously reasonable on their part to take precautions to secure a market for their coal at the increased price. They could do this in various ways... but they finally adopted the plan of appointing the shipping companies their exclusive agents for that purpose. On the other hand the shipping companies, if a Vend were formed, would either have to purchase coal from the Vend at increased prices or obtain their coal elsewhere with considerable risk of loss from an unsteady or insufficient supply and the introduction of fresh competitors in the shipping business. Some arrangement with the Vend would be advisable in their own interest, and again it was not unreasonable that the arrangement should take the form of an agreement of exclusive agency [51].

Thus, the Privy Council sanctioned a classic cartel that was enforced with impunity and naked self-interest and with little regard for users of coal, including State Governments, and for final consumers and employees in other industries. After this decision, a succession of Commonwealth Governments in Australia failed to launch any further prosecutions for price-fixing under the *AIPA*, despite many successful price-fixing actions having been launched in the US. It was not until the early 1960's that thoughts turned seriously to legislating against monopolies or collusive behaviour by firms, and even then this campaign was a solo effort by the then Attorney General, that led to only weak legislation being passed in 1967. It was not until 1974, under a new Labor Government (Labor had been out of power for some 30 years when it was elected in late 1972), that modern legislation was passed to control cartel behaviour. If it is true that "what a monopolist wants more than excessive profits is simply a quiet life", the decisions handed down by the Full High Court and by the Privy Council on the *Coal Vend* matter certainly ensured that they remained undisturbed in Australia generally for almost half a century.⁵³

Conclusions

The approach and reasoning of the decision in *Coal Vend* by Isaacs J cannot be faulted, at least in terms of its economics. It provides a text book example of how, in the absence of direct admissions or irrefutable 'smoking gun' commercial evidence, to analyse a huge volume of statistics and other written material in order to assess whether

⁵³ Ransom (1981), p.319.

a group of firms colluded, and whether that collusion caused social harm. Of course, the statute under which the case was tried required that the conduct at issue was engaged in with the intent to restrain trade to the detriment of the public. Purpose, or intent, is never an easy thing to prove for either individuals or corporations.

When trying to prove a unilateral misuse of market power (known as monopolisation in some jurisdictions), competition agencies frequently encounter evidence of boasting by executives that their actions are designed to eliminate or take market share from a rival. This is a normal part of the posturing and self-aggrandising behaviour that is not at all uncommon in the business world, and is hardly proof, without much more, of an intent to injure the public. When confronted with co-ordinated conduct, it is easy for defendants to claim that their actions were necessary for noble ends such as protecting capital and shareholder wealth, saving employees' jobs, ensuring an essential commodity is supplied to consumers, and so on. Here, generally a quite confined view is taken of just what parts of society are to be regarded as the public - in the language of economists, a partial equilibrium assessment is made rather than one based on a general equilibrium consideration.

Thus, statutory wording is crucial when framing legislation to deal with economic 'crimes'. The pending Australian cartel amendments will make certain types of cartel provisions a criminal offence if they are entered into with the intention of "dishonestly obtaining a benefit". The Australian legal standard for dishonesty as an element of intention is that the person being charged actually knew that what had been done was dishonest to the standard of ordinary people. Economics is an imprecise enough science at the best of times. Lawyers like 'bright lines'. Dishonesty in business when it comes to scams, deception, fraud, theft, or deliberately misleading advertising, can be objectively accounted for. Life can be tough in modern markets. Where can a non-arbitrary line be drawn to distinguish between honest behaviour (good, hard, interactive rivalry where only the best, socially speaking, survive) and dishonest conduct (where market forces are usurped and firms replace them with construct designed to work to their benefit only, or to the benefit of a small part of society, in the process endangering the welfare of society at large? This is a Herculean task.

Social attitudes, and certainly judicial displeasure, about price-fixing have hardened in the last decade in Australia. It is now widely regarded as inexcusable, and increased calls for criminal treatment of the conduct have now been met.⁵⁴ Of course, there is no hard Australian evidence to support the need for criminalisation as an effective punishment or deterrence mechanism. Leading CEOs who have been jailed in recent times for a variety of white collar crimes appear to have survived their prison terms (usually in relatively comfortable surroundings) and have quickly integrated back into society. But if society believes that making price-fixing a criminal offence will deter it, then it must ensure that the statute is clear and its words consistent with legal and economic processes that lend themselves to objective measurement, and assessment, and proof.

Of course, given that serious cartel conduct, and especially price-fixing, is to be criminalised, the bar for proof must necessarily be high. But this assumes that the antecedent condition is clear and objectively provable. There are many in Australia who doubt that the dishonesty condition that has been proposed will lead to (m)any

⁵⁴ As we write, the founder and Managing Director of Australia's largest cardboard box manufacturer has been charged with the criminal offence of giving false information to the ACCC in respect of a major price-fixing allegation, which had recently been settled with negotiated penalties endorsed by the Federal Court.

prosecutions, let alone convictions for price-fixing. This aspect of the Exposure Draft has been subject to many criticisms and submissions to the Government, and the final *Bill* that is presented to the Australian Parliament may omit the dishonesty requirement and adopt the US approach where no such requirement is present. But, in the event that at least some condition regarding intent remains, what can we learn from the *Coal Vend* case and the judgment of Isaacs J?

To some extent, any test designed to prove price-fixing that is denied by defendants must be in the form of a double black box – the test itself which cannot be prescriptive, and the black box of the defendant’s behaviour, which must be penetrated and have light shed upon it. While structured analyses of how to ‘prove’ such behaviour have been developed, ultimately it boils down to presenting evidence that discredits all possible innocent explanations, leading to only one possible inference - there was an agreement to fix prices. Isaacs J certainly provided a key template here, with his “such a concurrence of time, character, direction and result as naturally to lead to the inference that these separate acts were the outcome of pre-concert, or some mutual contemporaneous engagement, or that they were themselves the manifestations of mutual consent to carry out a common purpose, thus forming as well as evidencing a combination” statement, that now serves as a guide to Australian judges.

The approach by Isaacs J looked at detail - amazingly so - and produced an industry analysis that was as good as any carried out at that time by practising economists. Indeed his judgment would pass muster even today as a model of how to go about assessing market conduct and its impact on social welfare. He looked at structural market factors and how they impinged on conduct, in effect pre-dating the structure-conduct-performance paradigm developed at Harvard by E.S. Mason in the 1930’s and which still serves as a cornerstone (if not now the only one) evaluation procedure for competition authorities around the world. Isaacs J showed that he clearly understood that strategic behaviour was something that firms with market power could engage in, both unilaterally and jointly, to protect their current and future operating environment, once again using analytical methods that were decades ahead of their formal development in the academic literature in the 1970’s. He understood the nature and effect of entry barriers, and the need for entry to be possible in order to keep incumbent firms competitive. He understood the importance of evaluation at the margin. He could see how exponentially pernicious a comprehensive horizontal agreement was, in terms of damaging social welfare, when it was joined to a downstream agreement with the shipping companies who bought and delivered the coal interstate. End users of coal virtually had no options by which they could escape the greed of the Vend.

Isaacs J thus appeared to recognise that the public interest was a broad concept. Protecting the interests of a narrow section of the public (those on the supply side of the markets for producing and shipping coal) while certainly enhancing the welfare of part of the public, did not, without more, lead to the conclusion that the public in general had not suffered from the conduct in question. It was a matter of balancing out the gains and the detriments. While the statutory test was one of intent, he effectively adopted the position that intent could be gauged from the likely effects of the conduct, the effects of the conduct needed to be assessed right through to their impact on buyers of coal and then on to the impact on the final consumers of all goods made from processes that used coal as an input. Consideration of the public interest, unless confined sectorally by the statute, requires that an economy-wide examination be made.

The evidence confirming that the Vend was an illegal combination, therefore, was convincing to Isaacs J, and was easily assembled. But the next step to satisfy the statutory test was harder - the need to prove that the intent of the Vend was to act to the detriment of the Australian public. The test is stronger than the torts requirement to show that an outcome was reasonably foreseeable. Isaacs J took the view that the intent of the companies involved was effectively to shore up their own economic health (and perhaps that of their employees), to the exclusion of any consideration of the economic well-being of other coalminers, other shippers, end-users of coal, and the general public who were buying products for whose manufacture or transport coal provided an essential input for which there were no substitutes, either at all or that were cost-effective. Intent to cause detriment to the public interest was demonstrably present, therefore, even if derived indirectly by a process of elimination.

Coal Vend was lost on its two appeals not because of faulty economic logic or analysis, but because of the appeal courts' faith in the primacy of contract over all else, and the freedom for parties to advance their own self-interest. The freedom of parties to contract as they thought fit was seen an essential pillar of commerce. Undesirable impacts on parties outside the contract were not enough to declare the contracts invalid under the law. It would be fair to say that these learned judges understood little about the realities of cartels and monopolisation, and could not distinguish between productive and allocative efficiency. We would hope that a re-run of *Coal Vend* today in Australia under the same statute would produce the same first instance decision, which, if taken to appeal, would now be confirmed. While the law of contract is still important, the selfish acts of a few sellers and their freedom to contract as they desire would not likely be supported in the presence of demonstrated widespread social detriment.

And so to the criminalisation of price-fixing. Proving that firms have acted dishonestly in terms of social standards can perhaps be regarded as the modern equivalent of proving intent. Proving this beyond reasonable doubt sets a high bar, hard in front of a judge and perhaps much harder in front of a jury, for whom the nuances and reasoning of economics might well be a foreign language. Isaacs J showed how to prove the existence of a cartel. He also provided a method by which intent could be inferred, to the exclusion of any public benefit-enhancing alternative conclusion. The guidance exists for the Australian courts and those who argue in them. As economists, we urge that history be allowed to show the way.

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