

PRICE GOUGING, CONSTRUCTION CARTELS OR REPAIR MONOPOLIES? COMPETITION LAW ISSUES FOLLOWING NATURAL DISASTERS

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ABSTRACT

It is a commonly held myth that businesses have a tendency to engage in price gouging of essential products in the immediate aftermath of natural disasters. In the wake of Hurricane Katrina belief in this myth resulted in many US states enacting anti-price gouging legislation, however these have been little used following subsequent natural disasters, and have been heavily criticised from an economics perspective. This article considers the myth and reality of price gouging following the Canterbury Earthquakes. It suggests that the Canterbury Home Repair Programme was initiated as a governmental response to the myth of price gouging by construction companies, but that instead of decreasing anti-competitive conduct, the Programme has raised additional competition law issues. It argues for legislative restraint following natural disasters. The enactment of legislation to counter issues that are more myth than reality has the potential to create more competition law issues than it solves.

I. INTRODUCTION

“Sociologists have long identified substantial disconnects between public perceptions of post-disaster human behaviour and the empirical assessments of that behaviour”.¹ A US academic, discussing the legislative response to perceived widespread looting following Hurricane Katrina, concluded that this perception was more myth than reality, and argued that legislators should refrain from introducing legislation that will reinforce and perpetuate such myths. Another example of a post-disaster myth is that of price gouging. Some of the earliest first hand reports of natural disasters refer to this practice. After the 1666 Great Fire of London, the diary of Samuel Pepys described the price of eels increasing by 300 per cent.² After the 1703 London Windstorm,

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1 Lisa Grow Sun “Disaster Mythology and the Law” (2011) 96 Cornell L Rev 1131 at 1134.

2 Anon “The Diary of Samuel Pepys” <enicolson.hubpages.com>.

the price of ceiling tiles rose 400-500 per cent, and both straw for thatching and building labour increased by 200 per cent.³ The price of wagons, to move possessions, rose from USD 5 to USD 100 following the 1906 San Francisco Earthquake.⁴ Similar reports have occurred after recent hurricanes in the US, with thousands of complaints about price gouging emerging. A Washington Post poll following Hurricane Katrina showed that 72 per cent of respondents felt that oil companies were price gouging, and 80 per cent felt that the federal government was not responding appropriately. In reality, however, a post-Katrina investigation showed that only 0.06 per cent of gas stations engaged in price gouging, and even then, this was for a very short period of time.⁵ Ignoring the reality and relying on the myth, most US states now have anti-price gouging legislation.

This paper will discuss the myth of price gouging at two stages of disaster recovery: the immediate period post-disaster, and the longer term “rebuild” phase.⁶ It will consider economic and ethical arguments relating to price gouging and will suggest that, while prices often increase following a natural disaster, this is often due to increased costs of supply and the market reacting appropriately to shortages, and not to suppliers taking advantage of disaster victims. The paper will first consider international experience before focussing specifically on the events of the Christchurch Earthquakes. It will discuss evidence of price gouging after these earthquakes, and analyse the effectiveness of a rebuild strategy designed partly in response to the price gouging myth. Finally, it will consider a belated call for the imposition of price controls on rental properties, three years after the first earthquake. This paper will suggest that enacting legislation in response to perceived price gouging is an unnecessary and unwarranted step. While a Government clearly wishes to protect its vulnerable citizens, legislative interference to address short term problems can lead to more severe long term problems, which is clearly not in the interests of those citizens.

3 Risk Management Solutions “December 1703 windstorm, 300 Year Retrospective” <support.rms.com>.

4 Risk Management Solutions “The 1906 San Francisco earthquake and fire: perspectives on a modern super cat.” <support.rms.com>.

5 Federal Trade Commission “Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases” (Spring, 2006) <www.ftc.gov> at 192.

6 Kerstein suggests that there are three stages to a disaster: Phase 1, during and immediately after the disaster, where the primary concern is health, welfare and safety; Phase 2, the short term following the disaster, where health welfare and safety concerns still exist, but where some recovery commences; and phase 3, the long term recovery and return to normalcy: Frederic A Kerstein “An Overview Of Post-Disaster Fraud” (2006) 18 Saint Thomas L Rev 791 at 791.

II. THE MYTH OF PRICE GOUGING

While the term price gouging is often used following a natural disaster, there is no agreed upon definition of the term. Some definitions consider any price increase whatsoever to be price gouging, while others focus on an increase in profit and accept that there may be increased costs of supply following a disaster which can be fairly passed on to a consumer.⁷ Price gouging is generally considered to affect goods which have become essential both in the immediate post-disaster environment, for example batteries, generators, gasoline and bottled water, and also in the longer term recovery stage, for example building supplies and labour. As was suggested in the introduction, it can be argued that price gouging is more a myth than a reality. Actual examples are rare, and when they do exist, often appear to be short term responses to supply interruption, which are arguably justified in the changing post-disaster environment.

A. An Economic Perspective on Price Gouging

From an economic perspective, increased pricing during or following a disaster can be considered to be a natural and appropriate response to a shortage of essential products. Demand for particular essential items increases substantially post-disaster, whereas supply remains at the pre-disaster level, and impediments to resupply are likely to develop. As demand outweighs supply, the market will react in a predictable and efficient way, with the price of the product rising until supply meets demand, as those who value the product less drop out.⁸ This price increase sends important messages about the market to various stakeholders. Manufacturers and producers use this information to understand the increased demand and are therefore able to react to it in an efficient manner, by increasing production. Outside firms and entrepreneurs are encouraged by the increased pricing to bring additional supply into the affected area, giving consumers more purchasing options.⁹ Consumers learn that this product is now to be valued higher than it was pre-

7 See below for a fuller discussion of price gouging laws.

8 W David Montgomery, Robert Baron, and Mary Weisskopf "Potential Effects Of Proposed Price Gouging Legislation On The Cost And Severity Of Gasoline Supply Interruptions" (2007) 3(3) *Journal Of Competition Law And Economics* 357 at 358.

9 As an example, after Hurricane Wilma, a man in Miami hired a flat-bed truck and drove several hundred miles to North Carolina, where he purchased generators for between USD 300 and USD 500. He then returned to Miami and sold them for approximately double what he paid for them. Hyman and Kovacic argue that the subsequent prosecution was "seriously misguided policy" as the man's initiative increased supply of generators. They conclude "we do not need to give him an award for his initiative. The market did that, or at least it would have if he has not had to pay a fine to the state. But we certainly should not be penalizing him." David A Hyman and William E Kovacic "Competition Agencies with Complex Policy Portfolios: Divide or Conquer?" (February 20, 2013) *GWU Law School Public Law Research Paper No. 2012-70*.

disaster, and must therefore be conserved and used efficiently.¹⁰ In addition, knowledge that the price of essential products will increase acts as an incentive for a seller to stockpile in case of a disaster. The increased price, should the disaster occur, would be likely to compensate the seller for both the risk of purchasing beyond known short-term demand and the costs associated with storage.

Importantly, it should be noted that allowing price increases in a disaster situation preserves the competitive market. While a supplier is free to increase prices, if the increase is too great consumers will respond by purchasing from a lower-priced competitor, and the supplier will receive the appropriate message and adjust its pricing again.

Many consumers feel that prices should be capped during a natural disaster, and respond angrily to increasing prices by calling for the government to step in and control prices through price caps. From an economics perspective, however, price capping distorts the market by not allowing the messages described above to be sent. In addition, price capping would have other consequences. If the value a person places on a product following a natural disaster increases but the price remains the same, the person is likely to stockpile. If there is also a limited supply of the product, which is likely in a post-disaster environment, stockpiling by the first consumer in the supermarket line limits availability for subsequent potential purchasers.¹¹

Keeping the price at the pre-disaster level also fails to incentivise manufacturers and sellers to produce or purchase additional stock. It must be kept in mind that these parties will likely have increased costs of production or transportation as a result of the disaster, and without the ability to recoup these by increased prices there is no economic incentive to increase or even maintain supply. This might result in sellers not selling some existing stock if they are nervous about whether supply can be replenished.¹² Entrepreneurs and outside agents will also have no incentive to bring additional product into the market.

Price caps also ignore the fact that any time demand outweighs supply some form of rationing must occur. If rationing through price increases is

10 See, for example Federal Trade Commission, above n 5. Meyer considers a hotel example. Following a hurricane, a family of four arrives at a hotel. If the price of a room is capped at the pre-disaster price, the family might decide to rent two rooms. If the price has been increased, however, the decision might be made to rent only one room. While perhaps uncomfortable for that family, it preserves that second room for another family: David W. Meyer, "The Virtues of 'Price Gouging'" <www.ftc.gov>.

11 David W Meyer, "The Virtues of 'Price Gouging'", above, n 10, describes how, in the build-up to Hurricane Isabel in September 2003, many retailers sold out of flashlights and D batteries, which went to the first to show up, rather than those who needed them the most.

12 Following Hurricane Katrina, for example, 27 per cent of US crude oil production and 13 per cent of national refining capacity was lost immediately: Federal Trade Commission, above n 5, at viii.

prevented, an alternative must be found.¹³ The idea of first in line rationing has been discussed above. Another option is product rationing, where people are limited in the quantity of a product they can purchase, even when the price remains the same. Experience with this form of rationing creates additional problems, for example long queuing times.¹⁴ This creates an opportunity loss, with people spending hours queuing for a product when they could have been using that time more usefully, helping neighbours or repairing their own houses. Focussing on price capping ignores the fact that time might be considered by some people to be more valuable than money in a disaster situation. As an example of this, after Hurricane Rita, David Bercovicz drove over 200 miles from Broward County to Florida to purchase bottled water. He then returned to Florida and sold the water for USD 10 for 24 litres. He was arrested for price gouging on the basis that a local supermarket was selling the same product for half the price. The fact that people were prepared to buy from him rather than the supermarket suggests that other factors than price were involved in the decision making process, likely the long queues at the supermarket.

All forms of rationing open themselves up to gaming. Richer people, who value time more than money, will pay poorer people to wait in line for them¹⁵ and any form of rationing per person can be manipulated.¹⁶ Black markets are likely to emerge under such a system¹⁷ and there will also be concerns about bribery or favouritism.¹⁸ Any system of rationing per person must also be designed, publicised and implemented, which will result in delays in consumers receiving essential products. Finally, while the consumer might feel that he or she has paid a higher value for the product (through money but also through time spent to receive the product) the supplier has only received the money, and again is therefore not incentivised to increase supply.

- 13 See Becker "Comment on Price Gouging" (23 October 2005) <www.becker-posner-blog.com>.
- 14 Becker refers to the situation in 1979 when President Carter rationed gas to 10 gallons, and described long queues resulting. David W Meyer, above n 10, at 2, comments that after Hurricanes Katrina and Rita, consumers waited for hours for petrol, and began following gas trucks as they made their deliveries.
- 15 Michael Brewer "Planning Disaster: Price Gouging Statutes and the Shortages They Create" (2007) 72 Brook L Rev 1101 at 1127 commented that according to disaster reports, motorists in Florida paid people to wait in line for them.
- 16 Roxanne Nilan "A Prompt Grasp of the Situation" (2006) 30(1) Sandstone and Tile: Stanford Historical Society 12 describes the San Francisco earthquake of 1906, where milk was rationed per person. It was soon realised that some residents were outsmarting the system: "they borrowed the neighbours' kids when they came for milk". It took at least a week to work out a more effective system, interrupting the supply.
- 17 Brian Skarbek and David Skarbek "The Price Is Right!: Regulation, Reputation And Recovery" (2008) 6(2) Dartmouth LJ 235 at 242-3.
- 18 Gregory R Kirsch "Hurricanes And Windfalls: Takings And Price Controls In Emergencies" 1993 Virginia Lr 79 1235. Skarbek above at 244 gives example of vendors selling only to friends.

The Federal Trade Commission, reviewing price increases for gasoline following Hurricane Katrina, concluded that:

... consumers might be better off in the short run if they did not have to pay higher prices for the same quantity of goods; in the long run, however, distortions caused by controls on prices would be harmful to consumer's economic well-being.

and "if there is a right price for a commodity it is not necessarily the low price; rather it is the competitively determined market price."¹⁹ Culpepper and Block reach the same conclusion, using more colourful language:²⁰

When a government intervenes in the market by passing legislation that prevents sellers from adjusting their price to what it should be after a disaster, the situation is worsened. Business owners are treated as criminals, while the 'anti-gouging-enthusiast consumer' gets to rob them of money that is rightfully theirs, according to the market. The government is a co-conspirator to, and main proponent of, this economic crime. Consumers who truly believe that the government is helping them in such situations are sadly mistaken.... In times of emergency, when the demand for certain goods increases, this 'helpful' government regulation is the very reason that the resources are not available to those who need them.

Overall, therefore, if the goal is to increase supply of essential goods to people following a disaster, the most effective and appropriate way to achieve this is to allow the market to act without interference. Price gouging legislation, from an economics perspective, is unlikely to be effective.

19 Federal Trade Commission, above n 5, at 183. Geoffrey Rapp "Gouging: Terrorist Attacks, Hurricanes, And The Legal And Economic Aspects Of Post-Disaster Price Regulation" (2005-2006) *Kentucky L J* at 535, 555 suggests one situation in which price caps might be economically appropriate: where there has been a massive payment system collapse. If electronic payment processing systems fail, meaning people can't access money in their bank accounts, the situation changes because the market cannot respond appropriately. Products won't go to those who value it the most, but to those "whose money-under-the-mattress has survived the disaster" From an economic perspective, therefore, price caps do not actually achieve the desired result, which in this case is an efficient distribution of essential goods. For a counter argument, see David Skarbek "Market Failure And Natural Disasters: A Re-Examination Of Anti-Gouging Laws" (2007-2008) 37 *Pub Cont L J* 771.

20 Dreda Culpepper and Walter Block "Price Gouging In The Katrina Aftermath: Free Markets At Work" (2008) 35(7) *International Journal Of Social Economics* at 512, 514.

B. An Ethical Perspective On Price Gouging

Arguments against price gouging tend to rely on ethical language. Price gouging has been described as running contrary to “fairness and fraternity” and violating “a duty to treat others as an ends in themselves.”²¹ As Posner describes it:²²

... in times of catastrophe, with consumers hurting, the spectacle of sellers benefitting from consumers’ distress while (it seems) deepening that distress by charging them high prices, is a source of profound resentment and in a democratic society profound resentments trigger government intervention.

When legal terms are used to explain the objection to price gouging, the terms chosen often also have an ethical dimension to them, claiming that this is fraud, or coercion or exploitation.

A duty to treat people fairly can be seen from ancient times. Rules among Babylonians, Mesopotamians, Assyrians, and Egyptians imposed a duty on merchants to sell in good faith.²³ Both Chen and Brewer provide multiple additional examples of such duties. The Hebrew Talmud (“if thou sell unto your neighbour... ye shall not oppress one another”), has been interpreted by Talmudic scholars to prohibit overcharging, and has resulted in rulings that transactions in which the profit exceeds one-sixth should be void. Under Jewish law, interventions are permitted to adjust unfair prices. The Catechism of the Catholic church states that:

... taking and keeping the property of others is against the seventh commandment: [including] deliberate retention of goods lent or of objects lost; business fraud; paying unjust wages; forcing up prices by taking advantage of the ignorance or hardships of another.

21 Andy CM Chen “A Market Based And Synthesised Approach To Controlling Price Gouging” (2011) 4(1) Int J Private Law 128 at 128.

22 Richard Posner “Should Price Gouging In The Aftermath Of Catastrophes Be Punished?” (23 October 2005) <www.becker-posner-blog.com>. See also Brian Skarbek and David Skarbek, above n 17, at 238,, where the authors comment that in the wake of a disaster, politicians feel the need to do something and often want to be seen as doing something to help. Price gouging laws, which involve no additional costs for government except enforcement, are one of the fastest and cheapest methods of intervening, making them a very attractive choice for politicians.

23 Andy CM Chen “A Market Based And Synthesised Approach To Controlling Price Gouging” (2011) 4(1) Int J Private Law 128 at 128, and Michael Brewer, “Planning Disaster” (2007) above n 15, at 1104.

Islamic law prohibits Bay'al-mudtarr, (exploitation) and Ihtikar (hoarding). Muhammed is quoted as saying "those who bring grain to a city to sell at a cheap rate are blessed, and they who keep it back in order to sell at a higher rate are cursed." Brewer comments that these beliefs translated into norms of early secular markets, through a belief that there was a "fair price" for goods.

Today, a fair price is generally regarded as one which exists in a competitive market, or meets the "willing buyer, willing seller" standard. Arguments that the unique conditions of a natural disaster require either reversion to this original understanding of a fair price, or the calculation or imposition of another standard of pricing, however, are unconvincing.

Zwolinski argues that price gouging laws are problematic from both a fairness and a consequentialist perspective. In relation to fairness, he doubts whether it can be considered fair to expect the seller to absorb the increased cost of supply in order to benefit the consumer.²⁴ Becker agrees, commenting that after Hurricane Katrina consumers blamed petrol stations for price gouging, however, "the profits of most gas station owners went down, not up, after Katrina. They have to pay more for gas and the higher prices cut back on the demand."²⁵ Zwolinski continues that such an approach of preventing price increases is particularly unfair if the seller has acted rationally in obtaining a stock of goods in the knowledge that they would become essential during a disaster. The seller ought to be entitled to some benefit for this foresight.²⁶

From a consequentialist perspective, Zwolinski points out that price gouging legislation punishes only those who actually sell. A seller who stockpiles and withholds essential goods, for example, does not attract liability under price gouging laws as there is no positive duty to help others.²⁷ It seems arguable that a consumer benefits more from purchasing a product at an inflated price than he does from not being able to purchase the product at all.

The counter-argument is given by Michael Sandel.²⁸ He explains that arguments relating to price gouging revolve around three ideas: maximising welfare, respecting freedom, and promoting virtue. His argument is that the third idea, virtue, is often neglected but is a significant consideration:

In times of trouble, a good society pulls together. Rather than press for maximum advantage, people look out for one another. A society in which people exploit their neighbours for financial gain in times of crisis is not a good society. Excessive greed is therefore a vice that a good society should discourage if it

24 Matt Zwolinski "The Ethics Of Price Gouging" (2008) 18(3) *Business Ethics Quarterly* 347, 350.

25 Gary Becker "Comment on Price Gouging" (23 October 2005) www.becker-posner-blog.com.

26 Matt Zwolinski above n 24, at 351.

27 Matt Zwolinski, above n 24, at 356-7.

28 Michael Sandel "Justice: What's The Right Thing To Do?" (2009).

can. Price gouging laws cannot banish greed, but they can at least restrain its most brazen expression, and signal society's disapproval of it.

While this is a fair comment, it only justifies price gouging in its most extreme form, where excessive profits are made. Further, it considers price gouging only from the perspective of the consumer, failing to take into account the position of the supplier. Notably, it fails to take into account the fact that most increases that are condemned as price gouging are actually the result of increased costs of supply.²⁹ An analysis of price gouging which only considers the perspective of the consumer leads to another problem, identified by Rotemberg.³⁰ He argues that what a consumer considers fair is linked to the regret a consumer has in not buying a particular good before the disaster. He suggests that consumers do not tend to consider price increases of canned goods or non-essential goods to be unfair, because most consumers have a supply of these at home already. Consumers do, however, consider price increases of essential goods to be unfair, because they have not acted responsibly in purchasing these items for an emergency kit before the disaster. If this is true, and it does seem reasonable, then passing on blame to a supermarket for the preparatory omissions of the consumer is not itself a virtuous act as Sandel desires.

Giberson sums up the ethical arguments against price gouging well, "When the consequences of anti-gouging regulations are considered instead of just the intentions of their advocates, moral conclusions likely weigh against, rather than for, price gouging laws."³¹ While consumers might feel that price gouging is unfair, the translation of this into law does not take into account the altered position of the seller, and ignores the fact that the law places no liability on someone who stands back and does nothing to help the community in a disaster. A price gouger at least provides the benefit of moving essential products into the community, improving the position of the consumer who freely (although obviously unhappily) enters a contract for purchase.

C. Legal Comparisons With Price Gouging

The increase in prices following natural disasters is often described by reference to other legal terms. These comparisons, however, are not only legally inaccurate, but have the undesirable consequence of increasing or even promoting resentment from consumers towards any price increase.

29 See below for examples.

30 Julio Rotemberg "Customer Anger At Price Increases, Changes In The Frequency Of Price Adjustment And Monetary Policy" (2005) 25 *Journal Of Monetary Economics* 829.

31 Michael Giberson "The Problem With Price Gouging Laws" (2011) *Regulation* 48, 53.

Price gouging is often described by politicians as another form of “looting”,³² drawing a comparison with theft. This is clearly an inaccurate description. While the consumer might not like the price offered, he or she does enter into the transaction freely, and receives something of value in return. Other comparisons, for example with fraud, coercion and exploitation, suggest some level of moral wrongdoing which is not necessarily present. This can best be explained through an example: after the Christchurch Earthquakes, liquefaction resulted in tap water being undrinkable or, in many eastern suburbs, completely unavailable. Imagine that the price of bottled water in supermarkets tripled in response to increased demand. In this situation the supermarket cannot be said to have engaged in fraud by increasing the price. Fraud can be defined as a false representation of a fact. Assuming the supermarket has simply increased the price, and has not mislabelled the bottle or attempted to charge a price other than that stated on the shelf, there is no fraud.³³ There is also no coercion. Coercion is the use of force, intimidation, or pressure to compel an individual to do something against his or her will. While the consumer would obviously prefer to pay the pre-disaster price, that is not an option available to them, at least at this supermarket. The choice is to purchase or not, and the consumer will exercise free will in making that choice. In addition, in cases of coercion the force, intimidation, or pressure is generally caused by the person seeking to benefit. In a natural disaster scenario, the lack of water is not caused by the supermarket, but by external forces, making a coercion claim an uneasy fit. The third term, exploitation, is more difficult, and is fact-dependent. Exploitation involves taking unfair advantage of someone, usually when they are in a vulnerable position. In a post-disaster environment it is highly likely that residents are vulnerable, both from the stress of the situation and the shortage of essential products. Whether raising prices of these goods is taking unfair advantage, however, is unclear. There are numerous reasons why a price might increase. Supply warehouses may have been damaged, or may be located in inaccessible areas. There may be increased transport costs, due to earthquake damaged roads possibly not supporting trucks, or being simply impassable. Petrol prices have also likely increased. The supermarket itself might have been badly damaged and therefore required additional labour hours for cleanup before the store could safely open. Staffing issues might have resulted in the store owner paying bonuses to workers who might reasonably be prioritising their own situation over work, or paying additional staff who would not normally be rostered to work, in anticipation of an increase in consumers. These costs, and others, would be incurred by the supermarket owner. It cannot realistically be

32 After the Christchurch Earthquakes, for example, Mayor Bob Parker referred to price gouging as looting: “Parker: Rent Hikes ‘Looting’ By Another Name” (10 March 2011) <tvnz.co.nz>.

33 Note that Brian Skarbek and David Skarbek, above n 17, at 267 suggest that fraud may occur post contract, where a contractor subsequently realises he cannot complete the contract and deceives the customer.

said that the supermarket is taking unfair advantage and therefore exploiting consumers by passing some of these costs on. Exploitation would only occur if the profits received by the supermarket, and not the price charged, increased substantially.

Overall, therefore, the comparison of price gouging to other crimes is problematic. The crimes given as comparators are chosen as a means of expressing frustration with pricing, but are legally inaccurate and operate only to increase the frustration of others. This is not helpful in considering whether a legal response to increased pricing is warranted or desirable.

D. Price Gouging Legislation

While there does not appear to be an economic or ethical justification for price gouging legislation, Posner's statement that profound resentment of price fixing generally triggers governmental intervention is an accurate one, particularly in the USA.

Regulation of price gouging following a disaster can occur through either an Emergency Order immediately after the disaster or through existing legislation, the application of which is triggered by the disaster. As an example of the former, following the Taiwan earthquake in September 1999 an Emergency Order by the President and Government prevented hoarding and price gouging.³⁴ Another example is Florida's Executive Order 92-222-E, issued by the Governor on 23 August 1992, following Hurricane Andrew. The Order made the imposition or demand of "an exorbitant or excessive price by any vendor of fuels, foods, medicines, or other necessities" a violation of Florida's Deceptive and Unfair Trade Practices Act.³⁵

In the United States, Federal price gouging laws, for example the Petroleum Consumer Price Gouging Protection Act and the Federal Price Gouging Prevention Act, were introduced in 2007, with the latter being reintroduced in 2011, but have not been enacted. A White House White Paper took an economic approach in rejecting the need for legislation of this type, considering that it would "create an unnecessary and costly enforcement

34 Andy CM Chen "A Market Based And Synthesised Approach To Controlling Price Gouging" (2011) 4(1) *Int J Private Law* 128, at 128. Hoarding in this case referred to "non-merchants or merchants not in their main business who are purchasing large quantities of commodities needed by people in disaster regions, or ... merchants in their main business [who] are purchasing, storing, and holding from sales..." and 'price gouging' referred to "product characteristics, unit price, the percentage of the price increase, timing of the price increase, swiftness of the price increase, and extent that is acceptable to consumers, at the same time addressing whether the degree of price increase significantly and palpably exceeds the cost increase."

35 Gary E Lehman "Price Gouging: Application Of Florida's Deceptive And Unfair Trade Practices Act In The Aftermath Of Hurricane Andrew" (1992-3) 17 *Nova L Rev* 1092. The author also refers to Dade County and Broward County Commissioners passing county ordinances in Florida making price gouging an unfair business practice.

regime". The White Paper referred to price controls over gasoline in the 1970s which resulted in long queues and in economic recession as a reason for rejecting the need for legislative intervention.³⁶

At state level, price gouging legislation is common, but is inconsistent in terms of scope.³⁷ The legislation generally contains a triggering event, often a declaration of a State of Emergency by the President, a Governor or a local official,³⁸ and generally defines price gouging as an unacceptable increase in price from the pre-emergency price. The pre-emergency price may be defined as the average retail price for a period before the disaster,³⁹ the actual price immediately before the declaration,⁴⁰ or it can be left undefined. The unacceptable increase in price can either be defined as a price above a specific percentage increase from the pre-emergency price,⁴¹ a price above the amount of wholesale price increase,⁴² or through the use of language such as "unconscionable", "excessive", "exorbitant" or "unreasonable".⁴³

Price gouging legislation in other countries appears uncommon. In Australia, trade practices or consumer legislation may be used if actions against price gougers are considered necessary,⁴⁴ and this may be the approach adopted in other countries.

E. Price Gouging Legislation In Practice

In considering the effectiveness of price gouging legislation, it should be kept in mind that the threat of reputational damage, resulting in consumers taking their business elsewhere once the market has settled, often appears to be of greater consequence to suppliers than any liability under specific or general legislation for price gouging. While the 1906 San Francisco earthquake resulted in price increases for wagons and building supplies, an interesting

36 The White House "A White Paper On The Economic Consequences Of Gasoline 'Price Gouging' Legislation" (20 June 2007) < georgewbush-whitehouse.archives.gov >.

37 Fourteen states have no price gouging laws. Illinois allows the Governor to enact price controls but provides no guidance, See Brian Skarbek and David Skarbek above n 17, and Matt Zwolinski, above n 24, for comprehensive discussions of state laws.

38 Michigan appears to be the anomaly, prohibiting ever selling goods at unconscionable prices.

39 As examples, Florida and South Carolina use an average price over the 30 days before the disaster: Fla Stat ch 501.160 (2005), SC Code Ann 39-5-145 (2005)

40 As examples, Connecticut, Tennessee and West Virginia take this approach: Conn Gen Stat Ann 42.320 (2004), Tenn Code Ann 47-18 5103 (2005) W Va Code 46A-6J (2006).

41 As examples, Arkansas, California, New Jersey, Oklahoma and Utah take this approach: Ark Code Ann 4-88-303 (2006), Cal Penal Code 396 (2006), NJ Stat Ann 56:8-109 (2006), Okla Stat Ann tit 15, 777.1 (2005), Utah Code An 13-41 (2005).

42 As examples, Georgia, Hawaii, Louisiana and Mississippi take this approach: Ga Code Ann 10-1-393.4 (1995), Haw Rev Stat 209-9(1994) La Rev Stat Ann 29:732 (2005) Miss Code Ann 75-24-25(2003).

43 At least 18 states take this approach.

44 Julian Lamont and Christi Favor "Price Gouging In Disaster Zones: An Ethical Framework" (2009) 28(1) Social Alternatives 49, at 49.

anecdote recorded by the Stanford Historical Society demonstrated that competition in essential product markets otherwise kept prices low. When one grocery store raised its prices:⁴⁵

A photographer arrived and asked if he could take a picture of the front of the store with the proprietors - they were flattered to do so. He then informed them 'you are the only firm in Palo Alto who has raised the price of groceries, in view of the food famine which is threatened. This picture will be widely circulated in San Francisco, across the state of California and in the east, accompanied by the statement of this interesting fact!' their prices promptly fell to pre-earthquake level, and stayed there.

This is not an isolated incident. Newspaper reports following Hurricane Katrina in the US often described Governors threatening a naming and shaming approach if price gouging occurred, and in Japan, the media reported unfavourable pricing after the Kobe Earthquake in 1995. Following the Christchurch Earthquakes, politicians threatened a similar approach, and some hotel review websites still contain clear feedback from customers who felt price gouging had occurred. The long term implications of a short term price gouge must be an important decision making factor in any consumer industry.

Where price gouging legislation is enacted, Brewer concludes that these statutes "draw their moral weight from the goals they articulate, rather than their ability to achieve them."⁴⁶ Such a conclusion is supported by the conversion rate of price gouging complaints to investigations, and of investigations to prosecutions or settlements. While prices might initially rise following a disaster, it appears that they will often begin to correct themselves quickly, usually in response to the competitive market working effectively, and in such cases any legal response is often considered unnecessary.⁴⁷ This can be illustrated by the US experience with its price gouging legislation.

Following Hurricane Katrina, over 30,000 price gouging complaints were received from members of the public. The main focus of the complaints was gasoline, and the Federal Trade Commission initiated an investigation into

45 Roxanne Nilan "A Prompt Grasp of the Situation" (2006) 30(1) *Sandstone and Tile*: Stanford Historical Society at 1, 7.

46 Michael Brewer, above n 15, at 1119.

47 The 1703 Windstorm in London resulted in the price of tile rising 4-500 per cent, and straw for thatching rising 200 per cent. It was reported, however, that prices began to fall once it was clear consumers were not prepared to pay. People temporarily protected their roofs with cheap timber until building prices dropped to acceptable levels: Risk Management Solutions, "December 1703 windstorm, 300 Year Retrospective" <support.rms.com >.

this specific area.⁴⁸ The investigation revealed that in the week following Hurricane Katrina,⁴⁹ gasoline prices increased by an average of 50c per gallon, a rise of approximately 46 per cent. Prices had dropped by 35c by the time of Hurricane Rita,⁵⁰ but then increased again by an average of 25c. After a further 4 weeks, the price returned to the pre-Rita levels, and by December 2005, it had returned to pre-Katrina levels. The FTC acknowledged that the price increases were in part due to damage to crude oil production and refinery following both Hurricanes. While some gas stations did increase their prices beyond levels that could be attributed to increased supply costs, most only held these prices for 1-2 days, and the FTC accepted evidence in some of these cases that this was a response to “imprecise and changing perceptions of market conditions.”⁵¹

In addition to the FTC investigation, 42 states announced independent investigations of gas stations. Only 8 states subsequently charged retailers with price gouging in relation to gas stations, resulting in out of court settlements with approximately 100 stations.⁵² As an example, Florida investigated 9,215 stations, following 5,260 complaints, but filed only 2 cases. The FTC found no reported final decisions from the courts following state post-Katrina investigations, and commented that the number of settlements amounted to 0.06 per cent of the total number of gas stations in the US, suggesting that despite the myth of price gouging, its actual occurrence is minimal.⁵³

The FTC concluded that “the evidence is remarkably consistent with the competitive explanation. Based on well-established economic principles, the price increases were roughly in line with increases predicted by the standard supply and demand paradigm of a competitive market.”⁵⁴

Investigations by states were also reported after Hurricanes Rita⁵⁵ and Dolly.⁵⁶ After Hurricane Isaac in 2012, over 1,000 complaints of price gouging were made. All but 8 related to gasoline pricing, and all but a

48 Federal Trade Commission above n 5. The investigation was permitted under s 1809 Energy Policy Act, which requires the FTC to investigate whether gasoline prices are being manipulated by, inter alia, price gouging practices. It was also a result of s 632 of the Commission’s appropriations legislation for the 2006 fiscal year, which required the Commission to investigate “possible price gouging in the aftermath of Katrina.”

49 Hurricane Katrina formed on August 23 2005, and dissipated on August 30 2005.

50 Hurricane Rita formed on September 18 2005, and dissipated on September 26 2005.

51 Federal Trade Commission. above n 5, Executive summary, at x.

52 At 192.

53 At 192.

54 Executive summary, at ix.

55 See for example Abhi Raghunathan “South Florida Shortages Fuel Black Market” *St Petersburg Times*, October 29 2005, at 1B, which describes a man being arrested for selling 24 one litre bottles of water from a truck for USD 10.

56 See, for example, Naxiely Lopez “Hotels To Pay Fine For Price Gouging During Hurricane” *The Monitor*, March 8 2011, which reported 5 south Texas hotels paying UDS 80,000 in civil penalties after raising prices.

handful were deemed unfounded.⁵⁷ Following Hurricane Sandy in the same year, 2,000 complaints of price gouging were made in all industries. Again, the conversion rate was low. One news site reported 25 gas stations settling claims for USD 167,850.⁵⁸

The number of complaints that have proceeded to prosecution are minimal. Most of those businesses prosecuted have settled rather than proceeded to trial, and it must be considered that at least some of these businesses did not engage in price gouging but settled simply to avoid the risk of trial or reputational damage. One example that would fall into this category can be found following Hurricane Charley in 2004. A hotel had raised prices by 32.6 per cent in the week following the Hurricane, but over the next few weeks had gradually lowered the price back to the pre-disaster rate. It agreed to settle, rather than proceed to trial.⁵⁹ The hotel's actions in increasing price immediately after the disaster then slowly lowering it seems very similar to many of the cases discussed by the FTC and considered acceptable in the Katrina Gasoline price-gouging investigation, but the hotel might not have been prepared to take this risk at trial. Examples of not wanting to risk reputational damage can be seen following Hurricanes Gustav and Ike in 2008. In late August, Hurricane Gustav caused 95 per cent of offshore oil and gas refineries to close. Two weeks later, Hurricane Ike struck, worsening the situation. Over 4,000 complaints were received about the subsequent price increase of gasoline. Only 17 gas stations were investigated, and 16 settled quickly but denied any wrongdoing. The final gas station settled a year later. In this latter case, despite proof that while supply had increased the price by 85c, and it had only raised its prices 80c, it settled "only to avoid the costs and risks inherent in protracted litigation with the state".⁶⁰

Two reported cases demonstrate that even those investigations proceeding to prosecution may not actually succeed. An example of a case that was prosecuted in the electricity industry following Hurricane Katrina is that of Jude Raspino and his company Stuart Services. Raspino was accused by the Attorney General of Louisiana of charging three times the normal rate for services following Katrina, despite Raspino having clear documentary evidence to show he had not raised his prices at all. The judge denied a preliminary injunction.⁶¹ Another example is *White v RM Packer*.⁶² Four gasoline stations raised their prices after Hurricanes Katrina and Rita. Under

57 Ed Anderson "Hurricane Isaac Price Gouging Complaints Investigated" The Times-Picayune, 11 September 2012.

58 "New York Cracks Down On Price Gouging After Hurricane Sandy" May 2 2013 <www.abclocal.go.com>.

59 "AG Settles Hurricane Charley Price Gouging Claim" 14 December 2004 <myfloridalegal.com>.

60 Michael Giberson "The Problem With Price Gouging Laws" (2011) Regulation 48, at 48-9.

61 "Price-Gouging Accusations Create A Storm After The Storm" EC&M 105.1 (Jan 2006) at 6.

62 *White v RM Packer* 635 F3d 571 1st cir (2011).

Massachusetts law, a “gross disparity” between price and cost must be proven. In this case, the court found that while average weekly prices did increase, costs of supply were also climbing. The profit margins were therefore only rising “very moderately”. The case was dismissed.

There have been some examples of successful prosecutions under price gouging legislation, however many of these are old examples, and the conviction often turns on the wording of the statute rather than the moral blameworthiness of the individuals. In *People v Two Wheel Corp*,⁶³ the defendants had raised the price of generators by up to 67 per cent following Hurricane Gloria in 1985. An injunction to prevent the sale was granted, but the defendants appealed, arguing that the increase was due to increased labour and shipping costs. The court denied the appeal, determining that under New York law, this could not be taken into account. Two successful prosecutions occurred in New York following the 1998 Ice Storm. In *People v Beach Boys Equipment Co*⁶⁴ the defendants were found liable for selling generators for USD 1,200 each, which was double the price charged by others. While the defendants had purchased the generators for USD 1,000 each, they failed to explain the increased purchase price, and the judgment doubted whether this was an arm’s length transaction. In *People v Chazy Hardware*⁶⁵ the defendant purchased 54 generators for either USD 533 or USD 780 each. It then sold 40 of these for USD 780 and USD 890, prices which it described as reflecting its customary 28 per cent profit mark-up. Two days later, it sold the remaining higher priced units for USD 1,190. This further increase was explained as being additional costs for opening on a Sunday outside its normal trading hours, and additional maintenance and transportation costs. The court found that this increase was “unconscionably excessive” under the Act, even though with the extraordinary additional costs taken into account, the defendant actually made 4 per cent less profit on these latter sales than it normally would.

There are also examples of entrepreneurial individuals being arrested for purchasing essential goods and selling them for profit. Some of these have been discussed above. A further example can be found following Hurricane Fran in North Carolina in 1996. Over a million people were left with electricity, and ice became an essential item to cool food, baby formula and insulin. Four men rented refrigeration trucks and sold ice, purchased for USD 1.70 a bag, for USD 12 a bag. They were arrested for price gouging.⁶⁶ Another example is *Florida v Mikell*.⁶⁷ In this case, following Hurricane Ivan in 2004, three men purchased 22 generators for USD 550 and sold then for USD 650. The average price for the 30 days prior had been USD 300. The higher pricing

63 *People v Two Wheel Corp* 512 NYS 2d 439, 440 (NY App Div 1987) aff’d 525 NE 2d 692 NY (1988).

64 *People v Beach Boys Equipment Co* 709 NYS 2d 729 NY App Div (2000).

65 *People v Chazy Hardware* 675 NYS 2d 770 NY Sup Ct (1998).

66 Matt Zwolinski, above n 24, at 347.

67 *Florida v Mikell* <www.myfloridalegal.com>.

in part reflected the higher cost of purchase and also the fact that two of the men had made a 630 mile, 10.5 hour round trip, to purchase the generators. Despite this, the men were convicted and fined.

This trend of low conversion rates from complaints to prosecution can also be seen in Queensland, Australia, following Cyclone Larry in 2006. The Office of Fair Trading in Australia reported receiving only 12 complaints for gouging of petrol and milk, and only investigated two. It also reported price increases of 300 per cent for home repairs, but concluded that “there was the suggestion that the price hikes may not have been immoral.”⁶⁸

A study by Cavallo, Cavallo, and Rigobon⁶⁹ provides an interesting statistical analysis of prices of essential goods following the 2010 Chile earthquake and tsunami, and the 2011 Japan earthquake and tsunami. The authors used the Billion Prices Project at MIT, which collects price information from large online retailers around the world on a daily basis. The study was therefore able to consider prices of essential goods in these countries for 3 months before and 6 months after the disaster. In both countries, the prices in the supermarkets remained “surprisingly” stable,⁷⁰ although there were initial reports of price gouging in the first days. The real issue that the data revealed was the availability of products, identified by the fact that these products dropped off the radar for periods of time. In Chile, available products dropped by 32 per cent in the first two months post-disaster, but began to rise again. By the end of the study, 6 months on, only 15 per cent of products were not available. In Japan, available products dropped 17 per cent in the first 18 days post-disaster. By the end of the 6 month post-disaster period, availability was only 5 per cent lower than pre-disaster levels. Price increases, due to inflation, were only noticed after 4 months in Japan, and 6 months in Chile, despite the shortages. The reason for the price stability was considered to be fear of reputational damage. In Chile in particular, it was commented that firms feared price increases would lead to “customer anger”.⁷¹

The examples provided above support the classification of price gouging as a myth. The conversion rate between complaints and prosecutions or settlements is very low. It is interesting to note that the most commonly cited examples of successful price gouging prosecutions are older cases, and that these arguably would have been decided differently had the increased cost of supply following a disaster been taken into account. The Cavallo et al statistical study demonstrates that, in two very different countries, price gouging did not occur post-disaster and that supermarkets acted in a fair way towards their customers. While this did result in shortages, the manufacturers and suppliers received important messages about demand, and within 6 months

68 Julian Lamont and Christi Favor above n 44, at 50.

69 Alberto Cavallo, Eduardo Cavallo, Roberto Rigobon “Prices And Supply Disruptions During Natural Disasters” NBER Working Paper Series <www.nber.org>.

70 At 3. It should be noted that in Chile, the day after the earthquake the President announced an agreement with supermarkets to give away some basic foodstuffs.

71 At 1.

Japan's supply was close to meeting demand, and Chile's had improved from 32 per cent non-availability to 15 per cent. Legislation was not required in either case.

F. The Christchurch Experience

At 4.35 am on Saturday 4 September 2010, a magnitude 7.1 earthquake struck Darfield, about 40 km west of the Christchurch Central Business District, at a depth of 11 km. While the earthquake caused widespread damage, the fact that it occurred at a time when most people were asleep resulted in minimal injuries being reported. This earthquake set off an aftershock sequence which as of 6th April 2015 this has resulted in 16,005 aftershocks. The most significant of these was a magnitude 6.3 aftershock on Tuesday 22 February 2011, at 12.51 pm. It was centred 10 km from the city centre in the Heathcote Valley, and was 5 km deep. One hundred and eighty five people from more than 30 nations lost their lives, and over 11,000 people were injured. Other significant earthquakes hit on 13 June 2011, and on 23 December 2011, causing further injuries but no reported deaths. All of the earthquakes occurred on fault lines not known to be active prior to September 2010. The earthquakes have resulted in damage to more than 90 per cent of houses in the greater Christchurch area. Of these, an estimated 24,000 homes required major repairs or a complete rebuild.

Initial reports of price gouging occurred after the September 2010 quake, particularly in relation to building supplies and services, where it was commented that a "premium for earthquake jobs" was being added.⁷² A construction economist, John Jackson, warned early that price gouging would occur, and called for a "supremo" to lead the rebuild "to make sure there is no ripping off and price-gouging." The Chief Executive of the Canterbury Employers' Chamber of Commerce also called for "some sort of benchmarking... to make sure in a very constrained market there is no price-gouging."⁷³ Similar concerns were raised within days of the February 2011 earthquake, and the Government responded by threatening to "name and shame Christchurch retailers and other businesses" that engaged in price fixing.⁷⁴

Despite these early concerns, there was very little evidence of price gouging, with the exception of accommodation. While the US experience focused on gasoline pricing, this issue did not arise in Christchurch. Petrol was scarce, with petrol stations in the east unable to open due to lack of electricity, and for the first few days following the 22 February 2011 earthquake there was no possibility of resupply. Supply ran out and long queues developed at petrol

72 Liz McDonald "Price-Gouging Threat To Recovery - Economist" 15 September 2010 <www.stuff.co.nz>.

73 Ibid.

74 "Christchurch Quake: More Liquefaction That Sept" 25 February 2011, 8.30am <www.3news.co.nz>.

stations at the times advertised for the arrival of resupply tankers. Prices did not increase, however, even though within days of the February earthquake suppliers were warning that they would have to increase prices as a result of oil prices rising from USD 105 to USD 115.⁷⁵ On 1 March, a price increase of 5-6 c a litre occurred throughout the rest of New Zealand, but Christchurch was shielded from the increase, with suppliers commenting that holding prices was “appropriate” and “the right thing to do for now.”⁷⁶

The main area of immediate concern was housing. Many locals, particularly in the east, found themselves with no power, water, or electricity, and living in houses and neighbourhoods that were badly damaged. In addition, many visitors found their current accommodation inaccessible. Many of the major hotels in Christchurch were located in the Central Business District, which was subsequently renamed the ‘red zone’ and evacuated after the February 2011 earthquake. These people, faced with sleeping in the local Hagley Park, quickly sought alternative accommodation. Motels on the border of the red zone became attractive options, and some examples of increased prices were reported.⁷⁷

Christchurch Mayor Bob Parker described price gouging of rental accommodation as “looting by another name. You can’t put this in a polite way. It shouldn’t be happening, we’re not going to get through this if people take this approach”. While he acknowledged at the same time that any form of price control would create “new distortions”, the emotive language in relation to price gouging was clear. The Tenants Protection Association called for a price freeze on rental properties as a response,⁷⁸ as did a leader of a small and medium business action group.⁷⁹

While there were reports of rents rising by up to 150 per cent after the February earthquake,⁸⁰ a monthly report by the Real Estate Institute of New Zealand showed that rental prices for 3 bedroom houses had only risen NZD 40 per week in Christchurch between June 2010 and June 2011.⁸¹ Between June 2011 and June 2012, however, rental prices increased 18 per cent according to the Department of Building and Housing⁸² or 26 per cent according to statistics on TradeMe, an online auction site. TradeMe also

75 Hayden Donnell “Petrol Price Rise To Hit Quake-Ravaged Christchurch” 25 February 2011 <www.nzherald.co.nz>.

76 “Christchurch Spared From Petrol Rise” 1 March 2011 <www.nzherald.co.nz/nz>.

77 Michael Berry “Cost Of Night In Chch Hotel Up 32pc” 14 March 2012 <www.stuff.co.nz>

78 “Parker: Rent hikes ‘looting by another name’” 10 March 2011 <tvnz.co.nz>.

79 “Big hikes in rent will ‘push operators out of business’” 11 March 2011 <www.radionz.co.nz>. The impact on business resulted from the fact that businesses located in the red zone needed new buildings to operate out of, and unable to find suitable commercial property, looked for private rental properties as short term solutions.

80 “Parker: Rent hikes ‘looting by another name’” 10 March 2011 <tvnz.co.nz>.

81 This can be compared to a NZD 10 increase in other cities: Olivia Carville “No ‘Astronomical’ Rent Rises In Chch- Brownlee” 18 June 2011 <www.stuff.co.nz>.

82 The national average was 4 per cent: Department of Building and Housing “Key Canterbury Indicators: Rents” July 2012.

reported listings for Christchurch properties dropping 34 per cent while demand increased 47 per cent. Census data comparing rental prices in 2006 and 2013 has shown that the percentage of rental properties available for less than NZD 300 per week dropped from 40 per cent in 2006 to 26 per cent in 2013. The amount of properties available for rental properties between NZD 300-399 increased from 12 per cent to 32 per cent, as did availability for properties from NZD 400-\$499 (from 3 per cent to 11 per cent).

One of the interesting features of the Christchurch Earthquakes is that the major price increases in relation to rent have been most noticeable from mid-2012 onwards. One contributing cause of this may be the slow process of the rebuild, and for this reason, recent calls for price controls on rental prices will be discussed further later in this paper.

G. Conclusion on Price Gouging

Kirsch has suggested that governments faced with citizens demanding action in relation to price gouging have 4 basic options:⁸³

1. Forego action and let the markets work.
2. Enact price controls to stop gouging and keep goods affordable.
3. Purchase needed goods, if feasible and affordable, and distribute those goods to victims.
4. Take needed goods and distribute them to victims.

In the US, the general response at state level has been the second option. In Chile and Japan, the first option was used, although Chile also used either option 3 or 4 for some essential goods. Christchurch also chose the first option, although it may be considering adopting the second option for the specific housing problem.

While enacting price controls appears to be an obvious solution, the above discussion has suggested that not only is legislation inappropriate from an economic and ethical perspective, it is largely unnecessary from a practical perspective. In Chile, Japan, and Christchurch, Sandel's desired virtue has been achieved (albeit assisted by concerns or threats of reputational damage). Although a Government obviously wishes to be seen to be doing something to help disaster victims, market interference through price gouging legislation cannot be seen as a helpful interference.

83 Gregory Kirsch "Hurricanes and Windfalls: Takings and Price Controls in Emergencies" (1993) 79 VALR 1235 at 1258.

III. THE REBUILD MYTH

The third phase of a natural disaster is the rebuild phase. Myths of price gouging and unfair trade practices also arise in this phase as homeowners fear price gouging of both building supplies and the price of labour. As with price gouging in the initial post-disaster period, however, the myth does not appear to reflect reality. The actual issues that arise during the rebuild phase tend to fall into two categories, firstly contractual issues with construction companies, and secondly issues relating to the awarding of rebuild contracts by governmental agencies.

Contractual issues can involve construction companies not completing repairs to the satisfaction of the homeowner, but can also involve delays in completion or even the abandonment of contracts.⁸⁴

As an example, a study of the post-Sumatra Earthquake period⁸⁵ showed that only half of the 80-110,000 new homes required had been built after two years. One reason for this was the abandonment of construction contracts, with construction companies taking on too much work and failing to complete jobs.

In relation to the awarding of construction contracts, one obvious example of corruption is that of Sonny Shelton. Shelton was sentenced to 10 years imprisonment in 2002,⁸⁶ for using his position in the Guam Department of Parks and Recreation to organise bid-rigging conspiracies and to solicit bribes from contractors during the repair of damage following Super typhoon Paka in 2001. Another example relating to awarding of rebuild contracts was seen in the US during the Hurricane Katrina rebuild. In this case, the greatest issue was not corruption but inefficiency resulting from a lack of competition in awarding contracts. In September 2005, the month following Hurricane Katrina, the Accountability and Clean Contracting Bill was proposed. This Bill would establish an independent commission to investigate:

Federal Government contracting relating to Hurricane Katrina recovery, relief, and reconstruction, to prevent waste, fraud and abuse; and allegations of price gouging or profiteering relating to Hurricane Katrina recovery, relief, or reconstruction.

The Bill was rejected by the White House Office of Management and Budget, which stated that “we feel we have the controls in place to prevent

84 Brian Skarbek and David above n 17, at 267.

85 Makoto Takahashi, Shigeyoshi Tanaka, Reo Kimura, et al “Restoration After The Sumatra Earthquake Tsunami in Banda Aceh” (2007) 29(2) *Journal of Natural Disaster Science* 53, at 61.

86 Shelton was found guilty of 2 counts of wire fraud, 6 counts of bribery, 3 counts of conspiracy to restrain trade and 1 count of money laundering. This was later reduced to 8 years. US Attorney’s Office, Resentence for Austin J “Sonny” Shelton, 31 March 2005 <www.dhs.gov>.

abuse and fraud.”⁸⁷ This was unfortunately not the case, however, as by the following year the US House of Representatives had issued a report condemning the “issuance of billions of dollars in no-bid contracts, combined with inadequate contract management and oversight”.⁸⁸

Reconstruction following Hurricane Katrina highlights the costs to taxpayers of awarding rebuild contracts to contractors in the absence of a competitive bidding process. In September 2005, 51 per cent of reconstruction contracts were awarded by the Federal Government without competition. The House of Representatives report accepted that “the urgent needs in the immediate aftermath of Hurricane Katrina provided a compelling justification”⁸⁹ for this lack of a bidding process, but was unable to accept this justification beyond the first month. It criticised the fact that in October, 93 per cent of contracts were awarded without competition, and that by December the number, 57 per cent, was still high.

From August 2005 to June 2006 USD 10.6 billion was awarded in private contracts for recovery, with USD 10.1 billion of this awarded in contracts over USD 500,000. Only 30 per cent of these contracts were awarded with full and open competition. The resultant costs to taxpayers were high. Use of subcontractors, and sub-subcontractors increased, adding layers of additional costs. The report referred to two examples to illustrate this. First, the Blue Roof programme was created to cover wind-damaged roofs with blue tarpaulin. The contractors subcontracted the work, which was then subcontracted again. The additional administrative cost to taxpayers was 1,700 per cent higher than the actual cost of the work. Another example resulted in the taxpayer paying on average USD 2,480 for a job worth less than USD 300. The report clearly highlights the need for competitive bidding processes, and also the need to limit as much as possible the use of subcontractors.

A. The New Zealand Experience: The Canterbury Home Repair Programme

As has been described above, the New Zealand government did not see the need to interfere with price gouging in the immediate aftermath of the Christchurch earthquakes, which was arguably the correct move. Belief in the price gouging myth did, however, appear to manifest itself in the government’s approach to the rebuild. Concerned that construction companies would price gouge,⁹⁰ the government introduced the Canterbury

87 Quoted in US House of Representatives, “Report on Waste, Fraud and Abuse in Hurricane Katrina Contracts” (2006) at 2.

88 At 4

89 At 5

90 See for example Office of the Auditor General “Earthquake Commission: Managing the Canterbury Home Repair Programme” (October 2013), at [6.46] “EQC could have contracted with more than one provider, but thought this would have higher transaction costs and would also involve providers competing against each other for tradespeople and building materials.”

Home Repair Programme (CHRP), to be administered by the Earthquake Commission (EQC).⁹¹

When a person enters into a private insurance contract in relation to a residential building or to personal property in New Zealand, a premium of 15c per every NZD 100⁹² of insurance is automatically levied from that insurance contract into the Natural Disaster Fund.⁹³ If a natural disaster occurs, a homeowner is covered under the Natural Disaster Fund for the lowest amount of:⁹⁴

- a) The replacement sum specified in the insurance contract, if a replacement sum is specified;
- b) The amount to which the building is insured, if no replacement sum is specified;
- c) \$ 100,000.

Should the damage to the property be higher than this amount, the homeowner can claim from the insurance company the outstanding amount according to the terms of the individual insurance contract.

Within a week of the September 2010 Earthquake, EQC reported receiving over 44,000 claims. By 27 October this had reached 76,000 claims⁹⁵ and EQC called for tenders to “establish a project management team for repairing houses with moderate to relatively serious earthquake damage”.⁹⁶ This would become the CHRP. The call for tenders clarified that “claimants [homeowners] will be able to organise their own repairs if they choose to.” Interested companies had eight days to submit a tender, with EQC commenting that “the tender process will be run as quickly as realistically possible.” Fourteen applications were received, with Fletcher Construction ultimately selected as presumptive project manager.⁹⁷ Under the CHRP, damage claims of under NZD 10,000 would result in cash settlements with the homeowner,⁹⁸ claims between NZD 10,000 and NZD 100,000 were to be project managed by Fletchers (unless the homeowner chose to “opt out”),

91 The EQC is a Crown Entity, established under the Earthquake Commission Act 1993.

92 This amount was originally 5 c per NZD 100, but increased to 15 c per NZD 100 in February 2012.

93 Earthquake Commission Regulations 1993, reg 3.

94 Earthquake Commission Act 1993, s 18.

95 Homeowners have 3 months from the date of the event to lodge a claim. By this deadline, 159,059 claims were lodged: Media Release “EQC Accepting Late Claims Until Midnight Tonight” (6 December 2010).

96 Media Release “EQC Seeks Tenders For Quake Repair Project Office” (27 September 2010).

97 Media Release “Fletcher Construction Chosen to Manage Repair of 50,000 Homes in Canterbury” (15 October 2010).

98 This figure was increased to NZD 15,000 in July 2012.

and claims over the NZD 100,000 cap⁹⁹ would receive a cash settlement and be further dealt with by insurance companies. At first, the process appeared to operate smoothly. By 12 November, NZD 188 million had been paid out on 12,310 building claims and 800-1,000 houses were being assessed for damage per day.¹⁰⁰ On 18 November 2010, the first repairs began.¹⁰¹

What began as a potentially efficient way of organising the rebuild became complicated by numerous and frequent aftershocks. Every aftershock of 5.0 magnitude or greater was classified by EQC as a separate event, requiring new claims to be filed and assessments to be made.¹⁰² As each new event occurred, Fletchers necessarily shifted its focus from rebuild to emergency repairs. Homeowners became increasingly frustrated with the lack of information provided by EQC and/or Fletchers, and newspapers contained almost daily stories of frustration.

In June 2013, 2 years and 9 months after the first quake, the home repair programme passed the half-way mark. By February 2015 it has been reported that 96% of claims are either completed or underway.

The Office of the Ombudsman, which handles complaints against government agencies, began to receive increasing numbers of complaints about EQC and Fletchers relating to delays, lack of responses to requests for information, and lack of communication generally. In the 2009-2010 financial year, 12 complaints were received. In 2010-2011, this rose to 77 complaints. In 2011-2012, 159 complaints were made in the first three quarters of the year,¹⁰³ and 284 complaints made in the final quarter, for a total of 443. In 2012-2013, 838 complaints were received.¹⁰⁴

In October 2013 the Office of the Auditor General released a report on EQC's performance. It was critical of EQC's lack of communication, stating that "service has been poor for some homeowners."¹⁰⁵ The report referred to a survey carried out in October 2012 which showed that over half of the respondents who had dealt with EQC had described the experience as having a "moderate or major negative effect on their everyday lives from dealing with these matters."¹⁰⁶ It mentioned that 1265 complaints had been made to EQC¹⁰⁷ between September 2012 and August 2013. Of these complaints, 62 per cent were in relation to quality of repair work.¹⁰⁸

99 This amounts to approximately 24,660 houses.

100 Media Release "Update From The Earthquake Commission" (12 November 2010).

101 Media Release "EQC Welcomes Start of Repair Roll-out in Canterbury" (18 November 2010).

102 There were a total of 14 claims generating separating events.

103 Office of the Ombudsman, Statement Of Intent For The Period 1 July 2012 To 30 June 2015.

104 Office of the Ombudsman, Annual Report 2012-2013.

105 Office of the Auditor General, above n 90, at [4.4].

106 At [4.4] See also [4.14] citing EQC surveys which showed that the number one issue identified for improvement was communication.

107 This report focussed on EQC. Any complaints made directly to Fletchers were not part of this report.

108 Office of the Auditor General, above n 90, at [4.22].

In terms of the efficiency of the CHRP, NZD 1.5 billion had been spent by 30 June 2013. Of this amount, NZD 180 million was project management fees, which equated to approximately 12 per cent of the cost of each repair,¹⁰⁹ or NZD 4,500 per house.¹¹⁰ It has been estimated that by the end of 2014, these costs would have reached a total of \$2.5-3.1 billion, including \$288-333 million in project management fees.¹¹¹ The Office of the Auditor General felt that this was “at the higher end of what we consider reasonable in the circumstances.”¹¹² If the repair target is not met, the costs of the scheme are unlikely to be considered reasonable. Labour’s Earthquake Commission spokesperson Clayton Cosgrove described the report as “scathing”, stated that the satisfaction rating was “not good enough” and that EQC was in “disarray.”¹¹³ EQC Minister Gerry Brownlee said EQC was doing “pretty well” in the circumstances.

B. The Opt Out Policy

While Fletchers became the presumptive project manager for repairs between NZD 10,000- NZD 100,000, homeowners were given the ability to “opt out”. As EQC described it, “opting out means your repairs will no longer be managed by Fletcher EQC. Opting out allows you to:

- Choose your own contractor to undertake repairs;
- Control the time when your repairs will be undertaken;
- Have the opportunity to renovate your home or undertake additional work (at your own cost), at the same time as having your earthquake damage repaired.

The Opt Out Policy, as originally worded, appeared to work well. A homeowner who opted out would select a construction company and discuss a repair strategy with them, using the “scope of works” provided by EQC in its property inspections. The construction company would then contact EQC for approval to repair the damage as per the scope of works, and would invoice EQC directly. The initial wave of homeowners choosing to opt out reported two major benefits. First, repairs were completed quickly, as there

109 The Project Management contract is a cost-plus arrangement. All costs, including wages and salaries are paid, and in addition, Fletchers will receive 3.5% of the cost of the repair.

110 Office of the Auditor General, above n 90, at [6.37].

111 Office of the Auditor General “Earthquake Commission, “Managing the Canterbury Home Repair Programme” (October 2013), at 6.45.

112 Office of the Auditor General “Earthquake Commission, “Managing the Canterbury Home Repair Programme” (October 2013), at 6.5.

113 “Damning Report Into EQC Practices” 5 November 2013, <www.stuff.co.nz/national/9364474/Damning-report-into-EQC-practices>.

were numerous construction companies available in Christchurch.¹¹⁴ Second, the work was generally completed to an acceptable standard. This was a stark contrast to the frequent newspaper reports of shoddy workmanship by Fletchers contractors.¹¹⁵ As a result of these reports, opting out became a more popular option.

In June 2012, the Opt Out Policy was changed. EQC explained that the reason for the change was to allow homeowners to project manage their own repairs, and for EQC to avoid getting involved in disputes as to the standard of repairs, however the commonly held view was that so many people were opting out that Fletchers exerted pressure on EQC to change the policy. The new policy contained two vital changes which appeared to make opting out so disadvantageous that homeowners felt that it effectively gave Fletchers a monopoly on repairs. First, if a homeowner remained with Fletchers, Fletchers would project manage the home repairs and “you have peace of mind”.¹¹⁶ Under the new Opt Out Policy, the homeowner was to take on the role of the project manager. The Opt Out Policy clearly lists the responsibilities this entails:

- Managing all repairs to earthquake damage relating to the property
- Obtaining all necessary consents and ensuring repairs comply with all the relevant laws, including the Building Act
- Informing your insurer of the repair work to be undertaken and making any necessary insurance arrangements prior to work starting on your home
- Resolving any disputes that may occur
- Repairing all earthquake damage relating to the property

While these responsibilities are reasonable, the contrast in the language and manner used to describe each process made remaining with Fletchers appear to be the far easier option for quake-weary Cantabrians.

The major change to the Opt Out Policy, however, was in the method of payment to the construction company. Under the original policy, the construction company invoiced EQC directly. Under the new policy, the homeowner was responsible for “paying the contractor and forwarding their invoice to us for your reimbursement.” Very real concerns were raised by

114 Those opting out reported average repair times of 4-6 weeks, whereas the Office of the Auditor General report stated that the average repair time under the CHRP was 334 days, above n 90, at [3.65].

115 Marc Greenhill “Shoddy Repairs: I Could’ve Done A Better Job Myself” 23 August 2011, <www.stuff.co.nz> Charles Anderson “EQC Cops Shoddy Jobs Complaints” 1 January 2012 <www.stuff.co.nz> Jay Newton, “Three Years On: EQC Process Wasting Money, 5 September 2013 <www.stuff.co.nz>.

116 Earthquake Commission, Opt Out Policy (June 2012).

homeowners about this requirement. With the average annual income in Christchurch at approximately NZD 28,500,¹¹⁷ having cash on hand to pay for repairs at the maximum of NZD 100,000 was highly unlikely. While it was technically possible that a homeowner could submit contractor's invoices to EQC and receive the reimbursement before the payment to the contractor was due, the sheer number of complaints about the failure of EQC to communicate and assess properties in a timely manner made this a risk too great for many homeowners to take. In addition, if the cost of the repairs ran over the EQC-assessed amount, a homeowner opting out is warned "you will pay the difference", whereas a homeowner remaining with Fletchers still had "peace of mind" as "all the costs of the repair [would be] covered by [Fletchers]". For many homeowners whose EQC assessment had been of brief duration, again, this was considered too substantial a risk.¹¹⁸ Even the Canterbury Registered Master Builders Association responded to the change by saying there was little sense in opting out, and that people "are best to stay with Fletchers."¹¹⁹

The timing of deciding to opt out was also of concern. The policy stated that "your last opportunity to opt out is when Fletchers EQR phones you to book a scoping appointment with the contractor." The homeowner would have to opt out before the determination of the damage to the property was made, in other words before they had any information to base this decision on. In addition, some homeowners reported concerns that the amount of damage listed in the Scope of Works would be reduced if they decided to opt out prior to the scoping appointment.

Some construction companies responded by stating that they would not require payment before EQC reimbursed the homeowner, therefore putting themselves in financial risk. Other companies reported that they had no work, and were having to lay off staff.¹²⁰ For a badly damaged city, this was difficult news to hear.

In February 2013, the Opt Out Policy was again altered. This third iteration contained two notable differences. First, another layer of paperwork is required before a homeowner can opt out. Under the July 2012 policy, the steps involved in opting-out involved:

117 Statistics New Zealand, *Census of Population and Dwellings, 2013*. The average income in the 2006 census was NZD 23,400. This statistic refers to income for all people over the age of 15.

118 According to the Official Auditor General's Report, 23 per cent of these initial damage assessments were inaccurate, whether due to subsequent damage or inexperience of assessors: above n 90, at [3.17].

119 Carys Monteath "EQC Policy May Break Law - Expert" 11 September 2012, <www.stuff.co.nz>.

120 Liz McDonald "EQC Opt-out Change To Bring Job Losses" 7 July 2012 <www.stuff.co.nz>, Thomas Mead "40 Chch rebuild jobs to go" 14 June 2013 <www.stuff.co.nz>.

1. Go to the website and download the opting out package
2. Select a contractor to complete repairs
3. Send the 'request to Opt Out of EQC-managed repair' form to EQC
4. EQC will contact you within 15 working days to arrange a meeting with you and your contractor
5. EQC will send you your scope of works
6. EQC makes a decision on approving your opt-out request

Under the February 2013 policy, steps 2 and 3 are reversed. In addition, there is an additional step. Under the July 2012 policy, after submitting the opt out form; EQC will “contact you within 15 working days of receipt of your form. We will make an appointment to meet with you and your contractor on site ...”. This wording suggested that opting out was largely a formality, although a decision existed at step 6. Under the February 2013 policy, the insertion of an additional step (between sending the opt out request and selecting a contractor) required waiting for EQC to contact the homeowner to “let you know whether you can begin the opt out process”. The use of the word whether suggests that EQC could actually refuse permission for a homeowner to opt out, forcing the homeowner to remain with Fletchers. Even if this is not a fair reading of the policy, the addition of this step meant that the homeowner must seek approval from EQC at two different stages before he or she has successfully opted out.¹²¹ This additional approval step will undoubtedly cause further delays in the repair process.

The second change to the policy suggests even further delays. Under step 3 of the July 2012 policy, once a homeowner chooses to opt out, “EQC will contact you within 15 working days of receipt” to arrange the meeting. Under the February 2013 policy, the wording has changed to “EQC will contact you ...” with no time limit specified. One Opt Out repair company, Earthquake Services, reported being told by EQC that “it will take up to 6 months from the time a person opts out before they will give approval for work to proceed”.¹²²

The CHRP was arguably designed on flawed grounds, due to an unwarranted concern about price gouging. The Programme’s initial implementation, however, was positive. In contrast to the US Katrina model, a competitive tender was introduced, and although only eight days were given to submit a bid, fourteen companies were able to do so. The initial Opt Out Policy allowed homeowners the flexibility to choose a different contractor, without any obvious disincentives for doing so. Thus far, the Programme

121 The February 2013 policy also carries a clear warning “Important: Don’t authorise or start any repairs until EQC has given you written approval to go ahead ... if you start repairs before you have this ... this may mean we cannot pay your invoices”.

122 Earthquake Services “Opt Out Services” <earthquakeservices.co.nz>.

could be seen as a success. Problems arose with the two changes to the Opt Out Policy, described by EQC as allowing homeowners more flexibility, but described by the public as the result of pressure by Fletchers when the large number of people opting out made the Programme less profitable than anticipated. It is at this point that potential competition law issues arise. Could it be said that Fletchers, having a substantial degree of power in a market, was using this power to influence changes to the Opt Out Policy, which had the effect of restricting competition in the rebuild market? Or that Fletchers and EQC had entered into an agreement that had the effect of substantially lessening competition in the rebuild market? If so, ss 36 and 27 Commerce Act 1986 might be relevant.

*C. The Fix It Building Services complaint to the Commerce Commission*¹²³

In July 2012, following the first change to the Opt Out Policy, Fix It Building Services laid a complaint with the Commerce Commission.¹²⁴ The complaint was on the basis that:¹²⁵

... both EQC and Fletcher Building have acting alone and together taken actions which have violated at least 4 provisions of the Commerce Act and in doing so have caused & continue to cause significant public harm plus have caused and will continue to cause our business to suffer serious loss or damage.

It listed 7 sub-complaints to explain this.

The first sub-complaint was that EQC and Fletchers had “implemented processes which deliberately create impediments to clients who wish to consider opting out”. The second complaint is a more specific example of the first, that by requiring an opting out homeowner to pay the contractor and then seek reimbursement from EQC, this “substantially reduce[s] the homeowner’s ability to opt out subsequently significantly impacting on demand for opt out services and reducing competition to Fletchers control of the market.” Third, EQC and Fletchers have “prepared and disseminated information to claimants which is deliberately meant to create an impression that the ... scheme confers advantages to claimants over opting out”, and that these statements are blatantly false. Again, this was argued to reduce competition in the market. Fourth, setting a “point of no return” for opting out, at a time before the homeowner is able to view a scope of works has the effect of

123 The complaint and subsequent correspondence were obtained pursuant to an Official Information Act request by the author in September 2012.

124 The Commerce Commission investigates on behalf of consumers. A person could still bring a personal claim under the Commerce Act or Fair Trading Act, but the expense is likely to be prohibitive.

125 All wording and grammatical errors as per the complaint.

excluding competition. Fifth, the fact that Fletchers can authorise additional repairs for opt in clients, but that opt out clients must pay for these repairs personally means that the decision to allow Fletchers to both assess properties and be project manager “has been misused to exclude competitors”. Sixth, EQC is engaged in price fixing by setting unilateral rates for work and refusing to consider contractor’s quotes or additional information. Finally, EQC and Fletchers have taken advantage of market power by failing to publish repair guidelines, allowing no procedure for clients to dispute decisions and by creating the Opt Out Policy.

The Commission responded in August 2012, stating that it had decided to take no further action.

In relation to the claims that Fletchers has taken advantage of its market power (complaints 1 and 2) the Commission felt that “the fact that EQC allows property owners to opt out of the Fletcher EQR programme demonstrates that EQC is actually allowing competition in the relevant markets.” The second claim was rejected on the basis that “EQC explained that the changes were to prevent it being embroiled in disputes between property owners and repairers” and that owners and repairers “should be able to arrange a payment schedule which is acceptable to all parties given the knowledge that EQC will pay out”. The Commission dismissed the third claim on the basis that it considered the information “accurately outlined the genuine additional responsibilities” of a person opting out. In relation to the fourth claim, the Commission accepted EQC’s response that it does provide the scope of works before requiring a decision as to whether to opt out, and that having a final point to opt out meant that EQC could avoid inefficiencies and plan its work schedule appropriately. The fifth claim was rejected on the basis that EQC stated that this was not true. If additional work was needed, repairs would stop while EQC reassessed the property, regardless of whether the homeowner had opted out or not. The sixth claim was rejected on the basis of a misunderstanding of law. Price fixing cannot occur unilaterally, but must involve two parties. Finally, the Commission rejected the seventh claim as it felt that some of the points referred to were published on the EQC website.

Fix It challenged the finding. Most notably, it commented that it:

... was very disappointed to take the inference that the substantive ‘evidence’ used in the Commissions decision not to investigate further our complaint was verbal statements made by EQC staff. Whilst it would be nice to believe that such statements were true simple investigation highlights that a number are inaccurate and as such should not give rise to our complaint being rejected.

Fix It challenged in particular the factual finding that the scope of works was available before the opt out decision had to be made. It commented that this was inconsistent with the “How To Opt Out” points listed in the Opt Out Policy. Fix It also attached to its reply an email conversation between a homeowner and EQC in which EQC stated clearly that the scope of works did not occur until after the opt out decision had to be made. Fix It further offered to provide testimony from named homeowners who opted out, found that additional repairs would not be authorised, then opted back in because Fletchers would authorise the repairs. In relation to the comment that the payment should not create a disincentive to opting out, Fix It responded:

...this reasoning put forward by EQC has no credibility. With respect nor does your statement that the new process should not create a barrier to opting out. I challenge anyone to state that being faced with the possibility of having to find 10's of thousands of dollars would not create a barrier to choosing one supplier over another where no such possibility exists.

The Commission responded again that it would take no further action and that:

...while any difficulties obtaining a scope of works must have been frustrating for the affected individual homeowners and their possible repairers, we consider it is unlikely that such difficulties amount to a substantial lessening of competition or abuse of market power.

The Fix It complaint emphasises a couple of points. First, as Fix It pointed out, it is highly concerning that the Commission's investigation of an issue facing 90 per cent of residents in New Zealand's second largest city appeared to consist of a telephone call to EQC personnel, and an acceptance of the information provided by EQC, despite Fix It's offer to provide testimony from individuals affected.

Second, there is a clear disconnect between both parties. Fix It's complaint is clearly written by a lay person, lacking the polish and understanding of relevant legal provisions that a lawyer would provide. The Commission, on the other hand, responds in pure legal terms, and its response indicates a lack of understanding of the practical realities of the rebuild. Its claim that payment schedules can be worked out, for example, ignores the fact that construction companies cannot wait long term for a payment, even if this is guaranteed. They are likely to have increased overheads as a result of the earthquake, building supplies have likely increased in price, and staff need to be paid. At some point, the contractor will need paying or face liquidation or

receivership, and homeowners cannot afford to run the risk that this time will occur before EQC payments are made.

Whether a rephrasing of the complaint in more legal language might have resulted in a more successful outcome is unclear, but doubtful. The Commission is correct that the Fair Trading Act has no obvious application. The information provided in the Opt Out Policies is not misleading. It clearly states the advantages and disadvantages of remaining in the CHRP and of opting out. The potential application of relevant sections of the Commerce Act is more complicated.

Section 36(2) Commerce Act deals with use of market power, and states that:

A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of—

- (a) restricting the entry of a person into that or any other market; or
- (b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or
- (c) eliminating a person from that or any other market.

Fix It's overarching complaint is stated in sub-complaint 1, that EQC and Fletchers have "implemented processes which deliberately create impediments to clients who wish to consider opting out". Sub-complaints 2, 3, 4, 5 and 7 are effectively specific examples of sub-complaint 1.¹²⁶

The relevant person could be either EQC or Fletchers. While the Fix It complaint treats them as the same person, they are clearly distinct entities. Either one could satisfy the first requirement of a person having a substantial amount of power in a market: EQC is the monopoly disaster insurance provider,¹²⁷ and Fletchers, as presumptive project manager, clearly has substantial power in the construction market in Christchurch. The remainder of the section requires that the person take advantage of this power for the purpose of achieving (a), (b), or (c). It is arguable that all of these subsections have occurred as a result of the Opt Out Policy. Construction companies from outside Christchurch have likely been prevented from entering the market due to a lack of customers, and those construction companies operating in the construction market pre-September 2010 have likely been prevented or eliminated from competing due to the Opt Out Policy. These claims would obviously need to be supported by evidence, and some claims to this effect have been referred to above.¹²⁸ As the subsections refer to "this or any other

126 Although sub-complaint 3 can also be considered as a complaint under the Fair Trading Act, which was how the Commerce Commission chose to address it.

127 It should be noted that the Commerce Act applies to the Crown, and to body corporates that are instruments of the Crown in respect of the Government of New Zealand engaged in trade: Commerce Act 1986, ss 5-6.

128 At footnote 120.

market”, it is not relevant that EQC operates in a different market to the construction companies.

Assuming there is evidence to support these claims; two remaining elements must be proven. First, the person must “take advantage of” their market power, and secondly, they must do this for the “purpose” of achieving (a), (b), or (c). This is where the claim would run into difficulties. The Privy Council and the Supreme Court appear to have established that a determination of whether someone has “taken advantage of” their market power requires application of a counterfactual test.¹²⁹ The counterfactual test requires creating a counterfactual, or hypothetical, scenario in which a firm has the same characteristics as EQC or Fletchers, but does not have a substantial degree of market power, and then considers what this hypothetical firm would have done in the circumstances. If there is more competition in the hypothetical counterfactual scenario than there is in the real or factual situation, then the person has taken advantage of its market power. To phrase it a different way, if the hypothetical firm could have acted in the same way, the person has not taken advantage of its market power.

Applying the counterfactual test to EQC requires the creation of a hypothetical scenario in which EQC is not the only disaster insurance provider. The obvious counterfactual would therefore be a scenario where all insurance companies offered their own disaster insurance. Given this situation, it becomes necessary to consider whether firstly, the hypothetical insurance company would have set up a presumptive project manager scheme, and secondly, whether it would have made the same alterations to the Opt Out Policies. On the one hand, considering the sheer amount of claims likely to be received, a presumptive project manager scheme would be the easiest solution to organise repairs from an administrative perspective, as the insurance company would only need to deal with one company in relation to the repairs. On the other hand, the insurance company would need to secure a construction company to act as presumptive project manager, and if all insurance companies were taking this route, this might result in bidding wars and not be the most cost-efficient way of managing the repairs. Either approach is possible, resulting in the counterfactual test providing a less than clear answer. In addition, an obvious problem with designing the counterfactual in this way is that the easiest solution for an insurance company would be to simply pay out and allow the clients to organise their own repairs. This is what it is required to do under the insurance contract, and this is probably what its customers would likely want. In a competitive market, an insurance company that places conditions on insurance payouts, like who will complete the repairs, might find itself losing customers to those companies that simply

129 The counterfactual test is probably the sole test to determine ‘taking advantage of’ in New Zealand following the Supreme Court decision in *Commerce Commission v Telecom Corporation of New Zealand* [2010] NZSC 111, however see L Trotman and D Wilson, “New Zealand’s highest court considers taking advantage of market power to deter competition” (2011) 9 AJCCL 76 for a differing interpretation.

provide cash settlements. EQC, as a governmental body, clearly felt some obligation to not just pay out, but to assist in the rebuild, apparently to prevent price gouging. A more appropriate counterfactual might therefore be to introduce an alternative disaster insurance scheme through another governmental body. In this counterfactual, the alternative insurer would probably set up a similar scheme to the CHRP, suggesting that EQC has not taken advantage of its market power in creating the scheme.

The next issue is whether in these counterfactual scenarios the hypothetical firm would alter the Opt Out Policies in the way EQC has. In a competitive market, the answer is probably that they wouldn't. Imposing restrictions on how people repair their homes is likely to result in those people considering transferring their insurance to companies without restrictions for future claims. On the other hand, from an administrative perspective, EQC has justified its policy changes as increasing efficiency and streamlining the rebuild process. These factors would also potentially influence the hypothetical firms' decisions. The application of the counterfactual test to EQC does not, therefore, give an obvious answer.

Applying the counterfactual test to Fletchers is even more challenging. Fletchers was not responsible for the design of the CHRP, it merely tendered for the role of presumptive project manager. Whether it could be said that it subsequently took advantage of its market power to convince EQC to alter the Opt Out Policy to make it harder for people to opt out, is trickier. While this may be the feeling of some Cantabrians, there is no evidence to support this, and Fletchers has claimed that it did not have any influence over the subsequent re-writing of the policies.

Overall, a prediction as to the success of the counterfactual test is difficult by nature as it involves creating a hypothetical scenario that may be unrealistic in practice¹³⁰ and then predicting what might happen in this scenario. In this case, it would arguably be difficult to show that either EQC or Fletchers was taking advantage of their market power. Even if this could be considered arguable, the final step in a s 36 claim is to show that the person had acted with the purpose of satisfying (a), (b), or (c). While the Act allows a person to have more than one purpose, provided each purpose is substantial,¹³¹ the section does not include the wording "effect, or likely effect" seen in other Commerce Act sections. If it had, an argument that the Opt Out Policy and its subsequent revisions have had, or are likely to have, the effect, of satisfying (a), (b) or (c), might well succeed based on evidence of construction companies going out of business. Without this wording, the focus in s 36 is on purpose alone. EQC has explained, and the Commerce Commission has accepted in the Fix It complaint, that its purpose is to increase efficiency and

130 Since the Government considers that it has the responsibility of administering disaster insurance and levies payments from household insurance, it is unlikely that New Zealand would ever have two providers.

131 Commerce Act 1986, s 2(5)(b).

streamline repairs. Proving an additional purpose of eliminating Fletcher's competitors will be difficult.

In relation to a claim against Fletchers, it could be argued that a substantial purpose of influencing EQC to change the Opt Out Policy was to restrict competition, which would possibly be successful except for the problem of proving that it actually did influence EQC in re-writing the policies. Under the current understanding of s 36, therefore, a claim against EQC or Fletchers would be very difficult to establish.

Another possibly relevant section in the Commerce Act is s 27, which states:

... no person shall enter into a contract, or arrangement or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in the market.

The argument here might be that EQC and Fletchers entered into agreements in relation to either the CHRP or the Opt Out Policies, which resulted in a lessening of competition. Again, the application of this section might not be successful. While EQC and Fletchers did enter into a contract following the tender process, this would have contained reference to the first Opt Out Policy, and it is not this policy that is seen as being anti-competitive. It would be necessary to prove that there was a contract, arrangement or understanding in relation to the subsequent changes to the policy, and this will be difficult to prove. In addition, the requirement of a "substantial lessening of competition" is to be determined by applying the same counterfactual test discussed above. It is unlikely that a claim under s 27 would succeed, unless it could be shown that Fletchers influenced the policy changes.

In conclusion, while there is dissatisfaction with the CHRP and the Opt Out Policies, it does not appear that breaches of the Fair Trading Act or the Commerce Act can be established. Regardless of the legal position, however, the quantity and nature of the complaints suggests that placing one company as presumptive project manager is not necessarily an appropriate or effective way to organise a rebuild.

D. Looking Forward: Proposed Rental Caps

As stated above, the government initially refrained from interfering with the competitive market, even in the case of rental properties. This position has since been challenged by the other political parties. In March 2012, during a Parliamentary question and answer session, a NZ First MP asked whether the Minister for Earthquake Recovery considered it acceptable that rents in Christchurch were 50 per cent higher than reasonable market rents. The Minister responded that this claim did not appear to be supported by facts. Then-Labour MP for Christchurch East (now, Mayor of Christchurch)

Lianne Dalziel asked, “if we were able to produce evidence of significant price-gouging in the housing market in Christchurch, he would be willing to look at intervening in those instances?” The Minister responded that the Government was monitoring the situation.¹³² By June 2012, reports emerged of landlords asking for NZD 1,000 per week for modest houses, rental increases of 200 per cent, and one example of rent increasing from NZD 420 per week to NZD 960 per week.¹³³ More recently, in November 2013 NZ First referred to an example of a family hit with a NZD 100 rent increase as “irrefutable evidence that rent gouging is continuing” and that this “vindicating repeated calls from NZ First for a short term rent freeze in the city”.¹³⁴

In December 2013, the Human Rights Commission released a report entitled “Monitoring Human Rights in the Canterbury Earthquake Recovery”. One of its key recommendations was to “consider whether guidelines for rent control measures in the immediate aftermath of large-scale natural disasters should be developed and introduced.”

There are two reasons why this issue is being raised now. The first is the obvious frustration with the slow pace of the rebuild, which, three years on from the first earthquake, had only just passed the halfway stage. The second is the fact that data from the 2013 census began to be released in October 2013.¹³⁵ This provided comprehensive statistical data to support anecdotal evidence of increased rents and housing shortages.

It could be argued that the housing market is not working effectively, and that this warrants interference. However, some of the points discussed above in relation to price gouging remain relevant. First, a perspective that only considers one party (here, the tenant) is problematic. It is likely that these rent increases at least in part reflect increased costs imposed on landlords. Homeowners have noticed that insurance has increased substantially as a result of changes required by reinsurers.¹³⁶ In addition, EQC levies have increased from 5 c to 15 c per NZD 100 of cover, and Christchurch City Council rates increased by 6.5 per cent in July 2013, with similar increases planned for 2014 and 2015.¹³⁷ It was seen in the above discussion that if supermarkets could not increase prices to cover increased cost of supply they would not be incentivised to increase supply. In the same way, if landlords cannot recoup at least some of these increased costs by increasing rent, they

132 “Question and Answer” 21 March 2012, 678 NZPD 1143.

133 Liz McDonald “Rental Rises Called Obscene”, 29 June 2012 <www.stuff.co.nz>.

134 New Zealand First “More Evidence Of Rent Gouging In Christchurch” 21 Nov 2012, <nzfirst.org.nz>.

135 The Census was originally scheduled for 8 March 2011 but was delayed due to the national state of emergency following the 22 February 2011 earthquake. It was rescheduled to 8 March 2013.

136 Alanah Erickson “Insurance Shock As Costs Soar” 20 July 2013 <www.nzherald.co.nz>; Lawrence Watt, “Premium Hikes Hit All Cities” 2 October 2011 <www.nzherald.co.nz>, reporting an increase of 150 per cent.

137 Lois Cairns “Christchurch Rates Tipped To Rise 6.6%” 26 February 2013 <www.stuff.co.nz>.

will not be incentivised to continue offering property for rent. With property values in Christchurch rising 11.8 per cent from 2012 to 2013¹³⁸ selling the property becomes a valid option, resulting in decreasing properties available for rent. The second point is that issues with the housing market at this stage of the recovery are in large part due to the slow pace of the rebuild under the CHRP. The Government would be better served addressing this, rather than imposing rental caps.

International experience supports refraining from introducing a price freeze on housing. Milton Friedman and George Stigler, describing the 1906 San Francisco earthquake, remarked that despite 225,000 people being homeless and half of the housing being destroyed, the first San Francisco Chronicle published after the earthquake showed “not a single mention of a housing shortage!”¹³⁹ A study of advertisements in the Chronicle showed 1 person wanting to rent for every 10 offers for rent. The housing shortage was alleviated within 6 weeks. Forty years later, as people returned from the War, the population of San Francisco increased by almost a third, or 200,000 people. At this time price controls were imposed, and this resulted in a long housing shortage, which the Governor described as “the most critical problem facing California.”¹⁴⁰ A study of advertisements showed 375 people wanting to rent for every 10 offers for rent.

Friedman and Stigler concluded that the solution to the housing shortage was to be found in construction of new rental property, and that “It is an odd way to encourage new rental construction (that is, by becoming a landlord) by grudging enterprising builders an attractive return.”¹⁴¹ They doubted rent caps, described as rent ceilings would have a positive effect:¹⁴²

Rent ceilings cause haphazard and arbitrary allocation of space, inefficient use of space, retardation of new construction and indefinite continuance of rent ceilings, or subsidization of new construction and a future depression in residential building. Formal rationing by public authority would probably make matters still worse.

This comparison of different approaches to housing shortages in the same city, 40 years apart but affecting roughly the same amount of people, is useful in understanding how to respond to current calls for rental caps in Christchurch. The lesson remains the same as in other forms of price gouging.

138 Liz McDonald “Christchurch House Values Hit Record High” 7 November 2013 <www.stuff.co.nz>.

139 Milton Friedman and George Stigler “Roofs Or Ceilings? The Current Housing Problem” (1946) 1(2) *Popular Essays On Current Problems* 7, at 7 (emphasis in original).

140 At 8.

141 At 11.

142 At 21.

The most appropriate response is not price capping, but investigating strategies for the completion of the remaining 30,000 full repairs, a number which likely includes a large number of the 17,784 unoccupied dwellings in Christchurch according to the 2013 census. Having these houses available for occupation will increase supply, and likely cause rental prices to lower.

IV. CONCLUSION

This paper has considered the issue of price gouging following natural disasters and has suggested that experience indicates this is more a myth than a reality. While price increases may occur immediately post-disaster, these are generally the result of increased costs of supply or changing market conditions, and not of people seeking to profit from the disaster. Economic and ethical theories both provide persuasive arguments against enacting anti-price gouging legislation, and an examination of the application of US legislation post-disasters has shown this legislation to be unnecessary. This paper has suggested that a significant problem with buying into the price gouging myth is its influence on the rebuild strategy. The fear of price gouging in Christchurch fortunately did not lead to the enactment of specific price gouging legislation, but it did influence the development of the CHRP. While the tender process for presumptive project management appeared to indicate that it had learnt from issues of non-competitive bidding following Katrina, its overall cost to administer is at the high end of reasonableness, and is likely to exceed a reasonable cost by completion. Subsequent changes to the Opt Out Policy have led to frustration and anger from a significant proportion of Cantabrians, and has resulted in a claim of unfair business practices to the Commerce Commission. While this claim was dismissed, arguably correctly, this shows a real feeling of dissatisfaction with the chosen rebuild strategy and the government's intervention in the market. This frustration, coupled with the fact that three years on, the progress of the rebuild had only just reached the half way mark, has resulted in a perceived housing shortage in Christchurch, and increasing calls for further legislative interference to impose price caps in the rental market. A belief in the price gouging myth in one market has therefore arguably fed into the myth in other markets. Concern, particularly unfounded concern, about short term price gouging has had long term implications. The message to be learnt from Chile, Japan, and the 1906 San Francisco Earthquake appears to be to ignore the disaster myths, to trust that the market will correct itself, and to rely on existing laws and the power of the media to deal with any contractual or unfair trade practices issues. Any legislative interference, in the words of Friedman and Stigler, "involves still worse evils".