VERTICAL RESTRAINTS
IN THE DISTRIBUTION PROCESS
UNDER NEW ZEALAND
COMPETITION LAW

By

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B.Com., University of Auckland, 1985
LLB (Hons.), University of Auckland, 1986

A THESIS SUBMITTED IN PARTIAL FULLFILMENT OF
THE REQUIREMENTS FOR THE DEGREE OF
MASTER OF LAWS

in

THE FACULTY OF GRADUATE STUDIES
(Law)

We accept this thesis as conforming
to the required standard

THE UNIVERSITY OF BRITISH COLUMBIA

October 1989

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Date October 12, 1989

DE-6 (2/88)
ABSTRACT

The law relating to vertical restraints in the distribution process has sparked probably more controversy than any other area of competition law over the last 20 years. The debate has been fought out most fiercely between economists of various ideological schools invoking arguments of the importance of economic efficiency versus the need to protect small businesses and the freedom of sellers to choose their own methods of distribution. This has generated an extensive body of literature particularly in the United States. Surprisingly little however has been written in Australia or New Zealand on this subject. This thesis attempts to fill the void, although, in so doing, it does not seek to delve into the technical and complex aspects of law and economics in this area. Rather, it seeks merely to raise the basic issues in the New Zealand context from which base a more sophisticated study can subsequently be undertaken.

By way of introduction, the nature of vertical restraints in the distribution process are described and some background is provided to the areas of debate. The thesis then breaks up into two parts to examine the current state of the law in the United States, Canada, Australia and New Zealand in respect of, first, vertical price restraints and, second, vertical non-price restraints. Where appropriate, a comparative analysis is made to shed light on the interpretation of key words and phrases in the New Zealand legislation.

In respect of each type of restraint, the basic economic issues involved are then canvassed, given the strategic role which economics plays in understanding
why vertical restraints are imposed and their competitive effects. Thereafter, various legal and policy issues are discussed to assist in deciding upon the appropriate legal treatment of each type of restraint. Finally, an attempt is made to provide an analytically coherent framework within which to judge vertical restraints in the context of present competition policy.

The conclusions reached call into question the present total prohibition against resale price maintenance in New Zealand and advocate the need for more specific provisions regarding both price and non-price vertical restraints. In particular, it is suggested that a rule of per se illegality should only operate for conduct which attempts to fix, maintain or control the price at which products are resold, while a structured rule of reason should operate for all other types of vertical restraints based on a market power test administered in accordance with guidelines promulgated by the Commerce Commission.
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ACKNOWLEDGEMENT

I am very grateful for the support of family and friends throughout the writing of this thesis as well as the valuable comments provided by Professor W.T. Stanbury on the initial draft, particularly in regard to economic issues and the current state of the law in Canada. The usual absolution for any error or omission applies. Special thanks go to Rosemarie Page for her patience and diligence during the typing of this lengthy piece of work.
PART I

INTRODUCTION
A. OVERVIEW

Depending upon a number of economic factors such as the basic character of a product, availability of management and capital, risk and most importantly cost, a supplier will often decide to employ independent distributors to carry out the various functions in the distribution process\(^1\) rather than to operate the entire distribution process itself. In the contractual arrangements between the parties, it is not uncommon to find a variety of restraints aimed at achieving some measure of supervision and control over the manner in which the suppliers' products are marketed and distributed to the consuming public. A supplier has a legitimate interest in so doing because its reputation for quality, its established goodwill and its general competitive position are all clearly dependent upon the methods utilized by its distributors. Restraints imposed upon a firm operating at one level of the distribution process by a firm operating at another level of the distribution process, such as a supplier upon a distributor, are referred to as 'vertical restraints' and are to be distinguished from 'horizontal restraints' which are restraints between

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\(^1\) The distribution process is essentially the 'conduit' through which products flow from a supplier to the ultimate consumer. A supplier obviously commences the process by placing its products in the flow of commerce. A wholesaler usually supplies warehousing facilities as well as a network of local and regional transportation services that deliver the products to retailers. The retailer in turn is responsible for marketing and sale of the products. To simplify the discussion, it will be assumed that the distribution process only involves two tiers.
firms operating at the same level of the distribution process. The concern in this thesis is with vertical restraints only.

Vertical restraints can be classified into two categories. In the first category are restraints which restrict the distribution of a product and include:

(a) resale price maintenance (restrictions on the price at which products may be resold);

(b) territorial restrictions (restrictions on the territories within which products may be resold); and

(c) customer restrictions (restrictions on the customers to whom products may be resold).

In the second category are those restraints which limit a distributor's freedom to buy from firms that compete with the supplier and include:

(a) tying arrangements (arrangements whereby the purchase of one product is conditioned upon the purchase of a second product from the supplier or from some third party);

---

2 In the case of a dual distribution system, where a supplier also functions at the same level of the distribution process as a distributor upon which it has imposed restraints, the general view is that the system should be viewed as vertical rather than horizontal. See ABA Antitrust Section, Monograph No. 2, Vertical Restrictions Limiting Intrabrand Competition (1977) at 2 n.3 (hereinafter cited as "ABA Monograph No. 2"). See also Donald B. Rice Tire v. Michelin Tire Corp., 483 F. Supp. 750,754 (D.Md. 1980) and Red Diamond Supply Inc. v. Liquid Carbonic Corp., 637 F.2d. 1001 (5th Cir. 1981).
(b) exclusive dealing arrangements (arrangements whereby a distributor agrees not to purchase the products of a competing supplier); and

(c) requirements contracts (contracts under which a distributor agrees to purchase all or some fixed proportion of its requirements from the supplier).

While both categories of restraints are often considered together, they are conceptually different. Vertical restraints in the first category are essentially designed to limit competition between a supplier's distributors. Vertical restraints in the second category on the other hand are essentially designed to foreclose or exclude a supplier's rivals. This thesis focuses on restraints in the first category only.

Within the category under review, a distinction is normally drawn between price and non-price restraints. Price restraints, which will be considered in Part II, are those which directly or indirectly dictate the price or range of prices at which products may be sold or resold, while non-price restraints, which will be considered in Part III, do not directly or indirectly dictate prices.

It is proposed in respect of each type of restraint to first describe the nature of the restraint and its typical business application and justifications, then to discuss the legal status of the restraint in the United States, Canada, Australia and New Zealand, and finally to evaluate the law (a) by discussing the various

---

economic theories advanced to explain the restraint and its effects and (b) by analyzing particular legal and policy issues relating thereto. An understanding of each of the competing economic theories is considered important to help determine an appropriate policy position. A review of the current legal position in other jurisdictions is considered important because of the paucity of cases in New Zealand in this area and to help delineate appropriate guidelines for the treatment of vertical restraints in the distribution process under New Zealand competition law. The primary focus will however be on the law as it applies in New Zealand, although heavy reliance will be placed on Australian precedents in view of the similarity of equivalent provisions in the Australian legislation.

In the balance of this introduction, reference will be made to the types of business relationships in which the restraints under discussion arise, there will follow a brief discussion as to why competition law is relevant in this context with a brief mention of the more important provisions of New Zealand's competition legislation, the basic rules of analysis utilized in examining vertical restraints will then be described, the increasing application of economic theory in considering vertical restraints will be noted and finally there will be a brief outline of present competition policy in this area.

B. BUSINESS RELATIONSHIPS

The business relationships in which vertical restraints in the distribution process are imposed cover a wide variety of contractual arrangements. At one extreme, a supplier may simply provide products for resale purposes to a distributor and will receive its income by way of a markup on products sold. At the other extreme is the 'turn-key' franchise in which the franchisor licences its tradename and trademark, imparts, in confidence, its knowhow, and on a
continuing basis, provides guidance and direction on the precise manner in which it wants the franchisee to carry out its operations. The franchisor in this case may derive its income from a combination of an upfront payment, royalties and ongoing management and administration fees. The term "distribution arrangement" where used throughout this thesis is intended to cover the whole spectrum of business relationships where such restraints arise including franchises, licences, commission agency, and wholesale and retail distribution. The term "supplier" will hereafter be used to refer to entities at the first level of the distribution process such as franchisors, licensors, manufacturers and suppliers, while the term "distributor" will hereafter be used to refer to those entities authorized by the supplier to distribute its products and operating at the second level of the distribution process such as franchisees, licensees, dealers and distributors.

C. RELEVANCE OF COMPETITION LAW AND THE COMMERCE ACT 1986

The imposition of a restraint by a supplier upon a distributor will almost always have some effect on competition, whether it be intrabrand or interbrand. The detrimental effects to intrabrand competition which invariably result from such imposition will often outweigh any beneficial effects to interbrand competition resulting from the restraint and it is for this reason that competition law is relevant.

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4 Intrabrand competition involves competition between distributors selling different brands of the same product whereas interbrand competition involves competition between distributors selling different brands of the same product.
The underlying policy of all competition and antitrust laws\(^5\) is the preservation and promotion of competition. New Zealand is no exception in this regard. The Commerce Act 1986 (hereafter referred to as "the Act" or "the New Zealand Act" as appropriate)\(^6\) has as its underlying objective the promotion and regulation of competition in markets in New Zealand.\(^7\) To meet this objective, the Act, inter alia, proscribes, either specifically or generally, various restrictive trade practices which have an adverse effect on competition.

In particular, section 27 prohibits entry into a contract or arrangement or the arrival at an understanding containing a provision which has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market. Section 36 contrasts with section 27 by being aimed at purely unilateral practices in prohibiting any person who has a dominant position in a market from using that position for one of a number of proscribed purposes. Section 58 empowers the Commerce Commission ("the Commission"), the regulatory body under the Act with responsibility for investigation, enforcement and decision making of relevant matters, to authorize the entry into and performance of contracts,

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\(^5\) The term "antitrust law" is the American equivalent for the term "competition law". The two terms are used interchangeably throughout this thesis depending on the context.

\(^6\) The Act is the product of the Australia-New Zealand Closer Economic Relations Trade Agreement entered into between the two countries in 1983 under which both undertook to work towards the harmonization of their respective laws on restrictive trade practices (Article 12). This commitment to harmonization was most recently affirmed in the Australia-New Zealand Memorandum of Understanding on Harmonisation of Business Law dated 1 July 1988. The New Zealand Act, as will become apparent, is largely modelled on Parts IV and VIII of the Australian Trade Practices Act 1974 (Cth).

\(^7\) The Long Title states that it is "[a]n Act to promote competition in New Zealand".
arrangements or understandings to which section 27, inter alia, applies. Importantly, there is no power to authorize conduct in breach of section 36. The effect of an authorization granted under section 58 is that potential liability for pecuniary penalties (section 80), injunctions (section 81) and actions for damages (section 82) is removed.

D. RULES OF ANALYSIS

In evaluating the legality of vertical restraints, the courts, particularly in the United States, have traditionally adopted either a per se or rule of reason analysis and it is important to appreciate the effect and meaning of each.

Under a per se analysis, a restraint is held to be illegal without any consideration of the purpose of the restraint or its economic effects on the ground that it almost invariably harms competition through higher prices and reduced output without any redeeming pro-competitive benefits. All that is necessary is to prove the existence of the restraint. The appropriateness of and need for per se rules was explained by Mr. Justice Black in *Northern Pacific Railway v. United States* as follows:

[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without inquiry as to the elaborate harm they have caused or the business excuse for

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8 The only protection which a person has from the application of section 36 is if it is party to a contract, arrangement or understanding which has otherwise been authorized pursuant to Part V of the Act. However there would seem to be relatively few cases where authorization will be granted on this basis.

9 356 U.S. 1,5 (1958).
their use. This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to everyone concerned but it also avoids the necessity of an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable - an inquiry so often fruitless when undertaken.

The avoidance of an inquiry into the actual competitive effects of a challenged restraint deemed illegal on its face, means, in particular, that a court does not need to examine a supplier's market power, nor define the market nor evaluate any asserted benefits of the restraint. A per se rule therefore provides several advantages including predictability of legal rules, provision of a brightline deterrent to undesirable conduct and reduced judicial and enforcement costs.10

In contrast, a rule of reason analysis is far more complex requiring a full consideration of the justifications for and economic effects of the restraint including an inquiry into the history of the industry, the parties' intent, competitive benefits and harms of the restraint, definition of the market, determination of market power and so on. Whether a restraint is illegal therefore involves a weighing up of all the circumstances of a case. The classic formulation of the rule of reason was provided by Mr. Justice Brandeis in Chicago Board of Trade v. United States, where he said:11

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition, or whether it is such as may suppress or even destroy competition. To determine that question the Court must ordinarily consider the facts peculiar to the business to

10 See generally, ABA Monograph No. 2, supra note 2 at 25-32.

11 246 U.S. 231, 238 (1918).
which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint; and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained are relevant facts. This is not because a good intention will serve an otherwise objectionable regulation or the reverse, but because knowledge of intent may help the Court to interpret facts and to predict consequences.

The tests applied under the general rubric of the rule of reason have varied considerably to the extent that the distinction between the per se rule and the rule of reason has become very much blurred. The distinction is however of assistance in understanding the United States cases on vertical restraints and the problems faced in that country of having to construe virtually every restraint, whether it be horizontal or vertical, in terms of section 1 of the Sherman Act. The per se rule appears to have been a convenient alternative for those courts unwilling to develop an analytic structure for evaluating the economic effects of a particular restraint on competition under a rule of reason analysis. This unwillingness, and even distrust of economic theory, as a basis of legal rule making has been nowhere more evident than in cases dealing with vertical restraints, particularly those decided by the United States Supreme Court over the last 25 years.

E. INTEGRATION OF ECONOMIC THEORY INTO COMPETITION LAW

Judicial reluctance to apply economic theory, at least until recent times, was probably justified in view of the lack of consensus amongst economists as to the economic effects of most vertical restraints. It is fair to say that economists are no closer to agreement today; indeed they are probably more divided in their views

than they were twenty years ago. What is notable however is the increased sophistication in scholarship over this period as economists have sought to integrate economic theory into the area of competition law.\textsuperscript{13}

The increased emphasis on economics in antitrust analysis has been led by members of the so-called 'Chicago School', in particular Professors (now Judges) Bork\textsuperscript{14} and Posner\textsuperscript{15}. The Chicago School, using price theory analysis, emphasize economic efficiency (both allocative and productive).\textsuperscript{16} Conduct is classified according to whether it is (1) efficient; (2) inefficient; or (3) neutral. It is argued that the law should refrain from intervening not only when conduct is efficient or neutral, but also when the effects of such conduct can not be predicted sufficiently.\textsuperscript{17} The test used for determining efficiency is the effect of a restraint on output. If output increases as the result of a restraint, the restraint is assumed to have made the product more attractive to consumers and therefore produced a

\textsuperscript{13} For a review of the basic principles of economic theory which bear directly on competition policy, see Gellhorn, \textit{supra} note 3 at 45-90.


\textsuperscript{16} "Allocative efficiency refers to the placement of resources in the economy, the question of whether resources are employed in tasks where consumers value their output most. Productive efficiency refers to the effective use of resources by particular firms". R. Bork, \textit{supra} note 14 at 91. See also E. Fox, "The Modernization of Antitrust: A New Equilibrium", 66 Cornell L. Rev. 1140 (1981) at 1160-61.

positive influence on competition and consumer welfare.\textsuperscript{18} With the maximization of consumer welfare as the basic goal of antitrust, this is best achieved, it is argued, if the marketplace is free from governmental and monopolistic output restrictions. A monopolistic market is seen as particularly detrimental to consumer welfare because of the ability of the monopolist to increase prices and restrict output. Previously accepted social and political values, like protection of small traders and deconcentration of markets, which characterized the late 1950's and 1960's\textsuperscript{19}, are rejected.

Thus, their primary concern is horizontal collusion which is seen as the principal means by which the output of goods and services can be restricted and prices raised. Bork for instance argues that antitrust enforcement should be limited to horizontal price fixing and market division, horizontal mergers resulting in the acquisition of substantial market shares, and deliberate predation engaged in

\begin{footnote}
\textsuperscript{18} The term "consumer welfare" in this context should not be confused with the concept of "social welfare", although the two are often equated by the Chicago School. Here consumer welfare is defined in terms of efficiency, either static or dynamic depending upon the time frame. (Static analysis looks to optimal price/output configurations (Pareto optimality) in determining whether allocative efficiency exists in the short run. Dynamic analysis takes into account new technology, knowledge and tastes in determining efficiency over the long run). Social welfare on the other hand is concerned not only with efficiency, but the distribution of income. The maximization of consumer welfare will therefore not necessarily lead to a maximization of social welfare. One must accordingly distinguish economic welfare from social welfare.

\textsuperscript{19} Economic theory during this time coincided with political and social attitudes that favoured diffusion of market power, freedom of opportunity for individual traders and freedom of consumer choice. Notions of allocative and productive efficiency were notable by their absence. See Hawk, supra note 12 at 287-88.
\end{footnote}
to eliminate rivals from a market or at least delay their entry.\textsuperscript{20} Vertical restraints on the other hand are seen as almost always beneficial to the consumer, and therefore adherents of the Chicago School argue that such restraints should be completely lawful. Bork for instance argues that antitrust laws should not concern themselves with vertical price maintenance and market division, tying arrangements, exclusive dealing and requirements contracts.\textsuperscript{21} Posner, in a similar vein, proposes that purely vertical restraints involving no dealer collusion should be per se legal whether they be price or non-price in nature.\textsuperscript{22}

Newer members of the Chicago School continue to espouse similar views. The leading proponent in more recent times has been Professor (now also Judge) Easterbrook who in seeing the goal of antitrust law as the facilitation of efficient resource allocation argues that the free market disciplines inefficient firms and corrects monopoly faster and better than judicial intervention, and that the costs of erroneously banning efficient transactions are greater than the costs of erroneously blessing anticompetitive transactions.\textsuperscript{23} As a result, Easterbrook argues, the traditional techniques of antitrust analysis should be replaced with a


\textsuperscript{21} Bork, \textit{supra} note 14 at 406.


filter approach whereby conduct is screened out only if it is likely to reduce output and increase price.\textsuperscript{24}

The efficiency approach to antitrust analysis has not however been confined to the Chicago School. The Harvard School, although at one time perceived to be diametrically opposed to their Chicago counterparts, has also begun to see economic efficiency as the primary goal of antitrust with consumers as intended beneficiaries of such laws. The inability of smaller firms to survive in the competitive process is said to be justified if it is in the interests of efficiency. Harvard School advocates also counsel a more permissive treatment of vertical restraints, although they do not go so far as their Chicago School counterparts in regard to vertical price restraints.\textsuperscript{25}

Others, like Professor Williamson, also take a more tempered approach.\textsuperscript{26} Using a transaction cost model, not only are the efficiency gains arising from vertical restraints assessed, but the strategic purposes and effects that accompany such restraints are also evaluated. Williamson suggests that vertical restraints should be presumed to be efficiency-enhancing unless the industry has certain structural characteristics such as a dominant firm or a tight oligopoly. If such characteristics are present, then vertical restraints should be subject to close scrutiny to determine whether the restraints create barriers to entry, regularize

\textsuperscript{24} Easterbrook, \textit{id.} at 39.

\textsuperscript{25} See 3 P. Areeda and D. Turner, \textit{Antitrust Law} (Boston, Little, Brown & Co., 1976) and Fox, \textit{supra} note 16 at 1177.

trade or promote greater interdependence. Williamson argues that a firm in such a situation should not be charged with or found to have committed an antitrust violation if it can be affirmatively shown that "non-trivial" transaction cost economies are created by the vertical restraint under scrutiny.

These developments in economic theory have had a profound effect on judicial pronouncements in the United States, particularly in the area of vertical restraints. The first major decision to demonstrate a genuine willingness to consider economic efficiency in the vertical restraints area was undoubtedly Continental T.V. Inc. v. GTE Sylvania. In that case, decided in 1977, the Supreme Court expressly relied on the writings of the Chicago School commentators in holding that vertical non-price restraints should generally be subject to the rule of reason. In so doing, the Court reversed the per se rule laid down in United States v. Arnold Schwinn & Co., decided ten years earlier. Justice Powell, who gave the opinion of the majority in Sylvania, dismissed the entire "populist" tradition in a single sentence, often regarded since as the case's "critical" holding. He said:

Competitive economics have social and political as well as economic advantages ... but an antitrust policy divorced from market considerations would lack any objective benchmarks.


28 388 U.S. 365 (1967). This case, and Sylvania, will be discussed in more detail in Part III infra.

While Sylvania's discussion of the economics of vertical restraints was not particularly sophisticated by current standards, it signalled an entirely new direction in antitrust jurisprudence, one that has flourished since. Later courts have shown an increased willingness to apply the free market theories of the efficiency approach to a wide variety of vertical and horizontal circumstances.30

The early 1980's also witnessed a reversal of enforcement policy by the Antitrust Division of the U.S. Justice Department. During this time it prepared a number of amicus curiae briefs which favoured a more permissive treatment of vertical price restraints31 and in 1984 it issued Vertical Restraint Guidelines32 which were quite tolerant of vertical non-price restraints.

There has however been a reaction on both political and economic grounds to the so-called 'new-learning' of the 1970's. Critics argue that the Chicago School's exclusive emphasis on efficiency considerations is an inappropriate


31 See e.g. Amicus brief filed in Monsanto Co. v. Spray-Rite Service Corp., 104 S.Ct. 1464 (1984).

32 1985 Trade Reg. Rep.l (CCH) No. 687, Pt II. The Vertical Restraints Guidelines have been the subject of much criticism with the National Association of Attorneys General issuing their own Guidelines which take a much stricter approach to vertical restraints. For a discussion of both sets of Guidelines, see Part III C(2)(e) infra.
political and non-economic judgement. Some, like Professor Fox, still conceive of efficiency as the major guide to antitrust policy, but believe antitrust law should function to protect the competition process and advance consumer interests. Per se illegality, in her view, should be retained where (1) it is difficult to distinguish between restraints that are anticompetitive and threaten harm to consumers, and those that are neutral or potentially beneficial; (2) it is important to prohibit and effectively deter harmful restraints; and (3) there is little likelihood of loss to buyers of the product in question from overdeterrence.

Others advocate a more multi-valued approach to antitrust and therefore would condemn virtually all horizontal and vertical activity as per se illegal on the basis of predictability and deterrence. According to these critics, the Chicago School approach is too static and unduly assumes information symmetries. It is said that the traditional price theory that underlies much of the Chicago School analysis may underestimate the dynamic aspects of many business practices.

What has been the effect on New Zealand competition law of the Chicago School 'new learning' and the possible counter revolution of the so-called 'nouvelle vogue'? There has been some effect in the sense that the Commission and the Courts are increasingly facing arguments and asserted justifications resting on


34 Fox, supra note 16 at 1185.

35 See e.g. L. Sullivan, Antitrust Law, (St. Paul, Minn.,West Publishing Co., 1977). See also Fox supra note 16 at 1184.

36 See Hawk, supra note 12 at 289-90.
Chicago School analysis and efficiency considerations. More importantly, principles enunciated in decisions made by the Commission and the writings of some of its members reflect the influence of the developments in the United States over the past two decades. The revolution in United States law is however unlikely to be duplicated in New Zealand because of fundamental differences in policy and legislation. Any lead in embracing Chicago School principles would most likely have to come from Australia to whom New Zealand has generally looked for guidance in the past.

F. PRESENT COMPETITION POLICY

The present policy position, gained from Australian experience is to view competition as a process of rivalry between firms. This presupposes that a market should be both flexible and adaptable to changing desires and needs so as to allow dynamic interaction between firms. The assumption made is that the rivalrous interaction of firms in free and open markets which protects access and opportunity for firms without market power is likely to produce the best result for consumers in terms of resource allocation, efficiency and progressiveness. Indeed, the concern should be with determining whether or not the rivalry between


38 Fox, supra note 16 at 1179.

39 Id. at 1158. See also Tru Tone Ltd. et al. v. Festival Records Retail Marketing Ltd. (Unreported judgement, CA 85/88, 19 September 1988) ["The Act] is based on the premise that society’s resources are best allocated in a competitive environment where rivalry between firms ensures maximum efficiency in the use of resources"] and Statement of Hon. David Caygill, Minister of Trade and Industry in introducing the Commerce Bill to Parliament (Hansard, 11 June 1985).
firms goes beyond what is competitive so as to be unacceptable in the interests of society in terms of efficiency and economic growth. In this regard, the focus should be on keeping barriers to entry low so as to provide greater opportunity for entry and success of new firms in the market. Competition does not require that there be a large number of supplying firms or equivalently low rates of market concentration so long as there is actual and effective potential competition.

The Commission has recognized that a restriction in rivalry between two competitors or upon an individual competitor does not necessarily result in a restriction in rivalry. Indeed, it is fallacy to suggest that the competition test in the Act is concerned with the fate of individual competitors as opposed to the level of rivalrous behaviour in a market. For, as Fitzgerald J. said in Outboard Marine Australia v. Hecar Investments (No. 6) Pty Ltd., a case concerning a refusal by Outboard Marine to supply Hecar with outboard motors and thus alleged to constitute exclusive dealing under section 47 of the Australian Trade Practices Act 1974 (Cth),

It would, I think, be an unusual and exceptional case in which it could be shown that competition in a generally competitive market was or was likely to be substantially lessened by a refusal to supply one of a number of competitive retailers in the market with a product otherwise freely available and competitively marketed. Further, where there is a market which is generally competitive, it plainly does not follow that conduct which affects the balance of competition by advantaging or disadvantaging a particular dealer or dealers or a particular product necessarily lessens the competition in a market.


One must thus distinguish between the impact of conduct upon the competitive position of an individual and the effect upon competition in a market. It is the market context rather than the affairs of individual participants which must necessarily be taken into account.

It is well beyond the scope of this introduction or indeed this thesis to discuss the concept of competition in any detail and its role in serving economic, social and political goals. While economic efficiency is without doubt one of the more important of the Act’s underlying objectives, it is hoped that it does not reach the normative weight ascribed to it by the Chicago School in future competition policy. Both efficiency and economics generally have a role to play in any competition law analysis but their limitations must be recognized. Efficiency should be one of a number of goals pursued in order to serve consumer interests and make the best use of society’s resources.42

42 Fox, supra note 16 at 1158.
PART II

VERTICAL PRICE RESTRAINTS
A. GENERAL

The most typical vertical price restraint is resale price maintenance ("RPM") otherwise known as vertical price fixing. RPM basically involves a stipulation by a supplier of the price at which a distributor may resell its products. The stipulation may be 'direct' in the sense that the stipulation relates to the price at which the immediate distributor may resell its products, or it may be indirect in the sense that the stipulation relates to the price which a third person may resell its products. In its most usual form, a supplier will stipulate as a condition of the supply of its products that the distributor not sell below some minimum price. However the stipulation may equally be that the products not be sold above some maximum price or that price be determined by reference to some formula.

The practice has attractions for both suppliers and distributors, although different interests are often at play. For the supplier, the primary motivation is normally to ensure resale price stability in relation to its products, particularly in a dual-distribution situation. Thus the supplier may wish to ensure that its products are not priced by the distributor above the range for which they were intended, thereby increasing the distributor's margin and decreasing its sales. Conversely, the supplier may wish to prevent its products being specialised or sold as loss-leaders since this will disrupt orderly pricing and might even lead to a loss of reputation thereby detrimentally affecting goodwill and future sales. A supplier may even have an interest in price stability on the grounds that it promotes goodwill amongst its distributors. If one distributor is regularly selling at prices below those stipulated and consequently taking business away from those distributors who do not, it is likely that pressure will be brought to bear by these other distributors to bring the recalcitrant distributor into line. If the supplier
does not take appropriate action such as refusing to supply the recalcitrant distributor on terminating its distributorship, then it may well be that the remaining distributors cease to promote the supplier's products as vigorously as before or even cease to purchase at all. (Other, more subtle means include failing to renew a distributorship without giving any reasons therefor, granting discounts to those distributors who do adhere to stipulated prices and inducing third parties to boycott those who do not adhere). Still further, the supplier may wish to adopt a pricing policy which provides an incentive for its distributors to engage in increased promotion and point of sale servicing. It will seek to do this by establishing an adequate margin between the wholesale and the retail price, such that its distributors can engage in a certain level of non-price competition. From the point of view of distributors, it protects them from price competition and thus provides a more stable market.¹

The stability provided by RPM has however generally been seen to have adverse effects on the consumer through the elimination of price competition, the limitation on more efficient methods of distribution and generally higher prices. It is for this reason that most jurisdictions have prohibited the practice of RPM as will become clear in the next section.²


² Resale price restraints were comparatively uncommon until the latter part of the 19th century and the common law background of RPM is therefore somewhat obscure. There appears to be no reported English case on the subject prior to 1901. In that year, in Elliman v. Carrington [1901] 2 Ch. 275, an agreement whereby a dealer bound itself not to sell goods for less than specified prices was upheld, while in 1915, in Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge [1915] AC 798, an agreement where the supplier could, at its discretion, vary the minimum price was upheld. See generally, Donald & Heydon, supra note 1 at 359-61.
B. CURRENT STATE OF THE LAW

(1) United States

RPM was first held to be illegal per se in the United States in 1911. In that year, the Supreme Court in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*[^3] held that an agreement between a manufacturer of patent medicines and its dealers to maintain a minimum resale price violated section 1 of the Sherman Act.[^4] That section in material part declares every contract, combination or conspiracy in restraint of trade to be illegal. In regard to section 1, the Court ruled that a manufacturer is not entitled to restrict the resale of its products through interference with a purchaser's pricing decisions. The Court equated the effects of RPM with horizontal price fixing between dealers and rejected Dr. Miles' argument that minimum resale prices were necessary to protect it from price cutting which would erode its dealer organization. The Court did not however provide any real explanation why eliminating price competition between a manufacturer's dealers almost always constituted an unreasonable restraint of trade and thus must be condemned as per se illegal, other than that "agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices are injurious to the public interest and void".[^5]

[^3]: 220 U.S. 373 (1911).

[^4]: While most resale price arrangements in the United States have been held illegal under section 1 of the Sherman Act, section 2 of that Act and section 5 of the Federal Trade Commission Act have been used to similar effect. See e.g. *FTC v. Beech Nut Packaging Co.* 257 U.S. 441 (1922).

[^5]: 220 U.S. at 408.
In *United States v. Colgate & Co.*\(^6\) decided eight years after *Dr. Miles*, the Supreme Court faced the issue of whether Colgate had exercised a lawful unilateral right to refuse to deal with price-cutters. Unlike in *Dr. Miles*, there was no agreement between Colgate and its distributors obliging the latter to sell above a minimum price. The Supreme Court held that there was no violation of section 1 of the Sherman Act and, in the process, stated that the Sherman Act "does not restrict the long-recognized right of [a] trader or manufacturer engaged in an entirely private business freely to exercise [its] own independent discretion as to the parties with whom [it] will deal".\(^7\) According to the Court, unilateral RPM by manufacturers was permissible and therefore a manufacturer was entitled to announce its resale prices in advance and secure adherence by refusing to deal with those who failed to comply. While the reasoning of the Court was consistent with the basic requirements of section 1 that there be a "contract, combination or conspiracy" in restraint of trade, the treatment of RPM involving an agreement on the one hand and unilateral rpm on the other was obviously at odds.\(^8\)

The narrowness of the *Colgate* decision was demonstrated some years later in *United States v. Parke, Davis & Co.*\(^9\) where it was found that the actions of Parke, Davis went well beyond what was permitted by *Colgate*, namely to allow a manufacturer to maintain resale prices through unilateral refusals to deal with

\(^6\) 250 U.S. 300 (1919).

\(^7\) Id. at 307.


non-complying distributors. Parke, Davis was found to have solicited retailers' assistance in reporting discounts by other retail druggists, assured retailers that their competitors would maintain prices if they would do likewise, induced wholesalers to refuse to deal with retail druggists at discounts and permitted druggists who had been cut off for discounting to repurchase its products after exacting assurances that discounting would not take place in the future. The Court stated:

When the manufacturer's actions, as here, go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices ... he has put together a combination in violation of the Sherman Act.

In 1968, the Supreme Court in *Albrecht v. Herald Co.* extended the per se rule against RPM to encompass vertical agreements aimed at establishing maximum resale prices. In this case the defendant newspaper was held to have violated section 1 by refusing to sell to the plaintiff distributor after the latter had resold papers to customers at more than the suggested retail price. The Court recognized that maximum and minimum price fixing may have different consequences in many situations but stressed that "schemes to fix maximum prices, by substituting the perhaps erroneous judgement of a seller for the forces of the competitive

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10 ABA Antitrust Section, Monograph No.2, *Vertical Restraints Limiting Intrabrand Competition* (1977) at 73 (hereinafter cited as "ABA Monograph No.2").

11 362 U.S. at 44.

12 390 U.S. 144 (1968).
market, may severely intrude upon the ability of buyers to compete and survive in that market."^{13}

Movements to permit exemptions to the per se rule resulted in the passage of the Miller-Tydings Act in 1937 and the McGuire Act in 1952 which allowed States to enact so-called "fair trade" laws authorizing suppliers to establish minimum or stipulated resale prices for branded products if the products were "in free and open competition with other products of the same general class". Most States passed fair trade laws and, as a result, a large number of suppliers practised RPM as fair trade.\(^{14}\) In the 1970's, a number of States repealed their fair trade laws and, after a debate which had lasted for quite a number of years, the Consumer Goods Pricing Act of 1975 was enacted repealing the Miller-Tydings and McGuire Acts, effective March 11, 1976, and thereby re-establishing the status of RPM as a per se violation of section 1.

The re-establishment of the per se treatment of RPM and the subsequent holding of the Supreme Court in *Continental T.V. Inc. v. GTE Sylvania Inc.* that restrictions on the territories within which a distributor may sell or the customers with which it may deal were to be judged according to a rule of reason standard resulted in an inconsistency in United States law on vertical restraints. The majority in *Sylvania* specifically refused to reconsider the treatment of RPM, reasoning that the illegality of price restrictions had been established firmly for

\(^{13}\) *Id.* at 152.

\(^{14}\) The Miller-Tydings Act only applied to suppliers and distributors who were parties to actual agreements and therefore a supplier could not bind a distributor who had not signed a "fair trade" agreement. D. Marks and J. Jacobson, "Price Fixing: An Overview", 30 Antitrust Bull. 199 (1985) at 230-31.
many years and involved significantly different questions of analysis and policy.\textsuperscript{15} The more permissive treatment of non-price vertical restraints led a number of commentators to suggest that the economic basis for a per se treatment of RPM justified a reconsideration.\textsuperscript{16} The Antitrust Division of the United States Department of Justice under the direction of William Baxter added support to their cause by filing a number of amicus curiae briefs in 1981-83 urging the courts to reassess the per se ruling on RPM. The most significant of these briefs was that in support of Monsanto's petition for certiorari from the decision of the Seventh Circuit in \textit{Spray-Rite Service Corp. v. Monsanto Co.}.\textsuperscript{17} The brief urged the Supreme Court to reconsider and ultimately overturn the per se rule in \textit{Dr. Miles}.\textsuperscript{18} The Court chose not to do so but instead to clarify the application of the rule in that case.\textsuperscript{19}

\textsuperscript{15} 433 U.S. at 51 n.18. In a concurring opinion however, Mr. Justice White suggested that "the effect, if not the intention of the Supreme Court's opinion is necessarily to call into question the firmly established per se rule against price restraints." 433 U.S. at 70.


\textsuperscript{17} 684 F.2d 1226 (7th Cir. 1982).

\textsuperscript{18} \textit{Brief of the U.S. Department of Justice, Monsanto Co. v. Spray-Rite Service Corp.} No. 82-914, 1983. The Brief stated, inter alia, "There is no sound basis for assuming ... that resale price maintenance is so invariably anti-competitive as to justify per se condemnation ... The logic of \textit{Sylvania} compels the conclusion that resale price maintenance-like other vertical restrictions - is unsuitable for per se treatment." \textit{Id.} at 6 and 19.

The facts of Monsanto were that Monsanto had sold its herbicides under a distribution program where distributors were appointed for one-year terms renewable according to specified criteria, including full exploitation of the distributor's area of primary responsibility and adequate technical training for its sales representatives. Monsanto suggested resale prices to its distributors and took steps to assure that its suggestions were being followed. Spray-Rite, a known price-cutter, became the subject of numerous complaints lodged with Monsanto by its other distributors. When the time came for Monsanto to renew Spray-Rite's distributorship, Monsanto refused to do so. Spray-Rite brought suit alleging that Monsanto had stopped selling to it because it was cutting prices and that Monsanto was conspiring with other distributors to fix the resale prices of its herbicides. Monsanto denied the charges, alleging that the distributorship had been terminated for non-price reasons, specifically Spray-Rite's failure to use trained salesmen and adequately promote sales to distributors.

The Court held that a conspiracy may not be inferred merely from the termination of a distributor in response to complaints of price cutting from competing distributors. Rather, there must be direct or circumstantial evidence that "tends to exclude the possibility that the manufacturer and non-terminated distributors were acting independently" and that the supplier and the complaining distributor share "a conscious commitment to a common scheme designed to achieve an unlawful objective". In this regard, the Court specifically

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20 Id. at 1471.

21 Id. at 1473.
indicated that it wished to fortify the doctrines enunciated in *Colgate* and *Sylvania*. The Court stated:22

It is of considerable importance that independent action by the manufacturer and concerted action on non-price restrictions be distinguished from price-fixing agreements. If an inference of such an agreement may be drawn from highly ambiguous evidence, there is a considerable danger that doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded.

The Court also held that where there is proof of a vertical agreement between a supplier and one or more of its distributors, and proof that the termination of a distributor was "part of or pursuant to" the vertical agreement, the termination will be illegal if the vertical agreement is illegal.23 To prove a vertical conspiracy, the Court stated that there must be more than just "a showing that the distributor conformed" to the supplier's suggestions.24 There must be proof that the supplier sought "acquiescence or agreement" from the distributor, and proof that the distributor "communicated" its "acquiescence or agreement" to the supplier.25 Based on the facts, the Court found proof of a vertical conspiracy and evidence that Spray-Rite's termination was "part of or pursuant to" that vertical conspiracy.

22 Id. at 1470.
23 Id. at 1472.
24 Id. at 1471 n.9.
25 Id.
Following *Monsanto*, it was clear that a supplier, acting unilaterally, could refuse to take on new distributors which it anticipated would not adhere to its suggested resale prices; it could also announce to its existing distributors that it intended to terminate any distributor which did not follow those prices; and it could actually terminate distributors if their prices did not conform. In these cases, there would be no "meeting of the minds" or "common scheme". On the other hand, it was per se unlawful for a supplier to coerce adherence to resale prices, or to conspire with one of its distributors to terminate another for failure to maintain prices.26

A distributor, for its part, could "acquiesce" to a supplier's demand and "conform" to the suggested price without creating an agreement. On the other hand it could not "communicate" its acquiescence to the supplier.27 This is where the Court drew a line between unilateral action and a meeting of the minds.

The application of the per se prohibition against RPM was further clarified by the Supreme Court in its 1988 judgement in *Business Electronics Corp. v. Sharp Electronics Corp.*28 Building on its reasoning in *Monsanto*, the Court held that the termination of a low price distributor by a supplier falls within the per se prohibition only in circumstances where there is an explicit or implied agreement between the supplier and other non-terminated distributors to set resale prices at some level. The Court rejected the contention that the existence of an agreement

26 Steuer, *supra* note 19 at 7.

27 Id.

could be inferred merely on the basis of the termination of non-complying distributors and said:\textsuperscript{29}

Our approach to the question presented in the present case is guided by the premises of \textit{GTE Sylvania} and \textit{Monsanto}: that there is a presumption in favour of a rule-of-reason standard, that departure from that standard must be justified by demonstrable economic effect, such as facilitation of cartelizing, rather than formalistic distinctions; that interbrand competition is the primary concern of the antitrust laws; and that rules in this area should be formulated with a view towards protecting the doctrine of \textit{GTE Sylvania}.

While RPM remains illegal per se in the United States, it is notable that the stance taken by the Department of Justice since the early 1980's, and the subsequent narrowing of the per se rule, have generated extensive concern in Congress. Besides its action in preventing the Department from presenting its argument in \textit{Monsanto}\textsuperscript{30}, legislation was introduced in 1987 to codify the per se prohibition of RPM and a version of the Bill was passed by the House of Representatives in early 1988.\textsuperscript{31} It is understood that the Bill has not yet been passed by Senate. The Senate Committee Report accompanying the legislation was however extremely critical of the Administration for failing to file any RPM cases in recent years and for intervening on behalf of defendants in several privately initiated cases.\textsuperscript{32}

\textsuperscript{29} \textit{Id.} at 1519.


\textsuperscript{31} The Retail Competition Enforcement Act, 100th Cong., 1st Sess. (1987).

Canada was the first country to unconditionally prohibit RPM. Section 34 of the Combines Investigation Act 1951 provided that no dealer could directly or indirectly, by any means, require or induce or attempt to require any person to sell goods at a minimum price or mark-up or price specified by the seller.

Amendments made in 1975, effective 1 January 1976, broadened the prohibition in a number of respects. First, the prohibition was extended beyond the mere specification of prices to any attempt to influence a price upwards or discourage the reduction of prices. Second, the prohibition was extended beyond mere situations of resale to any situation where a product is sold, so also catching leasing and hiring. Third, the word "product" replaced the word "goods", so catching services. Fourth, the word "dealer" was replaced by the word "person" giving rise to the possibility that the section could apply to both horizontal and vertical relationships. Finally, a new offence was created extending to third parties the prohibition against a refusal to supply which is related to an attempt to enforce price maintenance. A notable narrowing of the prohibition resulted from the substitution of the words "or any like means" for the words "or any other means". No reason appears to have been given for the change, although the majority in R. v. Philips Electronics Ltd. felt that this was a clear indication of

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This possibility became evident in R. v. Peter Campbell (1981) 51 C.P.R. 284 where the manager of a rental car company was found guilty of price maintenance by inducing two of his competitors to raise their rental rates. See also R. v. Schelew et al. (1982) 63 C.P.R. (2d) 140.
Parliament's intention to substantially restrict the type of attempts which constitute an offence under the section.34

These amendments were largely repeated in section 38 of the Competition Act 1986 (to be renumbered section 61 under the 1985 Revised Statutes). Section 38(1)(a) of the 1986 Act now therefore provides that no person who is engaged in the business of making or selling a product shall, directly or indirectly:

by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in a business in Canada supplies or offers to supply or advertises a product within Canada.

This prohibition also applies to persons who extend credit by way of credit cards or are otherwise engaged in a business that relates to credit cards or who have the exclusive rights and privileges conferred by a patent, trademark, copyright or registered industrial design.

In order to establish an offence under this provision, proof is not required that a supplier actually succeeded in influencing upward or discouraging the reduction of another person's prices. A mere attempt to influence prices in this way can suffice. In R v. Moffats35 it was held that acquiescence by a person whom the accused had attempted to influence was not necessary to support a conviction.

34 116 D.L.R. (3d) 298 at 305. In this case, conduct which presumably would have been caught under the previous wording was held to be outside the section.

35 (1957), 118 C.C.C. 4.
The courts have generally given a broad interpretation to the requirement of an "agreement, threat, promise or like means". An attempt to influence upward or discourage the reduction of prices in this manner has been found for instance where a rebate was provided on sales made at a manufacturers' suggested list prices; special allowances were threatened to be removed if the retailer initiated downward price changes; and inducements were offered to comply with suggested prices including an offer to supply an additional, highly desired product and an offer to force other retailers to adhere to suggested prices.

Section 38(1)(b) of the Competition Act makes it a separate offence for any person to, directly or indirectly:

refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

The effect of this provision is to make it an offence to refuse to supply on the basis of price discounting.

In addition to the offence in section 38(1), section 38(6) of the Competition Act provides that:

No person shall, by threat, promise or any like means, attempt to induce a supplier, as a condition of his doing business with the supplier, to refuse to supply a product to a particular

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36 R. v. Campbell (1964) 3 C.C.C. 112.


person or class of persons because of the low pricing policy of that person or class of persons.

This provision is directed at controlling possible attempts by distributors to initiate refusals by their suppliers to supply to competing, lower price distributors. Violation of section 38(1) or section 38(6) is an indictable offence and is punishable by a fine in the discretion of the court or imprisonment for 5 years or both.\textsuperscript{39}

In regard to the issue of \textit{mens rea}, it has been held in a number of cases that it is not necessary for the Crown to prove that an accused person intended to have the effect of maintaining higher-than-competitive price levels. Rather, it is sufficient to support a conviction under section 38 if the Crown shows that the accused knowingly carried out the acts which constituted the offence.\textsuperscript{40}

There are several exceptions to the price maintenance provisions that are of importance in the present context. Section 38(2) provides that section 38(1) does not apply in situations involving affiliated companies or directors, agents, officers or employees of (a) the same company, partnership or sole proprietorship, or (b) companies, partnerships or sole proprietorships that are affiliated. In addition, section 38(2) provides that section 38(1) does not apply in situations where the person attempting to influence the conduct of another person and that other person are principal and agent.

\textsuperscript{39} Section 38(8).

\textsuperscript{40} \textit{R. v. Moffats}, supra note 35.
Sections 38(3), (4) and (5) clarify the treatment of suggested resale prices under the price maintenance provisions. Section 38(3) provides, in effect, that producers or suppliers who make suggestions regarding the resale prices of their products must, in order to avoid liability under the price maintenance provisions, also make clear to the person to whom the suggestion is offered that he is under no obligation to accept the suggestion. In the absence of proof to this effect, the making of suggestions respecting resale prices is deemed to be proof of an attempt to influence the person in accordance with the suggestion offered. Section 38(4) clarifies further that advertisements published by a supplier of a product, other than a retailer, that mention a resale price for the product, must make clear that the product may be sold at a lower price. Unless this is done, the publication of such an advertisement is deemed to constitute an attempt to influence upward the selling price of any person into whose hands the product comes for resale. It is not therefore uncommon to find the words "or less" used in advertisements including a suggested price. The courts have held that sections 38(3) and (4) do not constitute offences in themselves. Rather, they are examples of attempts to influence prices that may fall within the conduct proscribed in section 38(1)(a). Section 38(5) provides that the price maintenance provisions do not apply where the words "suggested price" or "suggested retail price" are in some way attached to a product or its package or container along with the price. (The use of suggested retail prices will be considered in more detail later in this Part.)

Finally section 38(9) in effect provides a defence to a person charged with refusal to supply under section 38(1)(b) where he believes that the person he has refused to supply has made a practice of: (a) using products supplied by the person

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charged as loss-leaders;\(^{42}\) (b) using such products not for the purpose of selling them at a profit but for the purpose of attracting customers to his store; (c) engaging in misleading advertising in respect of such products; or (d) failing to provide the level of service that might reasonably be expected by purchasers of such products. As will be seen shortly, these exceptions to some extent accommodate the positive rationales for price maintenance activities which have been advanced by modern antitrust scholars. It is notable, however, that the exceptions in section 38(9) do not apply to the basic offence of price maintenance under section 38(1)(a), nor do they apply to the offence of inducement to engage in refusal to supply under section 38(6). (The loss-leader defence will also be considered in more detail later in this Part.)

(3) Australia

The RPM provisions in the New Zealand Act are virtually a mirror of the equivalent RPM provisions in the Trade Practices Act 1974 (Cth) (hereafter referred to as "the Australian Act")\(^ {43}\) and therefore both can conveniently be considered together (as is done in the next section). The only significant difference is the inclusion of a defence along the lines of section 38(9) of the Canadian Competition Act to a supplier who withholds supplies of goods to a person who, within the preceding twelve months, has sold goods obtained from the supplier at less than their cost for the purposes of promoting business or attracting

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\(^{42}\) The loss-leader defence was considered in R. v. H.D. Lee of Canada Ltd., supra note 38. The Quebec Supreme Court defined loss-leader selling as sale at a price below invoice cost and re-affirmed an interpretation given earlier in the Philips case.

\(^{43}\) Sections 48,96,97,98 and 100. For a detailed discussion of these provisions, see R. Miller, Annotated Trade Practices Act 8th ed. (Australia, Law Book Co., 1987).
to his place of business persons likely to purchase other goods.\textsuperscript{44} The exemption does not however apply to genuine seasonal clearance sales of goods not acquired for the purpose of being sold at the particular sale nor does it apply in situations where the sale took place with the consent of the supplier.\textsuperscript{45}

(4) \textbf{New Zealand}

(i) \textbf{History}

RPM arrangements were first brought under the trade practice regime in New Zealand in 1958,\textsuperscript{46} but were not specifically dealt with until 1975. Section 28 of the Commerce Act 1975\textsuperscript{47} provided that no person shall be a party to any agreement or arrangement for the sale or supply of goods "between a wholesaler and a retailer" or "between two or more wholesalers" pursuant to which there is a direct or indirect indication of the price of goods sold and/or the imposition of conditions of sale affecting the resale price of goods sold. However three exceptions were provided, namely (a) where the particular agreement or arrangement had been approved in advance by the Commerce Commission and any conditions imposed by the Commission complied with; (b) where the trade practice was expressly authorized by any other Act; and (c) the agreement or arrangement


\textsuperscript{45} Section 98(3).

\textsuperscript{46} Trade Practices Act 1958, sections 19 & 20.

\textsuperscript{47} As amended by the Commerce Amendment Act 1976 (No. 67) and subsequently by the Commerce Amendment Act (No. 2) 1979 (No. 140).
was one under which the resale price or condition relating thereto was indicated to be a suggested price only.\textsuperscript{48}

The 1986 Act did not repeat section 28 of its predecessor but, as previously noted, adopted the equivalent provisions of the Australian Act.


Section 37(1) of the 1986 Act makes it unlawful for a person "to engage in the practice of resale price maintenance".\textsuperscript{49} The various acts constituting RPM are set out in section 37(3) and include:

(a) Making it known to a person that goods will not be supplied unless that person agrees not to sell those goods at a price less than specified;

(b) Inducing or attempting to induce a person not to sell goods at a price less than specified;

(c) Entering or offering to enter into an agreement for the supply of goods where one of the terms thereof is or would be that a person not sell the goods at a price less than specified or price that would be specified;

\textsuperscript{48} For a discussion of the RPM provisions of the 1975 Act, see Collinge, \textit{supra} note 1 at 198-208.

\textsuperscript{49} Section 37 deals with 'direct' and 'indirect' RPM, while section 38 deals with RPM enforced by third parties for which there is no equivalent provision in the Australian Act. As section 38 virtually mirrors section 37, only the latter section will be discussed for present purposes.
(d) Withholding the supply of goods for the reason that a person has not agreed not to sell the goods at a price less than specified or that the person has sold or is likely to sell the goods at a price less than specified; and

(e) Withholding the supply of goods for the reason that a third person has not agreed not to sell those goods at a price less than specified or has sold or is likely to sell those goods at a price less than specified.

Sections 37(4)(a)-(d) deal with the question as to when a supplier will be taken to have specified or price, while section 37(4)(e) deals with the issue of agency and deems anything done on behalf of or by arrangement with the supplier to have been done by that supplier. Finally, section 37(5) defines the term "sale" to include advertising, displaying or offering for sale, with the terms "sell", "selling" and "sold" having corresponding meanings.

It is notable that section 37 only applies to goods and not services, presumably on the basis that services can not generally be resold. It is therefore obviously important in any particular case to characterize whether a resale more properly involves a contract for the sale of goods or a contract for services. This characterization will determine whether or not section 37 is to apply. It is also

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50 As to the interpretation of a "specified price", see Miller, supra note 43 at 311.

51 Cf. Canadian Competition Act, section 38 which refers to the producing or supplying of a "product", defined in section 2 as including "an article and service". (Emphasis added)

52 As to the definition of "goods" and "supply of goods", see sections 4(b) and (c). See also The Heating Centre Pty Ltd. v. Trade Practices Commission (1986) A.T.P.R. 40-674.
notable that section 37(3) covers only minimum and not maximum prices in stating that the resale price must be "not less than" the price specified by the supplier.

It is clear from the various types of conduct listed that the ambit of section 37(3) is extremely wide. Whereas the conduct in (a) requires a person to be made aware of a supplier's intention, the conduct in (b) requires some positive act by which the supplier intends to persuade a person to comply, although the supplier's efforts need not be successful. Most likely to fall into this category are threats of termination for non-compliance and other forms of coercion. Conduct under (c) would appear to require that a legally binding contract be entered into or at least that an offer be made to this effect. It is notable in this regard that there is no reference to an "arrangement" or "understanding" as appears in sections 27 and 28 of the Act and therefore more than a mutual intention or expectation is required. Finally in regard to (d) and (e), any withholding of supply as a means of enforcing compliance by a reseller who refuses to adhere to a minimum resale prices is caught.\(^5\)

An important exception in regard to any allegation of inducing or attempting to induce a person not to sell goods at a price less than specified and falling with (b) above, is that a supplier may, pursuant to section 39 of the Act, recommend prices to its resellers so long as there is no obligation to comply with such recommendation.

\(^5\) For a detailed analysis of the various types of conduct constituting RPM and falling within the equivalent Australian provision, see Donald & Heydon, supra note 1 at 368-86.
(iii) **Specification of Prices**

As can be noted from section 37(3), a major element of each type of conduct listed is whether the supplier has "specified" a price. The extent to which a recommended price may be a specified price is obviously significant for a supplier if this results in the benefit of the exemption in section 39 being lost. The matter was in fact considered in *Mikasa (NSW) Pty. Ltd. v. Festival Stores*\(^{54}\) where the High Court of Australia held, in the context of a prohibition against the withholding of supplies, that it was not possible to maintain a distinction between minimum and mandatory prices. Walsh J. said:\(^{55}\)

> It would deprive the provision of any sensible operation if it were to be construed so as to make lawful a withholding of supplies for the reason that the potential customer was likely to sell at a price below the price which the supplier wishes to be maintained as the selling price, provided that his desired selling price was stated to be a recommended or a sensible price.

The Court in *Trade Practices Commission v. Bata Shoe Company of Australia Pty. Ltd.*\(^{56}\) came to a similar conclusion in holding that the fact that the specification of a price is couched in terms of a recommendation does not necessarily prevent it from being a specified price for the purposes of the Australian equivalent of section 37.

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\(^{54}\) (1972) 127 C.L.R. 671. On the facts, Spicer C.J. and Smithers J., of the Commonwealth Industrial Court, the court of first instance, found that the suppliers had gone beyond a mere recommendation and had made it clear that the recommended price list was in fact the minimum price list.

\(^{55}\) Id. at 647. See also Barwick C.J. at 635.

\(^{56}\) (1980) 44 F.L.R. 145.
There is no reason to believe that a similar interpretation would not be
given to the equivalent New Zealand provisions. Section 39 is expressly limited in
its operation to the terms of section 37(3)(b). Accordingly, the fact that the making
of a recommendation as to resale prices may fully accord with section 39, it may
yet be a sufficient specification to satisfy the requirements of section 37(3)(d). It
is important to remember that a price may be a specified price, but nevertheless
not "a price specified by the [supplier] as the price below which the goods are not
be sold". It would therefore seem safe for a supplier to legitimately specify that
a certain price is recommended so long as there is no request that this price be
adhered to nor any threat of action if it is not.

It is clear however that a price can be the specified price below which
goods are not to be sold without being specified in precise terms. In Trade
Practices Commission v. Pye Industries Sales Pty. Ltd. for instance, it was held
that what was called a "go price" and which could vary between $10-15 up or down
was such a price, while in the Bata decision it was held that it was sufficient that
a price be specified as not less than that charged by other established retailers.

It is also clear from section 37(4)(d) that where a supplier makes a statement
to another person of a price that is likely to be understood by that person as the

See Peter Williamson Pty. Ltd. v. Capitol Motors Ltd. (1982) 61 F.L.R. 257 at
261 where Franki J. did not accept a submission that a refusal to supply
would convert a recommended price into a specified price below which
goods were not to be sold. Whether or not the recommendation of a price
followed by a refusal to deal where the buyer has sold below the
recommended price can convert the recommended price into a specified
price below which goods are not to be sold depended, in Franki J.'s view, on
all of the circumstances.

price below which goods are not to be sold, that price is deemed to have been specified by the supplier as the price below which the goods are not to be sold. It may be that a statement of price, even if recommended, may well be likely in particular cases to be understood by distributors as the minimum price of the goods. In such cases, the exception in section 39 would not seem to be available.

(iv) **Withholding of Supply**

The most pervasive of the acts listed in section 37(3) to distribution in general are those set out in paragraphs (d) and (e), namely the withholding of supply for failure to maintain resale prices. By section 40, certain acts are deemed to constitute the withholding of supply. That section provides as follows:

For the purposes of section 37(3)(d) and (e) of this Act, the supplier shall be deemed to withhold the supply of goods to another person if -

(a) The supplier refuses or fails to supply those goods to, or as requested by, the other person; or

(b) The supplier refuses to supply those goods except on terms that are disadvantageous to the other person; or

(c) In supplying those goods to the other person, the supplier treats that person less favourably, whether in respect of time, method, or place of delivery, or otherwise, than the supplier treats other persons to whom the supplier supplies the same or similar goods; or

See B.P. Australia Ltd. v. Trade Practices Commission (1986) A.T.P.R. 701 in regard to the equivalent Australian provision (section 96(3)(f)). The test is objective.

Donald & Heydon, supra note 1 at 385.
(d) The supplier causes or procures a person to act in relation to the supply of goods in the manner specified in paragraphs (a), (b), or (c), as the case may be, of this section.

The effect of section 40, when read with sections 37(3)(d) and (e), is to remove any argument that liability can be avoided simply by specifying a resale price and leaving it to a distributor to voluntarily accept that stipulation or not. Thus, what may be lawful conduct in the United States under Colgate, is clearly not so in New Zealand.

Further guidance in the interpretation of paragraphs (d) and (e) of section 37 is given by section 42 which provides as follows:

(1) Where, in proceedings under this Act against a supplier for a contravention of section 37(3)(d) or section 37(3)(e) of this Act it is proved that -

(a) The supplier has acted in a manner referred to in section 40 of this Act; and

(b) During a period ending immediately before the supplier so acted, the supplier had been supplying goods of the kind withheld either to -

(i) The person in respect of whom the contravention is alleged; or

(ii) A person carrying on a similar business to that person; and

(c) During a period of 6 months immediately before the supplier so acted, the supplier became aware of a

Unlike under sections 98(2) and (3) of the Australian Act, no defence is provided in the New Zealand Act to a withholding of supply on account of the sale of goods at less than their cost (i.e. loss-leadering).
matter or circumstance capable of constituting a reason referred to in section 37(3)(d) or (e) of this Act --

it shall be presumed, in the absence of evidence to the contrary, that the supplier so acted on account of that matter.

(2) Nothing in subsection (1) of this section applies in respect of terms imposed by a supplier that are disadvantageous or treatment that is less favourable than the supplier accords other persons if the terms or treatment consists only of a requirement by the supplier as to the time at which, or the form in which, payment as to be made or as to the giving of security to secure payment.\(^2\)

The words "in the absence of evidence to the contrary" in section 42 make it clear that even when paragraphs (a), (b) and (c) of that section are proved, the presumption that the supplier was actuated by a desire to maintain resale prices does not arise if "evidence to the contrary" is produced. What "the contrary" of withholding for the "reason[s]" mentioned in sections 37(3) (d) and (e) means seems to depend on precisely what withholding for those reasons means.

A number of interpretations may be given to the word reason in sections 37(3)(d) and (e), namely whether the reason must be the main, only or just a reason for withholding supply so as to bring the sections into play. This matter was also considered in the Australian case of Mikasa (NSW) Pty Ltd. v. Festival Stores,\(^3\) where Mikasa, an importer and wholesaler of dinnerware which it marketed under the names 'Mikasa' and 'Premiere', refused to supply Festival, a company operating a number of discount houses, with its Mikasa brand. Festival alleged that Mikasa's

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\(^2\) See however United States v. Parke Davis 362 U.S. 29 (1960) where if the threat of non-supply is used to cajole compliance in any way, this requirement may well be satisfied.

\(^3\) (1927) 127 C.L.R. 617.
reason for refusing to supply it with this brand was because Festival declined to abide by the resale prices specified by Mikasa in its catalogue. Mikasa, on the other hand argued that for Festival to succeed, it had to show that the only reason actuating Mikasa was its belief that Festival would sell at prices below those specified by Mikasa. Mikasa asserted that in point of fact, the only reason by which it was actuated was quite different, namely its belief that the 'image' of its product would suffer if it were marketed by Festival. In regard to this issue, Chief Justice Barwick in the High Court of Australia said:

In my opinion it is not correct to so emphasize the participle in the phrase for the reason that as requiring the withholding of the supply to be for one reason only. In my opinion, if the likelihood that the would-be purchaser would sell at less than the specified price is an operative reason for withholding that supply, the supplier engages in the practice of RPM, however many reasons the supplier may in effect have for not supplying the goods to the would-be purchaser. The likelihood of price-cutting is not required, in my opinion to be the predominant reason; it is enough for this to be an operative reason, that is to say, a substantial reason in the totality of reasons for the withholding of the supply.

Walsh J. also spoke of a "substantial and operative reason", while Menzies J. (with whom Gibbs J. agreed) stated that "if the goods would not have been withheld had it not been for the likelihood of price cutting", then the withholding which occurred was illegal despite the existence of other reasons.

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64 Id. at 634-35.
65 Id. at 646.
66 Id. at 642.
The tests propounded by Barwick C.J. and Walsh J. in this case have to a large extent been adopted in section 2(5)(b)\(^\text{67}\) of the Act which provides that a person shall be deemed to have engaged in conduct for a particular reason if (a) that person engaged in that conduct for a reason that included that reason and (b) that reason was a substantial reason. The effect of section 2(5)(b) in the present context is that a violation of section 37 will be found to have occurred where the predominant reason for the withholding of supply, although secondary, was nevertheless present and substantial.\(^\text{68}\) It is clear at least that the particular reason, need not be the sole reason.

The result of the interpretation placed by the High Court in Mikasa on the expression "for that reason that" and the operation of section 2(5)(b) would appear to be that a supplier will be held to have engaged in the practice of RPM where (a) in regard to say section 37(3)(d)(ii) it can be inferred from a supplier's conduct that a "substantial" reason actuating the supplier in withholding goods from another person was that person had sold or was likely to sell those goods at less than the price specified by the supplier or (b) the three factual elements in section 42 are proved, and the supplier does not rebut the presumption by providing evidence to the contrary.

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\(^{67}\) The Australian equivalent is section 4F. In regard to sections 4F and 100(1) (the equivalent of section 42(1)) of the Australian Act, see Peter Williamson Pty. Ltd. v. Capitol Motors Ltd. (1982) 61 F.L.R. 257 at 263 where it was said that the 'reason' for withholding supply need not be the sole reason, but it must be one of real significance.

\(^{68}\) As to the application of section 4F(b) of the Australian Act to the equivalent of section 37(3) (namely section 96(3)), see The Heating Centre Pty. Ltd. v. Trade Practices Commission (1986) A.T.P.R. 40-674 at 47-436-38.
In regard to the withholding of supply, it is clear that a refusal to deal per se does not breach sections 37(3)(d) and (e). It is only where the refusal is for one of the enumerated reasons that a breach may occur. In regard to the equivalent Australian provision, Smithers J. in Trade Practices Commission v. Stihl Chain Saws (Aust.) Pty. Ltd. said:

That a refusal to supply goods to another who requests them on terms which the supplier is unwilling to trade with that other should be a withholding of supplies within the meaning of s.98(1)(a) [the equivalent of section 40(1)(a)] does not in itself imply that the supplier by withholding the goods is in some way acting in contravention of the Act. Section 98(1) is concerned not to create or define obligations but to state circumstances in which if other factors are operative in the transaction, the total conduct involved may well constitute a contravention of s.48. This may arise, inter alia, by reason of the provisions of s.96(3)(d) or (e). In other words, unless the conduct defined in s.98(1), which for the purposes of s.96(3)(d) or (e) is deemed to constitute withholding of supplies, is committed for a reason specified in s.96(3)(d) or (e) no contravention of the Act is involved.

(v) Termination for Failure to Adhere to Specified Prices

The extent to which a supplier may terminate a distributorship where one of the reasons for so doing is the discounting activities of a distributor was considered in Ron Hodgson (Holdings) Pty. Ltd. v. Westco Motors (Distributors) Pty. Ltd. It was held in that case that even though a franchisor had valid reasons for termination of a franchise, the RPM provisions of the Australian Act were infringed because a substantial and operative reason for termination was that the franchisee had sold or advertised or was likely to sell or advertise the franchisors products at a price less than specified.

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69 (1978) A.T.P.R. 40-091 at 17,894.
The Federal Court of Australia was called upon to consider a similar set of facts two years later in *Peter Williamson Pty. Ltd. v. Capitol Motors Ltd.*  where it was alleged that the respondent threatened to withhold the supply of BMW motor vehicles in contravention of section 48 of the Australian Act. In terms of the equivalent Australian provisions of sections 37(2) and 37(3)(d)(ii), the applicant claimed that the respondent was withholding the supply of vehicles of the reason that it had sold several vehicles at a price less than a price specified by the respondent as the price below which the goods were not to be sold. The applicant admitted selling several new BMW motor vehicles at less than the respondent’s suggested or recommended retail prices but claimed that the respondent had become aware of this at least six months before the date of termination. The respondent on the other hand pleaded that the applicant had not fulfilled its obligations under the relevant agreement and that termination was justified by a number of commercial considerations.

Having regard to the Australian equivalent of section 2(5)(b), Franki J. held that although price was a factor in the termination, the price at which a dealer sold cars was not a concern of the respondent; rather the important factor was whether the dealer’s business was a “viable proposition”. Although *Hodgson* was not cited, the tests in both cases appear virtually the same, and also accord with the meaning of the term “substantial” referred to above.

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Finally, in Direct Holdings Ltd. v. Feltex Furnishings of New Zealand Ltd. and Smith & Brown Ltd., the only New Zealand decision so far to consider section 37 of the Act, the High Court granted an injunction requiring both defendants to resume supply on terms no less favourable than those imposed on other furniture retailers and to prevent action being taken in relation to the plaintiff's other suppliers and trade competitors. The evidence disclosed that the first defendant had increased the wholesale price of its products to the plaintiff after coming under some pressure from the second defendant to rectify the plaintiff's discounting activities or face withdrawal of the second defendant's custom. The nature of the proceedings unfortunately meant that there was little analysis of section 37.

C. EVALUATION OF THE LAW

(1) Economic Issues

(a) Cartels

The traditional economic arguments justifying the application of a per se rule against RPM are that it involves the manifestation of either a supplier or distributor cartel. Where this can be proved, there is wide agreement that RPM is anticompetitive and therefore should be prohibited.

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73 For a comprehensive review of these and the numerous other explanations for adopting RPM, see T. Overstreet, Resale Price Maintenance Economic Theories and Empirical Evidence (Federal Trade Commission Staff Report, 1984).
In respect of the supplier cartel theory, the general hypothesis is that colluding suppliers, by imposing RPM, will attempt to make the pricing system more transparent and thereby make it easier to detect 'chiselling'.\(^{74}\) RPM will thereby preclude shaded wholesale prices from affecting retail prices and translating into additional sales, thus aiding suppliers in protecting their monopoly. While most analysts accept this hypothesis as possible, the conditions that an effective cartel has to meet (for example, few suppliers to enable easier coordination, homogenous products, no good substitutes and barriers to entry) are relatively onerous.\(^{75}\) The hypothesis necessarily requires all suppliers in the market to maintain the cartel price for their products at the retail level. A single supplier with a differentiated product practising RPM at the retail level obviously does not fit the hypothesis.\(^{76}\) Even generally, it seems questionable whether RPM will benefit a supplier since the effect of setting a minimum price above the competitive level will be to place a floor on resale prices, while setting the retail price below the competitive level will render RPM superfluous. The impact of RPM will seemingly be to reduce a supplier's sales and correspondingly its profits, for without RPM, distributors will sell more at a lower retail price, but pay the same wholesale price.

\(^{74}\) F.M. Scherer, "The Economics of Vertical Restraints" 52 Antitrust L.J. 687 (1983) at 691-92.

\(^{75}\) See F. Mathewson and R. Winter, "The Economics of Selected Vertical Restrictions" (University of Toronto, Law and Economics Workshop Series, 1984) at 27-29.

\(^{76}\) B. Dunlop, D. McQueen and M. Trebilcock, Canadian Competition Policy - A Legal and Economic Analysis (Toronto, Canada Law Book, 1987) at 250 (hereafter cited as "Dunlop").
In respect of the distributor cartel theory, the general hypothesis is that a supplier will be induced to maintain prices at a level which maximizes distributors' margins (at the expense of consumers who face higher prices and the supplier who loses profits from reduced sales). The supplier will effectively police and enforce the cartel, thus avoiding the problems of co-ordination that large numbers of distributors handling the same product often face. Such a hypothesis supports the rationale originally offered by the United States Supreme Court in Dr. Miles for a per se rule, namely that RPM was effectively equivalent to horizontal price fixing. In that case the Court said:

[T]he complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavoured to establish the same restrictions and, thus to achieve the same result, by agreement with each other. If the immediate advantage they would thus obtain would not be sufficient to sustain a direct agreement, the asserted ulterior benefit to the complainant cannot be regarded as necessary to support the system.

As under the supplier cartel theory, the conditions necessary to achieve an effective distributor cartel (for example, few distributors to enable easier inducement, homogenous products, no close substitutes and barriers to entry) are also onerous. Most analysts agree that co-ordination in the typically fragmented


78 220 U.S. at 408. There was however no evidence of a distributor cartel in this case. Baxter, for one, has noted that there was in fact a major horizontal antitrust case brought in 1908 or 1909 against a number of drug manufacturers, including Dr. Miles, and that a consent decree was issued in 1910 enjoining a number of practices, including RPM, in which this horizontal cartel had engaged. See W. Baxter, "Vertical Practices - Half-Slave, Half Free", 52 Antitrust LJ 743 (1983).

79 Mathewson and Winter, supra note 75 at 19-27.
The retail industry is difficult to achieve and that barriers to entry are normally low. The only real situation in which distributors as a group have the means to organize themselves and the ability to discipline each other is if their particular industry is subject to some legal restriction such as licensing. Even then a more practical move by a group of distributors with monopsony power would seem to be to extract a lower wholesale price from the supplier than to seek a fixed retail price. The more onerous conditions to be met by distributor cartels suggests that their existence will be even rarer than that of supplier cartels. This indeed is supported by a detailed review conducted by one commentator into the incidence of RPM allegations in Department of Justice cases for the period 1890-1980 and Federal Trade Commission cases for the period 1942-1979 in the United States.

(b) Free Riding

The major contemporary economic explanation for adopting RPM has been that it gives a distributor at the retail level a wider spread between its costs and price thereby inducing the distributor to compete on a non-price basis by engaging in additional pre- and post-sales activity such as displays, demonstrations, advertising and after-sales services. From an economic standpoint, the supplier will raise the pricing power of the distributor with the expectation that this will lead to more selling activity on the distributor's part which in turn will lead to an

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80 Dunlop, supra note 76 at 250-51.

81 S. Ornstein, "Resale Price Maintenance and Cartels", 30 Antitrust Bull. 401 (1985) at 415-21. See also Overstreet, supra note 73 at 161-62. Overstreet found that while distributor cartel behaviour is sometimes evident, a supplier cartel explanation for RPM is more often applicable. Even so, he concluded that "the evidence ... outside the drug and liquor trades suggests neither supplier nor dealer collusion explanations are likely to apply to all or even most instances of price maintenance".
increase in consumer demand and a consequent increase in the supplier's sales and profits.\textsuperscript{82} If a supplier does not set a minimum resale price, distributors will lack any incentive to engage in such additional sales activity because consumers can take advantage of pre-sale activities engaged in by the higher price distributors and then purchase from the distributors not so engaged who accordingly charge a lower price. In other words, low price distributors will 'free-ride' on the sales activity of the more costly and hence higher price distributors thereby gaining the benefit of extra sales without the concomitant expense of providing all these extra services itself.

The free rider principle had its genesis in an article written by Professor Lester Telser in 1962.\textsuperscript{83} Telser noted that in many instances, demand for a particular supplier's product was a function of the demand for the physical product and the accompanying pre- or post-sales services (which he termed "special services") offered to prospective customers by a supplier's distributors. To take an example, the average consumer who goes into a store to buy a sophisticated personal computer has very little idea of what he or she really needs in terms of memory capacity, speed of the central processing unit, brand of software, type of printer and so on. Whether or not this consumer will buy a computer will very much depend upon the skills and expertise of the salespersons available to explain its operations. Clearly this service is not costless. Thus, Telser pointed out, if one distributor provided this presale service to consumers but could not or did not separately charge for it, a prospective customer would go to that distributor, find


\textsuperscript{83} L. Telser, "Why Should Manufacturers Want Fair Trade?", 23 J.L. & Econ. 86 (1960).
out all he or she wanted to know about the attributes of the product and then go
down the road to a second distributor which sold the same product (but without
sales assistance) at a lower price. Under these circumstances, the second distributor
would have taken a 'free ride' on the services provided by the first distributor,
since without these services, the customer might not have bought the product at all.

Assuming that a substantial number of consumers placed a value on having
the product explained to them before purchasing it, it was seen to be in the
consumers' interests that distributors provide the service. However, without some
inhibition upon the free rider, distributors would be unwilling to provide an
optimal amount of such service. To state the matter in terms of the example
above, over time the first distributor would either cease to provide sales assistance
or would discontinue carrying the supplier's product at all. In either event,
distributional efficiency would be adversely affected. 84

The special services theory and free rider principle have been largely
endorsed by the Chicago School. 85 Posner, for example, argues that minimum
resale prices enables new manufacturers and manufacturers entering new markets
to attract competent and aggressive distributors and to induce them to make the
kind of investment of capital and labour that is often required in the successful
distribution of products unknown to the consumer. The manufacturer is then able

84 The foregoing is based on L. Popofsky and S. Bomse, "Sylvania to Monsanto: No Longer a Free Ride", 30 Antitrust Bull. 67 (1985) at 88-89.

to compete more effectively with established companies. Posner further argues that the imposition of a minimum resale price induces dealers to engage in promotional activities and to provide service and repair facilities necessary to the efficient marketing of a manufacturer's product, with the concomitant elimination of the so-called 'free rider' problem. In Posner's words:

The manufacturer can choose any level of presale services that he desires his dealers to provide and then, by setting the minimum resale price appropriately, assure that precisely that level of services is provided.

Given these pro-competitive benefits which are seen to flow from minimum resale prices in almost all circumstances, Posner, and others, advocate the application of a rule of per se legality. Per se legality is said to be justified by the alleged absence of either theoretical or empirical grounds for condemning purely vertical restraints as anticompetitive.

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86 Posner, id. at 283-85.


The free-rider principle has also been specifically recognized by the United States Supreme Court. In a passage seemingly unnecessary to the precise issue before it, the Court in *Monsanto* said:90

A manufacturer and its distributors have legitimate reasons to exchange information about prices and the reception of their products in the market. Moreover, it is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors' resale prices. The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that "free-riders" do not interfere. (Citations omitted.)

Telser's special services theory took some years to be accepted, one of the main reasons being that it was limited to a narrow range of products and distribution practices. The theory did not apply for instance to standard products like food, drink and clothing where consumers were unlikely to place too much value on pre-sale services in the form of explanations or demonstrations.91 However in the early 1980's, a number of commentators began to reconsider Telser's work and demonstrated that the range of services which were 'free-ridable'


91 An example is provided by the *H.D. Lee* case, supra note 38, where the accused argued that its jeans should have a special location in each store, special displays with mannequins, individual hangers and so on. Army and Navy, one of the stores refused supply because of, among other things, its failure to provide an adequate level of servicing, was said to simply stack up the jeans on a counter where the customer had to select his size and take it to the cashier! Beauchemin J. succinctly replied to this argument as follows: "However desirable from the supplier's standpoint is the amount of servicing and promotion a retailer will give his product, the test of [section 38(5)] is not the level of servicing which the supplier or manufacturer might expect but rather the level of servicing which the purchaser of a product might expect" (Id. at 198).
was much broader than Telser had suggested. More important than such obvious items as sales assistance or liberal warranty and returns policies were services broadly denominated as informational, promotional and reputational.92

Marvel and McCafferty for example have argued that RPM is designed to ensure that suppliers obtain certification of the quality and stylishness of their products from reputable distributors.93 In their view, customers may not care where they obtain their supplies of a product but may care that the product is sold at leading retailers simply because the decision of those retailers to handle the product indicates that is it consistent with their reputations. In this way RPM may be used to guarantee margins in order to make high quality products attractive for such retailers. To the extent that the free-riding of other retailers exists, the use of RPM is, in their view, of benefit to the public.

The theory that RPM may be a principal method of distributors lending their reputation to suppliers was extensively considered in a 1984 study by five academic consultants of the U.S. Federal Trade Commission into past RPM enforcement action. By way of overview the study observed:94

92 Popofsky and Bomse, supra note 84 at 91.


In each of the RPM studies the consultants found that vertical restraints were being used to protect the signal of high quality created by the retailers' general method of doing business. By carrying the manufacturers' products, retail stores with high quality reputations signal that the products are of high quality, thereby helping the manufacturers establish or maintain their products' reputations. This signal of high quality is free-ridable; other retailers could refrain from the expense of creating a quality reputation, yet have their sales of the manufacturers' products benefit from the certification efforts of quality-signaling dealers. According to our consultants, the manufacturers' desire to prevent the deterioration of this quality certification through free-riding explained, in part or in whole, the use of RPM in each of the three RPM cases studied.

The special services theory has certainly not been without its critics, particularly those who do not espouse the Chicago School approach to vertical price restraints. One of the most vociferous has been Professor William Comanor who has argued that it is only in special circumstances that the use of RPM to overcome free riding yields a net benefit to offset against the lessening of competition resulting from its imposition. In the absence of RPM, he argues, certain customers would have purchased the product in any case; with the advent of RPM, such customers are forced to pay a higher price. If there is in fact no free-rider problem he argues, there is no need for RPM to ensure the supply of services, since various distributors will inevitably provide the particular services demanded by consumers. "Indeed, with no free-rider problem, there would be more variety in the distribution services offered in the absence of [RPM] and the full range of consumer preferences would be more likely to be served".

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96 W. Comanor, "Vertical Arrangements and Antitrust Analysis", 62 N.Y.U.L.Rev. 1153 (1987) at 1157. See also Comanor at 1158 in regard to the free rider explanation being sufficient to explain the transferability of consumer perceptions from store to brand under the certification theory.
Another vociferous critic has been Professor Robert Pitofsky who has seriously challenged the competitive benefits alleged to flow from RPM. In particular he has attacked the arguments that RPM may be necessary to recruit distributors and that minimum resale prices induce distributor services. In respect of distributor recruitment, Pitofsky argues that higher retail prices mean most consumers do not want or need the additional distributors which are attracted by higher margins, and even if they do, a supplier can achieve the same end by lowering its own price, widening the margin for competing distributors, attracting more outlets and thereby benefiting consumers through lower prices from enhanced competition. In respect of inducing distributor services, Pitofsky argues that not many suppliers establish minimum resale prices for this purpose, and even if they do, there is no guarantee that a distributor, once its resale price is raised, will engage in the desired level of services unless it is contractually bound. Further, a distributor can be assumed to know better than its supplier the desired level of services necessary to sell a product and will provide such services or go out of business. Quite naturally, Pitofsky, like Comanor, very much favours retention of the existing rule of per se illegality, although he does accept the need for narrow, carefully defined exceptions to the per se rule in the case of new entrants and new products. Any such exceptions would only seem justifiable on this view if available for a reasonably short period of, say, three years. Even products regarded as technically complex and therefore requiring a great deal of explanation tend to become comprehensible to most consumers within a reasonably


98 Id. at 1494.

99 Id. at 1492-93.
short period at which time there is less need for RPM to support post-sale services. The personal computer is the obvious example in this case.

More temperate in his criticism is Professor Scherer, who has argued that, under certain conditions, the competition generated by a number of suppliers adopting a high margin policy to induce the provision of services by its distributors can lead to too much variety being offered and too much money being spent on services. The fragmentation of a market through the expansion of margins and services, and perhaps also through the entry of additional distributors to take advantage of the high margins may result, he argues, in loss of economies of scale or an increase in fixed costs, both absolutely and per unit sold. The likely loss of efficiency envisaged by Scherer in this situation obviously runs counter to the Posner/Bork theory that an increase in output necessarily enhances efficiency. There may be some increase in output as a result of the generally higher level of services, but this is likely to be adversely affected by the higher level of prices. As Scherer notes:

On a priori grounds, whether quantity demanded is increased or not depends upon the elasticity of demand with respect to service on the one hand, versus the elasticity of demand with respect to price on the other hand. You cannot tell in this rivalrous situation whether efficiency has increased or not.

100 Scherer, supra note 74 at 701-02.

101 Id. at 703.


103 Scherer, supra note 74 at 703.
On this basis, Scherer argues that RPM should be presumed legal only for relatively small upstream firms and in situations where its use is not ubiquitous. Where these conditions are not satisfied, he would require those who want to use RPM to bear the burden of proving why it should be allowed.

Most recently, Klein and Murphy have presented an alternative theory of how RPM and other vertical restraints operate to induce desired distributor services.\textsuperscript{104} The thrust of their theory is that private enforcement by way of active supplier monitoring and the threat of supplier termination assures distributor performance. Through the use of this mechanism, it is argued that a supplier can employ vertical restraints to reduce the short run gains to non-performing distributors (by limiting their ability to expand output) and to increase the long run gains to performing distributors (by creating a quasi-rent stream). It is said that the mechanism is applicable to any service that a supplier wishes a distributor to perform that is not in the distributor's own self-interest and where an explicit contract can not be written and enforced.

It is the very inability to predict the efficiency enhancing or reducing effects alluded to by Scherer which is at the heart of the debate between the economic theorists. There is no doubt that under certain very limited conditions RPM can facilitate cartelization at the supplier or distributor level.\textsuperscript{105} As shown earlier, the requirements for a plausible hypothesis of collusion are onerous, particularly at the retail level. However, some industries undoubtedly do display

\textsuperscript{104} B. Klein and K. Murphy, "Vertical Restraints as Contract Enforcement Mechanisms", 31 J.L. & Econ. 265 (1988).

\textsuperscript{105} See Overstreet, \textit{supra} note 73 at 81-82 and Orstein, \textit{supra} note 81.
the characteristics necessary to satisfy such requirements\textsuperscript{106} and it is for this reason that, at least from an economic standpoint, there would seem to be some need for proscriptive rules regarding RPM.

There is also no doubt that many suppliers do institute RPM as a means to give their distributors more pricing power, increase their margins and thereby induce them to perform more in the way of services, and that a number of distributors will attempt to take a free ride in this situation. However, with all due respect to Posner and other members of the Chicago School, it is submitted that the 'free rider' is not as widespread as they would have us believe,\textsuperscript{107} nor is RPM the most efficient means for accomplishing the service and promotion orientated goals of a supplier who may be concerned about a free rider problem. In the words of Scherer, it is somewhat of a 'blunt instrument' to ensure adequate distributor service because it raises the price of a product to a uniform level for all distributors, large or small, specialized or generalized and is not necessarily profit maximizing.\textsuperscript{108} For some distributors, RPM may elevate the price too little.

\begin{footnotesize}
\begin{enumerate}
  \item An example would seem to be the Australian petroleum industry, dominated as it is by 3-4 major competitors selling a heavily advertised, largely homogenous product that is very much essential to consumers. A case arising out of the use of RPM in this industry is \textit{B.P. Australia Ltd. v Trade Practices Commission} (1986) \textit{A.T.P.R.} 701. For a discussion of this case, see P.H. Clarke, "Resale Price Maintenance-Current Uncertainties in Law and Policy", (1987) 15 \textit{A.B.L.R.} 59.
  \item This view is supported by a 1984 FTC study which dealt with specific instances of RPM and concluded that there was little evidence that RPM was imposed to prevent free-riding on product specific [distributor] services". See Lafferty, Lande & Kirkwood, \textit{supra} note 94 at 27. See also F.M. Scherer, \textit{Industrial Market Structure and Economic Performance} (2ed, 1980) at 593 n.103 where Scherer states that although the free-rider problem may occur,"its empirical significance appears modest".
  \item Scherer, \textit{supra} note 74 at 701.
\end{enumerate}
\end{footnotesize}
This is no problem because section 37 of the Act, like RPM provisions in most jurisdictions, only relates to minimum resale prices. If a distributor wants to increase the price further, that is allowed. But for other distributors, particularly those selling high volume products, RPM probably elevates the price above the profit-maximizing level. "And when that is the case, it is no longer generally true that an elevation of price caused by [RPM] which leads through increased service provision to an output increase necessarily increases efficiency."\textsuperscript{109}

As already shown, the special services theory articulated by Telser is also too limited in terms of the types of products to which it applies, namely expensive, technically complex and rapidly changing rather than low price, frequently purchased items. Further, the need for RPM to induce post-sale services such as the provision of warranties and repair services and the adoption of returns policies is not always justified. It is becoming more and more common for suppliers to assume responsibility for these functions (or even to contract with third parties to do so) as well as to offer consumers the choice of taking a supplementary warranty at an additional charge. Thus, in many cases, post-sale services can be separated from the sale of the product itself (although tied to it), benefitting consumers through a greater range of price/service options on offer.

The economic explanation which would seem to most accurately account for the use of RPM is that advanced by Marvel and McCafferty linking quality concerns to the free rider concept.\textsuperscript{110} For those suppliers who have been able to

\textsuperscript{109} \textit{Id.}

\textsuperscript{110} In two of the case studies dealt with in the 1984 FTC Report, the special services theory was found to be either inappropriate or an incomplete explanation, a more satisfactory explanation of RPM in these cases being
create a brand image for their products and have obtained a certain degree of
market power which goes along with a product's acquired distinctiveness, RPM can
then be used as a differentiating device to promote that brand image. However
the use of RPM in this situation only makes economic sense for certain types of
products and suppliers. It is submitted that the theory is implausible for non-
luxury items and for small, relatively unknown suppliers. What is of prime
concern to distributors when making buying decisions is the anticipated consumer
demand for the product in question. While that demand may be influenced by
consumers' impressions of the product, it is unlikely to be affected by the image of
a supplier, unless that supplier is fairly well-known. In other words, it should only
be in rare cases that the exclusivity and status associated with a high priced
product will result in a reduction in demand if one or more distributors begin to
sell below the normally high price. It defies basic economic theory to suggest that
such a marketing phenomenon applies to all but the most well-known luxury
products. Perhaps it is that some suppliers adopting RPM do so in the hope of
enhancing their reputation and that of their products. Such an argument was
raised in Trade Practices Commission v. Lois (Australia) Pty. Ltd., where the
reason given by the respondent for endeavouring to maintain the price of its
products was to preserve its image as a supplier of high quality apparel.

111 (1986) A.T.P.R. 40-645. For a discussion of this case see P.H. Clarke, "Resale
A.B.L.R. 59 at 63-64. See also Federal Trade Commission v. Levi Strauss 433
(c) **Discounting**

Those labelled 'free riders' under the special services theory have normally been discounters because of their alleged failure to offer the mix of pre- and post-sales services that a supplier decides is the most efficient means of marketing its products. A number of commentators\(^{112}\) have however come to their defence, both on a theoretical and an empirical level, in terms of the contributions that discounters have made to consumer welfare and competitive markets. These contributions, it is argued, are sufficient to earn discounters special consideration in antitrust law.\(^{113}\)

(i) **Contribution to Consumer Welfare**

The most obvious contribution to consumer welfare is said to be that of lower prices, thereby enabling consumers to buy more products for less money.\(^{114}\) Even from general observations this is undoubtedly true. These lower prices are achieved by the ability of discounters to buy products in relatively large

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114 Id. at 3. Interviews with five spokesmen for the discount in 1982 indicated that the estimated price differential between discounters and non-discounters was in the range of 10-15%. A survey conducted by the National Mass Retailers Institute the same year indicated that approximately 30% of its members' sales would be affected if RPM was legalized. Applying these figures to the estimates of the overall size of the discount industry in the U.S. at that time suggested that $30-$90 billion of current discount sales might come under RPM if it was legalized, thus implying an aggregate consumer loss of $6-$18 billion. See "Foreword: Antitrust and the Discounters' Case Against Resale Price Maintenance", 14 Antitrust L. & Econ. Rev. 1 (No.3, 1982) at 4.
quantities, thereby receiving quantity discounts, plus their own distribution efficiency. It is this second element which is seen as most notable in accounting for the consumer price gap between discounters and non-discounters. Consumer sensitivity to price has always seen price being used by discounters as their major competitive weapon. But, over recent years, efficiencies arising from innovations in management, internalization of wholesaling functions, innovations in service concepts (for example, replacement of sales personnel by self-service) and scale economies in general due to higher sales per store have led to reductions in operating costs which could be passed on to consumers.\textsuperscript{115} RPM is seen by discounters as a barrier to innovation, because the incentive to develop more efficient means of getting products from the supplier to the consumer is lost. Any reductions in operating costs achieved by innovations can not be passed on to the consumer in the form of lower prices nor can discounters secure for themselves the greater volume sought which might otherwise be available if they could use these lower prices as part of their marketing strategy. An assured high margin or a fixed number of units is seen to be of no real consolation.

Another important contribution to consumer welfare is said to be the greater choice of product mix and ancillary services which is offered, thereby enhancing consumer sovereignty.\textsuperscript{116} In this regard the consumer has a choice between paying a higher price and taking advantage of all the ancillary services

\textsuperscript{115} Steiner, \textit{supra} note 112 at 153-55.

\textsuperscript{116} Gerla, \textit{supra} note 113 at 5. Allied to this is the ability of consumers to assess the cost of ancillary services, and indeed the true cost of the product. Discounters are thus also said to serve as a source of information on comparative price and value not only to their own customers but via their price advertising to other customers as well. See Steiner, \textit{supra} note 112 at 183-87.
which may be offered by a particular distributor or foregoing those services in consideration for a lower price. In fact there is often little or no difference between the overall level of services offered by a traditional retailer and a discounter although the assortment of these services is often different. Defenders even claim that discounters as a class significantly outperform non-discounters in terms of customer service. Whether or not this is the case, consumers demand at least some level of service and therefore discounters are guaranteed to lose customers if they do adhere to the free rider model of 'reaping where they have not sown'. Professor Steiner, one of the strongest supporters of the discounters estimates that the free rider scenario accounts for only about 15% of cases involving vertical restraints such as RPM. In his view, the adoption of RPM in the balance of cases is determined by the type of product and market share of the distributors involved.

The thrust of Steiner's thesis is that a supplier cannot generally sell to both discounters and non-discounters in the same market and that a supplier's sales and profits will fall if a switch is made to discounters before they have attained a size sufficient to assure the supplier of at least as much sales volume and profits as the non-discounters with whom the supplier is currently dealing. At that point, it pays the supplier to switch because the lower margins of the discounters and the lower consumer prices will increase the supplier's own sales and profits at the same wholesale price. This however poses somewhat of a dilemma: if the supplier cannot afford to sell to discounters until they have attained a sufficient market share,

117 Steiner, supra note 112 at 155 n.19; Pitofsky, supra note 112, at 1493 n.24.

how do they in fact reach that critical level if no-one is prepared to sell to them? Steiner offers no solution other than that it is important for public policy that the growth of new and efficient forms of retailing not be inhibited and to achieve this discounter should not be denied the type of product they are most suited to sell, namely the well-known, low or medium priced product brand that does not require a large amount of explanation.119

Steiner's views on related matters are also interesting. He sees the function of providing information, whether it be product specific information and/or the reputation of the product whose trademark the consumer is going to respect, as conferring market power on whoever performs that function. When a distributor can perform that function, as in the case of a weak brand (that is, where there are a large number of small suppliers whose products do not have a strong consumer franchise), the retailer can "substitute between different [suppliers'] brands, play one [supplier] off against the other, make the [supplier] sell to him at marginal cost, and capture all of the potential producer-plus distributor surplus for [itself]."120 If, on the other hand, the brand is strong (that is, where there are a small number of suppliers whose products are well-known and command a large market share), then the supplier has the ability to make its distributors compete more aggressively to the point where the supplier can get its distributors to sell at close to factory cost and thereby capture the surplus for itself.121 As such, Steiner sees suppliers and distributors very much as competitors for that surplus in

119 Id. at 86 and 90-91.

120 Id. at 89.

121 Id.
contrast to the current wisdom that sees suppliers and distributors in a complementary relationship, supposedly relying on each other's efficiency. To the party then that controls the function of providing product-specific information and the quality certification which consumers rely on goes the market power and monopoly profits (if any).  

It is only in situations where a manufacturer has some form of market power that Steiner believes it is necessary to declare RPM illegal. Thus he sees it as unproductive to bring RPM cases against suppliers in fragmented industries where such suppliers have no market power, while in the case of a small innovative firm with a new product, he views RPM as unobjectionable and possibly even pro-competitive.

From an economic standpoint, Steiner's views seem eminently sensible. There seems little point in an enforcement agency, like the Commission, bringing an action against a small supplier who, because a little price cutting has developed in its line of products, has invoked RPM. What would occur if the price cutting continued would be that other distributors would drop this line, get another and sell it at the previous margin or more. Nothing would be accomplished except to

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122 Steiner, supra note 112 art 159-60. Irrespective of who gets the market power, Steiner's thesis brings out a further weakness in the special services theory in assuming that it is always efficient for services to be provided by a distributor, even in the case of a new product. The function of providing product-specific information and indeed reputation is increasingly falling on the shoulders of suppliers. This is so it would seem because the scale economies of mass-communication make it more efficient for a supplier rather than a distributor to do so. So it is also the case that suppliers are increasingly providing the back-up service that goes along with any warranty.

123 Id. at 196-97.

124 Id.
restrict one supplier; consumers would not have gained in any way since there would be no change in aggregate output or prices.

There also seems little point in the Commission bringing action against a small firm with a new and innovative product. A distributor which has invested a great deal of time, effort and money into establishing a product deserves some protection from what Steiner terms the "missionary free-rider" (that is, distributors who begin handling a product knowing that is marketable, and who are able to sell it at a lower price because they have not had to bear the expense of promotional work). At the same time, the amount of protection need only be for a short period of time sufficient for consumers to become aware of the product and for the distributor to recoup its costs plus a little more as some reward for its efforts.

ii) **Contribution to Competitive Markets**

The contribution to competitive markets arises through what is termed "intertype competition", defined by Professor Palamountain as "the competition between different types of distribution".\(^{125}\) The rivalry between distributors is said to result not only in price competition per se, but the development of more innovative and efficient modes of distribution.\(^{126}\) As already noted, this has the effect of reducing operating costs which can then be passed on to consumers in the form of lower prices.


\(^{126}\) Gerla, *supra* note 113 at 6.
Professor Gerla has identified a number of different ways in which discounter have been able to promote interbrand competition, namely by forcing competing distributors to press suppliers for price concessions, by forcing retail outlets to create private brands and by providing an outlet for many low-priced, unbranded products and products with less-known brand names. The many examples provided by Gerla and Steiner of the varied product categories in which intertype competition has played a crucial role in reducing margins and prices provide undeniable evidence that the discount industry has had a beneficial effect on interbrand competition in spite of the Chicago School's reluctance to accept this fact.

This increased competition from discounter is obviously not always welcomed by competitors especially where their own inefficiency does not allow them to match the discounter's lower margins and prices. To counter the potential loss of sales and drop in profits, recourse is often made to a variety of tactics designed to bring the discounter back into line in terms of price or even to have them completely cut off from the source of supply. The imposition of minimum resale prices by a supplier and the withholding of supply where induced by competitors of the discounter not only risks running afoul of competition laws, as already noted, but stifles and may even remove completely the ability of discounter to engage in price competition as well as providing a disincentive to the development of new, innovative and efficient modes of distribution.

127 Id. at 6-7. See also text accompanying note 137.

The effect on price competition is likely to be particularly severe where RPM is imposed by a supplier with a significant degree of market power because it is selling a highly differentiated branded product.\textsuperscript{129} If a product has a strong brand this, by implication, means that the degree of interbrand competition for that product is likely to be lower than usual. The existence of other brands is said to provide neither an alternative source of supply for discounters nor an effective check on prices charged by a supplier in situations where RPM is most likely to be adopted.\textsuperscript{130} Products with strong actual or potential brand identities are said to be exactly the products that modern discounters must carry in order to thrive and provide competition at both supplier and distributor levels.\textsuperscript{131}

It must be borne in mind when assessing the claims of discounters and their adherents that the continued proscription of RPM is very much in their self-interest. However, from an economic standpoint, the contributions to consumer welfare and competitive markets briefly reviewed above are undeniable and therefore this must be borne in mind in deciding upon the appropriate treatment of vertical price restraints. It is important that new and efficient retailing innovations not be discouraged by making it difficult for discounters to obtain leading brands and reselling them at prices which reflect their greater efficiency. In this regard, the focus of the Commission's attention should be on keeping barriers to entry low so as to facilitate new distribution techniques. Having regard also to the legitimate interests of suppliers, especially where they are small,

\textsuperscript{129} Pitofsky, \textit{supra} note 112 at 1492 n.22.

\textsuperscript{130} Gerla, \textit{supra} note 113 at 18.

\textsuperscript{131} \textit{Id.} at 18-19.
suggests that the Commission should be more concerned with larger suppliers with strong brands.

(d) **Pricing**

A number of empirical studies have been undertaken as to the effect of RPM on retail prices but their conclusions are the subject of some debate. The most instructive are those conducted by the Antitrust Division of the U.S. Department of Justice which was able to compare prices before, during and after the "fair trade" years as well as between states that did or did not adopt the laws.

A study conducted by the Department in 1956 in which the prices of 119 fair traded items were compared revealed that the prices of these items in the eight cities surveyed exceeded non-fair trade prices by an average of 19%.\(^{132}\) This finding accorded with the results of other independent studies carried out around this time, although these studies showed that the overall price range within which price-maintained items were sold tended to narrow.\(^{133}\)

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\(^{132}\) See *Fair Trade: Hearings on H.R. 1253 before the House Committee on Interstate and Foreign Commerce*, 86th Cong., 1st Sess. 506-7 (1959) (Testimony of Robert Bicks, First Assistant of the Antitrust Division of the Department of Justice).

A 1970 study by the Department of 78 different consumer products showed that in non-fair trade states, consumers could purchase more than half the products at lower prices than in non-fair trade states. This study noted:

The almost universal pattern developed in this study was higher sales per store in cities or states without resale price maintenance laws, a lower figure for stores in jurisdictions without the non-signer clause in their 'fair trade' acts, and even lower sales figures for stores in resale price maintenance jurisdictions with a non-signer clause.

The most recent detailed survey of the empirical evidence regarding RPM in the United States concluded that RPM in most cases increased the prices of products sold, although this was not always the case.

Those using these studies to support a strict treatment of RPM have also been able to point to specific examples where consumer prices dropped as a result of suppliers being forced to give up RPM (as well as those suppliers being better off than before in terms of sales and profits). The most recent and well-known case is that concerning Levi Strauss in the sale of its very strong brand of apparel. In keeping with the RPM tradition in the industry, Levi Strauss maintained the traditionally high gross margin of close to 50% right through the 1970's jean craze until intervention by the U.S. Federal Trade Commission. After it abandoned

134 ABA Monograph No. 2, supra note 10 at 79 n.327.

135 Fair Trade Laws: Hearings on S.408 before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, 94th Cong., 1st Sess. (1975) at 176. The reference to a "non-signer clause" is to those states which required all distributors to adhere to minimum resale prices as long as one of them signed a contract with a supplier to this effect.

136 Overstreet, supra note 73 at 160.
RPM, its sales increased substantially (as did its profits and share price), it was able to maintain its distribution with lower prices and consumer prices came down materially. The reduced retail gross margin and consumer price of the preeminent Levi Strauss brand also had the effect of forcing down the margins and prices of all other brands so that they could remain viable competitors.137

Those calling into question the findings of the Department of Justice point to the fact that the pressures of competition rendered the fair trade laws relatively ineffective even before they were repealed in 1975, therefore making comparisons unhelpful. A number of states in fact never passed fair trade laws, courts in a number of other states struck down their statutes as unconstitutional or otherwise unenforceable and out of the 21 states that did at one time authorize fair trade within their jurisdiction, only five had non-signer provisions.138 Thus, distributors in a number of states were able to ignore a supplier's stipulated minimum resale prices, while in others suppliers chose not to enforce compliance because of the costs of enforcement and the fear of losing large distributors as customers. When a significant number of sales of certain products began being made at prices below the fair trade minimum, the entire RPM system for that product tended to collapse. Suppliers who did try to enforce minimum prices found themselves losing sales and thus were forced to abandon the practice in order to maintain market share.139

137 For a detailed discussion of this and other cases, see Steiner, supra note 11 at 171-87.

138 Scherer, supra note 107 at 593.

139 Id. at 594.
Of the studies conducted in other jurisdictions, particularly Canada, their general conclusions have been that the level of prices and retail margins when RPM is in place tends to be higher than it would be under competitive conditions. It has been noted in each study however that comparisons between competitive prices and maintained prices are difficult to make and that RPM affects the prices of different products in different ways.\textsuperscript{140}

What the United States and Canadian experiences do suggest then is that RPM generally does tend to increase prices of selected products although this may be as much a result of the structural characteristic of the particular industry involved as well as other factors. This view is supported by the most recent survey of empirical evidence regarding RPM in the United States which found that RPM increased the prices of products sold with RPM in the period under review (namely 1965-1982) although this was not always the case.\textsuperscript{141} Whether or not the total proscription of RPM is warranted on this basis alone is a moot point, but the effect on prices is certainly also an important factor to be taken into account in deciding upon the appropriate treatment of vertical price restraints.


\textsuperscript{141} Overstreet, supra note 73 at 160. The FTC study also found that RPM was often useful to relatively small firms selling in structurally competitive markets, but such use was unlikely to be harmful to consumers; it determined that RPM occurred within all types of market structures, but, as noted above, was unlikely to facilitate collusion among manufacturers in the majority of these markets; and it concluded that the per se prohibition of RPM in the U.S. was "extremely difficult" to defend on the basis of economic logic. Id. at 81-82 and 176.
Legal and Policy Issues

(a) Legislative Policy

The adoption of the equivalent RPM provisions of the Australian Act in 1986 appears to have been made in the interests of uniformity without any regard to the extent of the practice in New Zealand or to the justification for a total prohibition. The RPM provisions in the 1974 Australian Act largely mirrored those first introduced in 1971 as an amendment to the Trade Practices Act 1965 which in turn were largely modelled on the United Kingdom Resale Prices Act 1964 (now 1976). A review of New Zealand, Australian and English texts reveals surprisingly little about the legislative policy behind the treatment of RPM in the 1958 and 1975 New Zealand Acts or the Australian and United Kingdom legislation to which New Zealand would inevitably have had regard.

What can be gleaned from these texts is that the prohibitions in the United Kingdom followed a series of reports by the Monopolies and Mergers Commission which showed that RPM was operating against the public interest in

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144 RPM still remains permissible in respect of books (Re Net Book Agreement (1957) [1962] 1 WLR 1347) and medicaments (Re Medicaments Reference [1970] 1 WLR 1339).
several industries\textsuperscript{145}, while in Australia the legislation appears to have been influenced by pressure from the Australian Council of Trade Unions to allow development of the discount industry and prohibit the withholding of supply.\textsuperscript{146}

As noted earlier, the first country to enact specific legislation dealing with RPM was in fact Canada in 1951\textsuperscript{147} after a report of the MacQuarrie Committee to study combines legislation in that country had recommended that RPM be prohibited.\textsuperscript{148} The Committee was unable to accurately assess the extent of the practice in Canada at that time, but was of the view that "the practice ... is widespread, it covers whole classes of goods, and ... is ... of significant and growing proportions".\textsuperscript{149} The Committee concluded its report by saying:\textsuperscript{150}

\begin{quote}
The Committee has studied resale price maintenance in the light of the two standards of judgement originally set up, namely, the desirability of a free economy and the need for economic efficiency. This study has led the Committee to the general conclusion that resale price maintenance, on the growing scale now practised, is not justified by either of these standards. It represents a real and undesirable restriction on competition by private agreement or "law" and its general tendency is to discourage economic efficiency. That is why, in our opinion, the prescription and the enforcement of
\end{quote}

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\textsuperscript{146} See Dunlop and Heydon, \textit{supra} note 1 at 9.

\textsuperscript{147} Combines Investigation Act S.C. 1951 (2nd Sess.) c. 30s1.

\textsuperscript{148} Committee to Study Combines Legislation, and \textit{Interim Report on Resale Price Maintenance} [The MacQuarrie Report] (Ottawa, Queens Printer, 1952).

\textsuperscript{149} \textit{Id.} at 3.

\textsuperscript{150} \textit{Id.} at 71 of the MacQuarrie Report.
\end{flushleft}
minimum resale prices must be viewed as manifestations of a restrictive or monopolistic practice which does not promote general welfare.

It is submitted that this same policy pervades the current RPM provisions in the Australian and New Zealand Acts, both Acts based as they are on promoting competition through enhanced economic efficiency for the benefit of the public at large. This view is borne out by the comments of former Australian Attorney General N.H. Bower who gave as reasons for banning RPM in Australia "that the practice tends to remove incentive to sell goods cheaply and that, in general, the practice works against the objectives of efficiency which are so important if our efforts to resist present inflationary pressures are to succeed."\(^{151}\)

The need to control inflation as the basis for the banning of RPM in Canada also reflects the opinion of two Canadian commentators. They state:\(^{152}\)

> In our view it is incorrect to ascribe the introduction of a price maintenance in 1951 to a desire of Parliament to use competition policy to protect the interests of small business. The proximate cause of RPM was the highly regarded MacQuarrie Committee Report in 1951 and the high rate of inflation being experienced at the time.

New Zealand also was experiencing inflationary pressures at the time of enactment of the 1975 legislation, as indeed was the rest of the world, but it is doubted that this was in fact the prime motivating factor. Rather, as is often the


case, New Zealand had lagged behind its Commonwealth counterparts in enacting specific provisions dealing with RPM and it is likely that it was the desire for consistent treatment of RPM as well as the general belief at that time that RPM had the effect of suppressing price competition in the market to the detriment of consumers that prompted some action by Parliament. Concern for the elimination of price competition such that the consumers may lose the opportunity to benefit from the increased efficiency or other competitive advantage of a particular distributor is consistent with comments made in the only Australian case so far to consider RPM in light of the overall policy of the Act where it was said:\textsuperscript{153}

\begin{quote}
It is clearly the intention of Parliament to lay down conditions for the conduct of corporate trade and commerce which will ensure that traders operate in competitive conditions and that the public has the benefits which flow therefrom. So far as resale price maintenance is concerned the object of the Act is to create conditions in which the public will benefit from traders competing with each other in respect of prices unfettered by price restraints imposed by suppliers of goods upon retailers.
\end{quote}

Moves in the United States towards a more permissive treatment of RPM appear, somewhat surprisingly, to have gone largely unnoticed in New Zealand or Australia. Any policy change in this direction by either the New Zealand or Australian Parliaments seems unlikely in the immediate future.

In contrast, Canada may well see a change in its legislation if the recommendation by the MacDonald Commission in 1985 to review that country's

\footnote{\textit{Trade Practices Commission v. Stihl Chain Saws (Aust.) Pty. Ltd.} (1978) ATPR 40-091 at 17,895.}
RPM provisions is taken up. ¹⁵⁴ Such a review, it was suggested, might determine that RPM should be illegal only when its detrimental effects on competition outweigh its benefits, or alternatively RPM could be made a matter for review by an administrative tribunal such as the RTPC as is now the case with exclusive dealing, tied selling and market restriction. ¹⁵⁵

(b) Comparative Treatment of Horizontal Price Restraints

Policy statements concerning horizontal price restraints are, at least in Australia and New Zealand, also conspicuous by their absence. There is little doubt in any jurisdiction however that price fixing by competitors is far from benign. As far back as 1927, Stone J. in the leading decision of *United States* v. *Trenton Potteries Co.* said: ¹⁵⁶

> The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed.


¹⁵⁵ *Id.* The Commission's recommendation was based on a detailed study by Mathewson and Winter which contended that there are circumstances in which RPM could in fact provide significant economic benefits. The study in fact recommended that RPM should be made legal except where it facilitates the establishment of a supplier or distributor cartel. See F. Mathewson and R. Winter, Competition Policy and Vertical Exchange (Toronto, University of Toronto Press, 1985) at 37.

This view was forcefully endorsed in 1940 by Douglas J. in United States v. Socony-Vacuum Oil Co. Inc. where he said:\textsuperscript{157} 

Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered or stabilized prices, they would be directly interfering with the free play of market forces.

With these views in mind, horizontal price fixing in the United States has largely remained unchallenged as one of the restraints which is the proper subject of per se illegality under section 1 of the Sherman Act.\textsuperscript{158}

The practice in New Zealand was first generally caught by section 19(2) of the 1958 Act and in the 1975 Act, the practice was specifically dealt with in section 27 which made it an offence for any person to be a party to an agreement or arrangement relating to the prices at which or terms upon which goods should be sold. Provision was made in section 29 for an agreement or arrangement to be approved, while there were also a limited number of exceptions.\textsuperscript{159}

\footnotesize
\begin{itemize}
\item\textsuperscript{157} 310 U.S. 150, 221 (1940).
\item\textsuperscript{158} It should be noted however that a trend has developed in a number of recent decisions not to apply a per se rule to horizontal price fixing. See e.g. Broadcast Music, Inc. v. Columbia Broadcasting System Inc. 441 U.S. 1 (1979) and NCAA v. Board of Regents of Univ. of Oklahoma 468 U.S. 85 (1984). For a discussion of these and other recent decisions see F. Spinnella Jr., "Categorisations and Presumptions in Horizontal Antitrust Cases", 22 N.E.L.R. 295 (1987).
\item\textsuperscript{159} For a discussion of these provisions, see Collinge, supra note 1 at 187-98.
\end{itemize}
Relevant provisions in the present Act again are largely modelled on the equivalent Australian provisions. Section 30(1) of the 1986 Act provides:

[A] provision of a contract, arrangement or understanding shall be deemed for the purposes of [section 27] to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market if the provision has the purpose, or has or is likely to have the effect of fixing, controlling, or maintaining, or providing for the fixing, controlling or maintaining of the price of goods or services, or any discount, allowance, rebate, or credit in relation to goods or services. (Emphasis added.)

The practical effect of section 30 is that all horizontal price fixing arrangements are illegal per se unless authorized under Part V of the Act. The present Act also contains a limited number of exemptions including joint venture pricing (section 31), recommended price provisions where there are not less than 50 parties to the contract, arrangement or understanding (section 32) and joint buying and promotion arrangements (section 33).

A detailed discussion of horizontal price restraints is well beyond the scope of this thesis. The brief review of section 30 above is intended however to focus upon the comparative treatment of horizontal price fixing as the basis for assessing whether the treatment of horizontal and vertical price restraints is consistent given the empirical evidence that RPM may in some instances facilitate collusion and

160 Sections 45A(1)-(4) and (7)-(8). For a discussion of these provisions, see Miller, supra note 43 at 65-69.

161 For a discussion of the authorization provisions, see text accompanying Part III, notes 79-81 infra.

162 It should be noted that these exemptions only relate to arrangements falling within section 30; such arrangements are still subject to section 27.
more generally that there will also almost always be a contract, arrangement or understanding between a supplier and distributor where RPM is involved. As Monsanto demonstrates, there will be few cases of purely unilateral action, such that there is no "meeting of the minds". This will arise for example where a supplier listens to and acts upon a complaint from a distributor, where a supplier urges a price cutting distributor to hold the line on price, or where a supplier explains its pricing preference in repeated or enthusiastic terms.  

Of immediate note is the provision for authorization of a price fixing agreement under section 30 in contrast to the absolute prohibition of RPM under section 37. Why this is so appears largely unexplained, particularly in light of the fact that section 88(2) of the Australian Act specifically denies authorization for arrangements fixing, controlling or maintaining the prices of goods (but not services), subject the equivalent exceptions mentioned above in sections 31-33 of the New Zealand Act. If the Australian experience is anything to go by however, few, if any, authorizations are likely to be granted. Also of note is that section 32, like section 39, allows for the recommending of prices, although nothing is said about the obligation to comply. It would seem that an understanding that there be compliance with recommended prices will fall afoul of section 30 itself.

Both sections 30 and 37 are comprehensive in their attempt to proscribe price fixing, whether it be horizontal or vertical. To this end, one may question why section 37 should not also be subject to a competition test, like section 30, and

163 See cases cited in W. Andersen, "The Antitrust Consequences of Manufacturer-Suggested Retail Prices-The Case for Presumptive Illegality", 54 Wash. L. Rev. 763 (1979) at 777.

164 See Miller, supra note 43 at 66-69.
indeed the rest of the trade practice provisions in the Act. In this regard, it is instructive to briefly refer to the leading Australian decision of Radio 2 UE Sydney Pty Ltd, v. Stereo F.M. Pty. Ltd. & Anor.\textsuperscript{165} concerning the general application of the Australian equivalent of section 30. In that case, Lockhart J. in the Federal Court Trial Division was called upon to consider the actions of two Sydney radio stations which offered equal advertising time on both stations at combined rates. His Honour stressed the importance of distinguishing between arrangements which restrain price competition and arrangements which have an incidental effect on price. In his view, not every arrangement between competitors which has some effect on price is per se unlawful, nor were the price-fixing provisions introduced to make arrangements unlawful which affect price by improving competition. Such a view he saw as consistent with the approach adopted in the United States' cases and he cited Socony in support.\textsuperscript{166} He then said:\textsuperscript{167}

\begin{quote}
It is fundamental to [the price fixing provisions] that the relevant conduct, in purpose or effect, substantially lessens competition-or would be likely to do so. If competition is improved by an arrangement I cannot perceive how it could be characterized as a price fixing arrangement within the ambit of those provisions.
\end{quote}

While Lockhart's approach, seemingly unwittingly, showed great similarity to the trend developing in the United States of distinguishing between price and non-price restraints on the basis of materiality of effect on price so as to avoid


\textsuperscript{166} The characterization of conduct depending upon its effect on price will be discussed in more detail in Part IIIC(2)(b).

\textsuperscript{167} Id. at 43,920.
application of the per se rule, the cases upon which he relied scarcely gave him support for this approach. It was no surprise therefore that the case was the subject of some criticism. When the case came up on appeal, the appellant alleging that the evidence disclosed a price-fixing arrangement within the meaning of section 45A of the Act and that such arrangement automatically involved a breach of section 45 (the equivalent of section 27) of the Act, the Full Court unfortunately found it unnecessary to consider this second allegation in disposing of the case. The Full Court did say however:

In our view the word 'fixing' in s.45A takes colour from its general context and from the words - "controlling or maintaining" - and not every determination of a price, following discussion between competitors, will amount to a price 'fixing'. There must, we believe, be an element of intention or likelihood to affect price fixing before price "fixing" can be established. This will often be a matter of inference, requiring no direct evidence for it to be established.

With respect, even this approach seems at variance with the policy underlying the section. There is no reference to "intention" in section 30; a provision need only have "the effect" of price-fixing to come into play.

Nevertheless, the approaches taken both by Lockhart J. and the Full Court may indicate the future approach of the Australia courts in this area and, if so, it certainly calls into question why horizontal price-fixing, which has traditionally

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170 Id. at 72.
been looked upon with more disfavour than RPM, should be the subject of more permissive treatment.

c) **Consignment Sales**

A fundamental issue to the very application of the RPM provisions of the Act is the meaning of the term "resale" in section 37. By the use of this word, it is arguable that the section does not come into play in a situation where an agency relationship\(^{171}\) can be said to exist such as where a supplier sells products on a consignment basis through distributors. In legal terms, a sale involves a transfer of property and no such transfer takes place where one person is acting as agent for another. Where a consignment system is being used, the transfer of property takes place between the supplier and the ultimate consumer and therefore no resale is constituted as the consignee does not take title at any stage. From this it follows that "the specification" to a distributor who is an agent "of the price below which goods are not to be sold" would not appear to be prohibited. The argument is reinforced by the reference to "another person" in section 37(3) which implies that that person has its own legal personality and will sell goods on its own behalf rather than on the supplier's behalf. An agency relationship between a supplier and "another person" would seem to deny this separate legal personality.\(^{172}\)

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\(^{171}\) In legal terms, "agency" is used to connote an authority or capacity residing in one person to create legal relations between another person in the position of a "principal" and third parties. In the business world however, its significance is by no means thus restricted. See *Kennedy v. De Trafford* [1897] AC 180,188 (per Lord Hershell). Whether or not an agency relationship exists will depend on the facts in each case. See e.g. *International Harvester Company of Australia v. Carrigans Hazeldene Pastoral Company* (1958) 100 C.L.R. 644.

\(^{172}\) See Donald and Heydon, *supra* note 1 at 363.
Such a legalistic argument would appear to defeat the economic purpose behind the prohibition. It has however been used with this end in mind in a number of significant distribution arrangements. The most notable test of its use was in United States v. General Electric Co.\(^{173}\) where the United States Supreme Court was called upon to consider a RPM scheme operated by General Electric under which it retained title to its products and merely consigned them to agents for resale. In upholding the consignment, the Court said that "genuine contacts of agency" did not violate section 1 of the Sherman Act "because the owner of an article, patented or otherwise" was not prohibited from "fixing the price by which his agents transfer the title from him to such consumer".\(^{174}\) Critical to this case was the finding that there was no conspiracy or combination.

An almost identical consignment system came up for consideration in Simpson v. Union Oil Co.\(^{175}\) This time however the Supreme Court held that there had been a violation of section 1 of the Sherman Act and sought to distinguish General Electric on the basis that there was no coercion in that case, unlike here. More specifically, the Court held that the consignment agreement was a sham by placing most of the incidents of ownership upon the shoulders of the so-called

\(^{173}\) 272 U.S. 476 (1926).

\(^{174}\) 272 U.S. at 478.

\(^{175}\) 377 U.S. 13 (1964).
consignee\textsuperscript{176} and that there was in substance a sale for resale purposes. Speaking for the majority, Mr. Justice Douglas said:\textsuperscript{177}

As we have said, an owner of an article may send it to a dealer who may in turn undertake to sell it only at a price determined by the owner. There is nothing illegal about that arrangement. When, however, a 'consignment' device is used to cover a vast gasoline distribution system, fixing prices through many retail outlets, the antitrust laws prevent calling the 'consignment' an agency, for then the end result of \textit{United States v Socony-Vacuum Oil Co} ... would be avoided merely by clever manipulation of words, not by differences in substance. The present, coercive 'consignment' device, if successful against challenge under the antitrust laws, furnishes a wooden formula for administering prices on a vast scale.

The Supreme Court in \textit{United States v. Arnold, Schwinn & Co.}\textsuperscript{178} decided just three years after \textit{Simpson}, upheld a consignment plan imposing territorial and customer restrictions on otherwise independent distributors. No price fixing was involved in \textit{Schwinn}, but the Court did indicate that price maintenance in a bona fide consignment system might be unlawful. As will be discussed in Part IIIB, the distinction between sale and consignment transactions made in \textit{Schwinn} was

\textsuperscript{176} The consignment agreement specified that while title to the consigned gasoline would remain in the supplier and the supplier would pay all property taxes thereon, Simpson, as distributor, "must carry personal liability and property damage insurance ... and is responsible for all losses of the 'consigned' gasoline in his possession, save for specified acts of God." \textit{Id}, at 15.

\textsuperscript{177} \textit{Id}, at 21-22.

\textsuperscript{178} 388 U.S. 365 (1967).
strongly criticized in Sylvania\textsuperscript{179} and the decision was ultimately overturned. Where this leaves the law in the United States is uncertain\textsuperscript{180}.

The law is certainly clearer in Canada. The 1975 amendments extending the price maintenance provisions to situations beyond just resale mean that consignment selling is now caught. Consignment selling was also made a civilly reviewable practice as part of those amendments following a number of reports indicating that it had been used in the past to avoid the price maintenance and price discrimination provisions of the Combines Investigation Act.\textsuperscript{181} Section 48 of the Canadian Competition Act of 1986 now empowers the Competition Tribunal to order that a supplier cease the use of consignment selling where the practice has been introduced by a supplier of a product who ordinarily sells the product for resale for the purpose of either (a) controlling the price at which a dealer supplies the product or (b) discriminating between consignees and other dealers. While no remedial orders have yet been made under this section, it is clear that a supplier's motive will be critical in any case. If there is a sound business reason for

\textsuperscript{179} 433 U.S. 36 (1977).

\textsuperscript{180} See however Mesirow v. Pepperidge Farm Inc, 703 F. 2d 339 (9th Cir. 1983) where a consignment agreement setting wholesale prices was held not to be illegal.

engaging in the practice rather than an anticompetitive purpose, then the section is unlikely to have application.\textsuperscript{182}

With no case on point in Australasia, one is forced to conclude that, on a strict interpretation of section 37, RPM in a bona fide consignment arrangement would appear to be lawful although, if the American experience is to be relied on, the per se prohibition against RPM cannot be avoided by clever draftsmanship. The Commission and the courts can be assumed to be primarily concerned with substance rather than form, and therefore the mere use of the terms 'consignee' or 'agent' will not necessarily be definitive.\textsuperscript{183} Where a distributor is clearly independent such that it acts on its own behalf rather than on behalf of its supplier and takes title to and bears the risk of loss on inventory, then a bona fide consignment arrangement will obviously be held not to exist. Factors pointing towards the existence of a bona fide consignment arrangement on the other hand will be if title and risk in goods remains with the supplier, a distributor has a right to return unsold goods or a supplier has a right to demand their return and if payment is only due upon actual sale of the goods rather than within some specified time. Even when a bona fide consignment arrangement is in use, it is arguable that it may still constitute an infringement if adopted as part of a deliberate plan to control the price at which goods are resold, especially if some form of inducement is involved. Section 37(3)(b) would then come into play, and it is unlikely that section 39 would be available as a defence.

\textsuperscript{182} Kaiser, \textit{supra} note 32 at 3.1.14.

\textsuperscript{183} TPC \textit{v. Pye Industries Sales Pty Ltd.} (1978) A.T.P.R. 40-088.
The possibility of an agency exception to the RPM provision, while illogical when one considers the purpose behind those provisions, would seem unlikely to constitute a ground for inducing a supplier to establish a system of consignment selling or to vertically integrate. A large number of other factors will inevitably be taken into account in choosing the appropriate form of distribution arrangement including the nature of the industry and the nature of the product. While American and Canadian experience in the past has shown there to be grounds for so doing, no empirical evidence appears available to gauge its most recent use. The fact that no remedial orders have been issued by the Canadian Competition Tribunal under section 48 or its predecessor suggests that those provisions have been effective. There therefore seems great merit in amending section 37 and/or introducing a simple provision into the New Zealand Act along the lines of that in section 48 to cure what appears to be a long overlooked and illogical loophole.

(d) Minimum vs. Maximum Resale Prices

As noted above, section 37 of the Act proscribes only minimum resale prices and not maximum resale prices. With all vertical price fixing per se illegal in the United States, one may question why RPM should be treated any differently in New Zealand dependent upon whether it involves the specification of minimum or maximum resale prices.

The majority in Albrecht v. Herald Co.\(^{184}\) offered a number of justifications for adopting a rule of per se illegality for maximum price fixing and it is worthwhile to consider each in turn. First, it was said that it limits the freedom

\(^{184}\) 390 U.S. 145 (1968).
of distributors to sell at the price they consider most appropriate. This justification really comes down to a question of the extent to which competition laws should preserve free and unfettered competition and so prohibit any contractual restriction which inhibits a distributor from acting in accordance with its own discretion. The development of the concept of "workable and effective competition" as the definition of "competition" under the Act is recognition that complete economic freedom can not and never will exist except in the most perfectly competitive market. All restrictions involve some limitation on freedom of action, hence the requirement for any lessening of competition under section 27 of the Act to be substantial.

To determine if a restriction hinders competition, its effects must be measured against the principal economic concerns of the Act, namely the prevention of restraints to free competition in business and commercial transactions which tend to restrict production, raise prices or otherwise control the market to the detriment of consumers. Establishing maximum resale prices does not necessarily restrict production, raise prices or otherwise control the market to the detriment of consumers; such a policy would in fact likely lower prices, thereby leading to an increase in output from the increase in demand. To this extent, the first justification can largely be disposed of.

185 Id. at 152-153 (per White J.) ["... schemes to fix maximum prices, by substituting the perhaps erroneous judgement of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market."].


Second, it was said that a maximum price may be fixed too low to allow a distributor to provide the amount of services necessary for the type of product being sold or which a consumer desires and is willing to pay. This justification assumes, contrary to Posner’s conception of the special services theory, that a supplier is unable to determine the price at which its distributors will engage in an appropriate amount of non-price competition and at which the supplier will maximize its own sales; that is, if the maximum price is set too low, inadequate services will be provided and the supplier’s sales will not be maximized.

What is being said in essence is that a distributor should be entitled to determine this optimal price itself. But a profit maximizing price for a distributor will not necessarily be the same profit maximizing price for a supplier. If a distributor has market power, it may, because of product differentiation, location or other economic factors, be able to command supra competitive profits at the expense of a supplier. An example might be a franchised restaurant chain where, because of the particular location of one restaurant, the relevant franchisee is able to charge much higher prices for meals than franchisees in other locations. The higher sales charged disrupt uniformity across the chain and therefore may affect sales and profits overall. In this situation, a maximum price will not only benefit the supplier but consumers and other distributors as well.

Third, it was said that maximum price fixing may channel distribution through a few large or specifically advantaged distributors who otherwise would

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189 See Posner, supra note 85 at 291-92.
be subject to significant non-price competition.\textsuperscript{190} However this is a question of fact depending as much on other factors such as a supplier's choice of distributors, distributor efficiency, provision of discounts and so on.\textsuperscript{191}

A fourth and final justification offered was that the actual price charged under a maximum resale price scheme often operates as a de facto fixed price.\textsuperscript{192} As such, the scheme has all the attributes of a minimum resale price fixing scheme. If this is the intended effect, then in New Zealand both section 27 and section 37 would apply. Obviously if maximum resale prices are above the competitive level, distributors are free to sell below such prices and competition can not but be enhanced. The objection to RPM is quite the opposite, namely that it keeps prices above the competitive level and thereby precludes competition.\textsuperscript{193}

The Supreme Court in \textit{Albrecht v. Herald Co.} relied on \textit{Kiefer Stewart v. Joseph E. Seagram & Son.}\textsuperscript{194} which involved horizontal maximum price fixing, to justify application of a rule of per se illegality to vertical maximum price fixing.

It will be recalled that one of the traditional justifications for proscribing

\begin{footnotesize}
\begin{enumerate}
\item Albrecht v. Herald Co. 390 U.S. at 152-53.
\item ABA Monograph No. 2, \textit{supra} note 10 at 93.
\item Albrecht v. Herald Co. 390 U.S. at 152-53.
\item 340 U.S. 211 (1951). In this case, the respondent agreed to sell its products only to those wholesalers who would resell below stipulated price ceilings. The Court held that the stipulated maximum resale prices inhibited the wholesalers' rights to select a fair price for their products just as effectively as minimum resale prices. \textit{Id.} at 213.
\end{enumerate}
\end{footnotesize}
minimum resale prices is that it involves the manifestation of a distributor cartel whereby a supplier acts as an instrument of the distributors in policing and enforcing the cartel price. In the case of a supplier adopting a maximum resale price policy on the other hand, there is no logical reason why distributors would be motivated to collectively seek a maximum price. They are unlikely to be concerned about a competitor raising its price, but only that their own prices are high enough to give them an adequate return on capital. The benefit of a maximum resale price policy would seem to lie primarily with a supplier who will set a price which maximizes its own prices. As Harlan J. noted in his dissent in Albrecht, there is no single horizontal restraint on otherwise competitive distributors but merely a series of distinct vertical restraints between a supplier and its distributors, with no one distributor economically interested in the maintenance of a vertical restraint with any other distributor.195

It is not surprising that the decision in Albrecht has been the subject of extensive criticism196 to the point where there is now virtual unanimity that a rule of per se illegality against maximum sale prices makes no economic sense. One commentator has gone so far as to say:197

I know of no economist, respectable or otherwise, who has come up with a rationale for proscribing maximum price fixing in recent years.

195 390 U.S. at 159-60 n.4.

196 See e.g. 32 P. Areeda and D. Turner, Antitrust Law (1978) at 255 n.13, Pitofsky, supra note 97 at 1490 n.17; and Scherer, supra note 74 at 705-06.

A number of lower courts have sought to circumvent the application of *Albrecht*198 and it is at least arguable that its basis has been undermined by *Sylvania*. This arises from the fact that *Albrecht*, which involved the assignment of exclusive territories to distributors, was based in part upon the prohibition of exclusive territories in *Schwinn*, which prohibition was itself expressly overruled in *Sylvania*.199 The current enforcement policy of the Department of Justice and Federal Trade Commission in the United States also means that few, if any, cases will be brought challenging maximum resale price schemes.

In light of the foregoing, the present treatment of maximum resale prices under the more general provisions of the Act therefore seems justified. Vertical price ceilings should generally be pro-competitive as a supplier who uses them will normally be trying to lower prices to consumers and, when that is the case, the effect should be to increase price competition at the retail level. This was generally recognized in the leading New Zealand decision on this point, *Tru Tone Ltd. et al. v. Festival Records Retail Marketing Ltd.*200 The respondent in this case

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198 See e.g. *Jack Walters & Sons Corp. v. Morton Bldgs., Inc.* 1984-2 Trade Cas. (CCH) 66,080 (7th Cir. 1984). In this case, Judge Posner argued that a supplier-imposed price ceiling is intended to limit the power that an exclusive territory gives a distributor and should be lawful if the exclusive territory arrangement itself meets a rule of reason test.

199 Id. See also Posner, *supra* note 102 at 12 ["The logic of *Sylvania* is that restrictions imposed on dealers by manufacturers promote interbrand competition and are therefore not per se illegal, save perhaps if the manufacturer has a monopoly. That logic demolishes *Albrecht*."] It should be noted however that *Albrecht* was cited as authority in *Arizona v. Maricopa County Medical Society* (457 U.S. 332 (1982)) so as to condemn as agreement between a group of doctors establishing maximum fee schedules for policy holders under certain insurance plans. Although the facts disclosed horizontal price fixing, the vertical per se rule was relied upon.

200 September 19th, 1988, Court of Appeal of New Zealand, CA 85/88.
sought to set maximum retail prices for its records, cassettes and discs as a condition of supplying them to retailers. It gave evidence that its philosophy was to keep its products at a competitive level and generally below that charged by its competitors so as to maximize sales in the long term. (One may also assume that it wished to ensure some measure of price stability by itself advertising the maximum price nationally. These seem to be the obvious rationales for adopting the policy). Even so, the fixed maximum resale price gave the retailers a margin of 38-43%, comparing favourably with the margin of other distributors of as low as 33 1/3%.

In the High Court, RPM and maximum price stipulations were found to be quite different in concept and effect, the Court concluding that maximum price stipulations may or may not reduce competition in a market dependent on the circumstances. The Court of Appeal was not required to decide this issue, but cited a lengthy passage from Harlan J.'s dissent in *Albrecht* in support of the appellant's concession that maximum retail pricing is not in itself illegal or anticompetitive.\textsuperscript{201}

The Court of Appeal was in no doubt on the facts that the respondent's maximum retail pricing neither had nor was likely to have the effect of substantially lessening competition in the relevant market under section 27 of the Act. The Court also rejected the appellant's contention that a separate market existed for each individual record, tape and disc and there was therefore no question of dominance under section 36.\textsuperscript{202}

\textsuperscript{201} Id. at 23.

\textsuperscript{202} Id. at 20-21 and 26.
Similar justifications to those presented by the majority in Albrecht were either dismissed or found to be unconvincing. In particular, the appellants argued that the respondent's enforcement action resulted in virtual price uniformity in the retail pricing of the respondent's products in contrast with a degree of price variation for the products of other suppliers. They did not however say how the maximum price stipulation threatened or affected their profits and their ability to compete nor why they needed a higher mark-up from the respondent in regard to its products than for those of other suppliers. Indeed, the evidence showed that several stores still competed for price on the respondent's albums and overall there was no evidence of any actual or likely lessening of price competition in the relevant market.203 The Court concluded by saying,

\[
\text{[I]n a real sense [the respondents] price ceiling is pro-
competition in that it provides a check on retailers who}
\text{through location or otherwise have less competition-induced}
\text{constraints over the prices they charge.}
\]

\[
\text{To put it another way, there is a real prospect that without}
\text{maximum pricing stipulations retailers in this market will not}
\text{pass on [the respondent's] costs savings on to the public.}
\]

203 Id. at 26. A similar argument to that raised by the appellants in Tru Tone, namely that maximum prices prevent distributors from obtaining the benefit of higher prices should the market so warrant, was noted in the Report to the Hon. The Minister of Trade and Industry of the Inquiry into the Terms of Motor Vehicle Franchise Agreements (1985) in regard to the maximum prices specified by national franchise holders. The essence of the motor vehicle dealers' argument was that in a deregulated environment, dealers should be able to charge higher prices if they wish, particularly in respect of makes in short supply. The Commission, like the Court in Tru Tone, was not required to comment on this issue, the dealers also presenting no evidence. The national franchise holders obviously had a legitimate interest in preventing their dealers from taking full advantage of any situation of short supply on the basis that any price increases would cost them long-run goodwill and strategic position.

204 Id. at 26-27.
This is not to say that price ceilings are benign. They may in fact be anticompetitive in some situations but in few enough to make a per se prohibition inappropriate. The advantage of the present treatment is that any substantial anticompetitive effects can be discerned, weighed against any procompetitive effects and the practice struck down if necessary. No change therefore seems warranted at the present point in time.

(e) **Recommended Resale Prices**

The inclusion of section 39 of the Act allowing the recommending of resale prices by a supplier was undoubtedly influenced by the Report of the United Kingdom Mergers and Monopolies Commission on Recommended Prices in 1969.\(^{205}\) The Report was prompted by evidence that recommended prices were being used to simulate resale price maintenance and were in fact having the desired effect.\(^{206}\) The Monopolies Commission confirmed that this was the case, but took time to consider the alleged advantages of recommended prices. It rejected the submission that such prices reduced administrative costs by assisting resellers to price their goods, there being no reason why independent resellers could not undertake this exercise themselves. The Commission did however support to some extent the submission that recommended prices make advertising more effective, particularly for new products, by the publishing of a "de facto" maximum price.\(^{207}\)

\(^{205}\) *Recommended Resale Prices* (1968-69 H.C. 100

\(^{206}\) Merkin & Williams, *supra* note 145 at 234.

\(^{207}\) *Id.* at 235.
As to the general effect of recommended prices on price levels, the Commission's findings were inconclusive to say the least. The Commission found that in trades where the practice of recommended resale prices was prevalent, prices tended to be uniform, although they might be higher or lower than in trades where it was not prevalent. More importantly, it was also found that the number of cases in which prices will be higher where a recommended price is followed was likely to be significant particularly where the recommendation of resale prices was used in conjunction with practices such as restriction of outlets in terms of territory or product and/or if there was a monopoly in the supplying industry. In other cases, where, for instance, a supplier was entering the industry, it was found that the effect of the practice might be to keep prices lower. Depending then on the trade concerned, the practice might be either beneficial or harmful to the public interest.

Having reached this conclusion, the Monopolies Commission did not recommend that the practice should be banned in all circumstances but did recommend banning the recommending of resale prices in selected cases after investigation. Neither Australia nor New Zealand took up this second option, requiring instead, as already noted, an explicit statement that recommended resale prices are only recommended and that there is no obligation to comply with any recommendation. Canada similarly, as also already noted, requires that a producer or supplier make it clear that a person is under no obligation to accept a suggested resale price and will in no way suffer in its business relations if it does not follow the suggestion. Compliance with the Canadian Competition Act further requires that suppliers of a product, other than retailers, must indicate that the product can
be sold at a lower price.\textsuperscript{208}

Does the mandated use of recommended prices effectively legalize RPM, by allowing suppliers to do indirectly what the law forbids them to do directly, even with these strict requirements? It was shown in Part IIB that there is some risk in the specification of a recommended price being seen as the specification of a price below which goods are not to be sold and therefore being caught by section 37. But suppliers are often able to use subtler techniques such as preticketing, catalogues, price lists, and promotional literature to take advantage of the exemption. Preticketing and so on strongly suggest that a distributor should sell an item at the set price. Advertising by a supplier announcing the recommended resale price of a product will likely make a distributor reluctant to charge a different price, otherwise the distributor may be required to create, develop and pay for its own advertisements.\textsuperscript{209} A distributor may well use a recommended resale price for comparative advertising purposes but this in itself runs the risk of

\textsuperscript{208} Section 38(3) and (4). These provisions were brought in with the 1975 amendments, the situation before this time being that suggested prices were not attacked provided that nothing was done to enforce them. It is notable that the McQuarrie Report, supra note 148 at 71, originally recommended that it should be made an offence for a supplier "[t]o recommend or prescribe minimum resale prices fpr his products", although the Committee was concerned to ensure that the established practice of issuing price lists not be interfered with.

\textsuperscript{209} A supplier may also enter into some form of joint advertising arrangement with a distributor, conditioning its contribution upon the distributor agreeing not to advertise a product at a price less than recommended by the supplier. But even this sort of arrangement may be at risk. See Trade Practices Commission v. Sharp Corporation of Australia Pty. Ltd. (1975) 8 A.L.R. 1255 (Hearing on December 11th, 1975, noted at p. 17 of 1975-76 ATPR Report) where the TPC alleged that the subsidization by Sharp of 50% of a reseller's advertising costs was dependent on the reseller selling at Sharp's recommend retail prices. A fine of $5,000 was imposed. Cf. PDQ, Inc. v. Nissan Motor Corp. 577 F.2d 910 (1978).
infringing the Fair Trading Act 1986 whereby an advertisement may be held to be misleading and deceptive if it compares a selling price with a higher 'recommended price' and leads consumers into the erroneous belief that the difference between the two in fact represents an actual saving. There may obviously be a saving if the 'recommended price' is the price habitually charged, but more often than not the usual price charged is less than the recommended price and closer to the advertised price. To this extent, the consumer is likely to be misled or deceived.

The use of recommended resale prices obviously has various advantages in terms of price uniformity and stability. It does however have all the hallmarks of outright RPM by reducing price competition, especially where a large number of a supplier's distributors adhere to the recommended resale price rather than engaging in their own pricing. Very real arguments can therefore by made for the repeal of this exemption if the present treatment of RPM is to be continued.

(f) Withholding of Supplies

It will be recalled from the previous section that a supplier may be held to have engaged in the practice of RPM where in regard to, say, section 37(3)(d)(ii) of the Act, it can be inferred that a "substantial" or "operative" reason actuating the supplier in withholding goods from a reseller is that (a) the reseller has sold or is likely to sell the supplier's goods at a price less than specified, or (b) the three factual elements mentioned in section 42 are proved and the supplier does not rebut the presumption by providing evidence to the contrary.²¹⁰

²¹⁰ See text accompanying notes 61-70 supra.
From this, the question arises as to the extent to which a supplier is free to adopt a marketing strategy that involves selecting only certain distributors to market and sell its products. In other words, is a supplier obliged to deal with 'all-comers' regardless of its marketing strategy. A supplier's freedom to deal is countered by the competing claims of distributors (particularly new and small distributors) to be able to carry on business without interference from the restrictive distribution practices of suppliers and by the interests of consumers in more efficient distribution and lower prices.

A supplier's decision to restrict its channels of distribution may be for any one or more of the following reasons which are totally unconnected with RPM:

(a) a supplier may, for example, decide to supply wholesalers only, and not retailers or indeed consumers;

(b) a supplier may decide to deal only with, say, specialist clothing stores to the exclusion of department or discount stores;

(c) a given quantity may be too large to be supplied without disrupting a supplier's production, storage or distribution, or conversely it may be so small as to be unprofitable;

(d) a distributor may refuse to sell other products of the supplier;

(e) a distributor may lack the technical expertise to handle products requiring complex service or installation;
(f) a distributor may lack the financial resources necessary to handle a product requiring a large investment in terms of promotion and distribution facilities;

(g) the credit status of a distributor may be suspect or unknown to the supplier, or there may be a history of unpaid or overdue accounts;

(h) a supplier may wish to ensure that the marketing of its products attains a certain standard and that the presentation of its products appeals to the market segment for which it is intended;

(i) the expense of transporting products to a distributor may be exorbitantly high or transportation may be just plainly unfeasible and impractical; and

(j) a supplier may not have the resources to maintain contact with and provide ongoing technical, marketing and sales assistance to a large number of distributors.\(^{211}\)

A withholding of supply for marketing reasons such as these should not be caught by the Act unless there are serious anticompetitive consequences.\(^{212}\)

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\(^{212}\) In general terms, the Act does not prohibit a refusal to deal per se nor does it place an obligation upon a person to deal with anyone or everyone. If a supplier is in a dominant position in a market and it refuses to supply a distributor or potential distributor, this may amount to the use of a dominant position for the purpose of restricting the entry of or eliminating a distributor from the market, or preventing or deterring competitive
Invariably however, a withholding of supply is for reasons connected with RPM because price is so often an element in a marketing strategy which calls for selective distribution. The problem lies in distinguishing those situations in which the maintenance of resale prices is not the real reason for the withholding from those in which it is. Examples of the former might be:-

(a) a supplier may want its distributors to undertake a certain level of instore promotion and advertising in the marketing of its products and will only supply those who are prepared to put in the necessary effort and incur appropriate costs. Those distributors seeking to 'free-ride' on the marketing efforts of other, may cause the latter group to curtail or even cease altogether their promotion and advertising of the supplier's products if they feel they are bearing an unfair burden. The supplier's sales will inevitably fall as a result.

conduct in the market so as to contravene section 36. Further a supplier who refuses to supply a distributor in order to induce the distributor not to deal with a third party may be said to have entered into or given effect to a provision in a contract, arrangement or understanding that substantially lessens competition in a market so as to contravene section 27. (In this situation also, a supplier may be at risk under section 36). Australian authority gives some support for a refusal to supply where there have been no prior dealings, even if there is no alternative supplier (see MacLean & Anor v. Shell Chemical (Australia) Pty. Ltd. (1984) A.T.P.R. 40-462 and Queensland Wire Industries Pty. Ltd. v. The Broken Hill Proprietary Company Ltd. & Anor. [1988] A.T.P.R. 40,841. Canadian authority on the other hand places a special obligation on those in a dominant position to supply (see Restrictive Trade Practices Commission, Report Concerning the Manufacture, Distribution and Sale of Ammunition in Canada (Ottawa, Queens Printer, 1959) and R. v. Electric Reduction Co. of Canada, (1970) 61 C.P.R. 235) Section 47 (to be renumbered section 75) of the Canadian Act also allows the RTPC to order one or more suppliers to accept a customer within a specified time on usual trade terms if certain conditions are met. The position is quite different however once a distributor has been appointed and supplies have been made available, unless there are good commercial reasons for the subsequent refusal. See United Brands Continental B.V. v. Commission [1978] E.C.R. 207.

The problem is largely evidentiary with surrounding facts often complicating the matter for example, periodic refusals to supply while accounts remain outstanding, erratic supply in response to complaints to authorities and deliberate late delivery.
(b) A supplier may want to prevent its products from being 'specialled' or 'loss-leadered' either (i) to protect its smaller distributors from excess price competition or (ii) to avoid bringing the reputation of its products into disrepute and thereby detrimentally affecting goodwill and future sales. If smaller distributors are driven out of the market or those who do adhere to specified prices are unable or unwilling to meet the discounted price, the reduced number of distributors or reduced promotional effort may lead to a decrease in sales overall.

(c) A supplier may believe, as empirical evidence has shown in some cases, that the optimal price at which the sale of its products will be most successful is not necessarily the lowest price. Certainly in regard to products aimed at the more affluent segment of the market, higher prices may make products more appealing as an indication of quality. If the products become the subject of price cutting, their image may be tarnished, certain segments of the market may cease to buy them and those distributors normally catering to this market segment will reduce or even cease stocking the products.\(^{214}\)

If RPM is an element of a supplier's marketing strategy, then a withholding of supply in any of the above situations will seemingly be condemned no matter how substantial any non-price related reasons may be.

This problem arises because section 2(5)(b) only requires that the reason why a person engages in certain conduct (which by virtue of section 2(2)(a)

includes "refusing to do any act")\textsuperscript{215} need be "a" substantial reason rather than "the" substantial reason.

The motivational analysis which the present Act requires the Commission and the Courts to undertake is fraught with difficulties given that any business decision involves mixed motives. The present analysis also renders the Commission and the Courts unable to weigh up the anticompetitive effects of any marketing strategy involving RPM. A number of solutions may be proposed.

(a) a supplier may be allowed complete freedom to withhold supplies from any distributor it chooses.\textsuperscript{216} This alternative is however unpalatable given the anticompetitive effects which may result where the supplier possesses market power;\textsuperscript{217}

(b) the situations in which a supplier may legitimately withhold suppliers as part of its marketing strategy may be listed (for example, inadequate promotion of a supplier’s products, disproportionate emphasis on a competing supplier’s brands, poor payment record, fraudulent sales practices and so on). Such

\textsuperscript{215} Section 2(2)(c) goes on to provide that a refusal to do any act includes "(i)\textsuperscript{[r]}efraining (otherwise than inadvertently) from doing that act; or (ii) \textsuperscript{[m]}aking it known that that act will not be done".

\textsuperscript{216} The converse is to impose a duty on suppliers to deal with distributors who meet some threshold of responsibility. This may be appropriate when justified by social and political ends but is wholly inappropriate from an economic standpoint in regard to this particular issue. \textit{Cf.} Anderson, \textit{supra}, note 163 at 790.

\textsuperscript{217} No case has yet been heard under the present Act dealing with a pure refusal to deal.
a list is however likely to be extensive, and even then inadequately and clumsily drawn.

(c) the situations in which a supplier may not legitimately withhold supplies may be listed in more sophisticated and narrower terms than is at present the case. As in (b), a supplier should be able to withhold supplies from a second person for reasons unconnected with RPM (for example, where the supplier legitimately doubts the distributor's credit worthiness or decides that the distributor may not provide adequate services). Again, such a list is likely to be difficult to draw.

(d) any practice, whether or not it involves an element of RPM, would be subject to the general tests of the Act, namely a "substantial lessening of competition" test in respect of any contract, arrangement or understanding or a 'use of dominant position' test in respect of unilateral action by a supplier possessing a sufficient degree of market power. The problem with this alternative is that a supplier's actions are judged merely on the basis of their effect on competition and so a supplier may be compelled to deal with distributors who do not fit in with its marketing strategy yet provide a great deal of price competition.

It can be seen that none of the above solutions can achieve the perfect result but, within the policy of the Act, it is submitted that if a supplier has a predominately lawful purpose for withholding supplies from one or more distributors as part of its marketing strategy and such strategy does not have anti-competitive effects, then it should not be condemned as unlawful even though it contains an element of RPM. To this extent, solution (d), or at least a modified form thereof, would seem to be most appropriate, necessitating the repeal of some,
if not all, of the present RPM provisions. How this recommended treatment of the withholding of supplies should fit in with the overall treatment of RPM under the Act will be discussed in the conclusion to this Part.

(g) **Loss-Leadering**

The omission of a defence of loss-leadering in both the 1975 and the 1986 Acts is notable when one compares the Canadian, Australian and also the English legislation. Of all the justifications for retaining RPM, it was the fear of loss leader selling which was most commonly raised in arguments by suppliers, and the factor which most accounted for the initial reluctance to legislate against RPM.\(^{218}\) The concern of suppliers was that loss leadering tended to bring the reputation of their products into disrepute and thereby detrimentally affected the goodwill and future sales of their products. A related concern of suppliers was that products frequently used as loss-leaders might cause some distributors to cease promoting or even to discontinue selling the suppliers' brands because it was unprofitable to do so. This would thereby leave suppliers with fewer outlets and a likely drop in sales. Indeed, loss-leader tactics might even cause some distributors to go out of business where the products in question constituted a major part of their business and they were able to survive at competitive but not loss-leader prices.

Loss leader selling was the subject of a major inquiry by the Restrictive Trade Practices Commission ("RTPC") in Canada in 1955.\(^{219}\) The RTPC found that

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\(^{218}\) The need to prevent loss leading was accepted by the Lloyd-Jacob Committee in the United Kingdom in 1949 as sufficient justification for prohibiting collective RPM and not individual RPM.

the term "loss-leader selling" may be applied to any level of pricing, extending from a price in any degree lower than a supplier's suggested resale price to a price at or below net purchase cost. The evidence up to the time of the inquiry indicated to the RTPC that sales below net purchase cost were made infrequently, and when such selling was engaged in, it was generally for periods of short duration by merchants of comparable standing. No need was therefore seen to recommend legislative action to control or suppress the practice.

Despite the 1955 Report, a legislative amendment was passed in Canada in 1960\textsuperscript{220} to provide for a defence to a refusal to deal which was based on a prospective customer's practice of loss-leadering. Section 3 of the Resale Prices Act 1964 (UK) provided a similar defence by way of an exception to the general rule that goods may be withheld from "dealers" who have cut or would be likely to cut the supplier's resale price\textsuperscript{221} and Australia followed suit in enacting its RPM legislation in 1971.

The policy of the Australian Act is to allow a supplier to protect itself from a reseller who engages in the sale of the supplier's goods at a loss in order to attract custom or to promote the reseller's business in some way, resulting in the supplier's goods gaining a reputation as inferior goods and damaging the market

\textsuperscript{220} S.C. 1960 c. 45, section 14 adding section 34(5) to the Combines Investigation Act (now section 38(9) of the Competition Act).

\textsuperscript{221} See Lever, supra note 142 at 95-96 and In Re Net Book Agreement (1957) [1962] 1 WLR 1347 where impracticality of preventing the use of goods as loss leaders without an effective system of RPM was recognized in the case of books.
prospects of the supplier. Accordingly, as previously noted, a supplier can lawfully withhold the supply of goods to a second person who, within the preceding twelve months, has sold goods obtained from the supplier at less than their cost for the purpose of attracting or otherwise promoting business from persons likely to purchase other goods. However, in taking advantage of that defence, the supplier cannot use as the reason for the withholding of supplies a genuine seasonal or clearance sale of goods that were not acquired for the purpose of being sold at that sale, or a sale that takes place with its consent.

The exception for loss-leadering has however proved to be of little practical significance with only three cases having been decided in Australia to date and only four in Canada. This supports the view expressed by the RPTC in its 1955 Report wherein it found little evidence of sales below cost. In this regard, a distinction must be made between a sale below cost and a sale yielding no net profit. Examples of the latter are far more prevalent. It is not uncommon for a

222 See Donald & Heydon, supra note 1 at 381.

223 Section 98(2).

224 Section 98(3). See also Canadian Competition Act, section 38(9) and text accompanying note 42 supra.

225 Some difficulty has been experienced in defining the terms "cost" and "loss" in the context of the loss-leader provisions. In Trade Practices Commission v. Orlane Australia Pty. Ltd. (1984) 51 A.L.R. 767, the Australian Federal Court was of the opinion that "cost" referred to "the cost of obtaining or landing the goods: that is, 'landed' or delivered cost or, as it is put, net acquisition cost". In regard to the expression "loss", the Court saw the "simplest and most obvious meaning" as being "a selling price that is below the delivered cost to the seller ... any departure from the acquisition cost test is fraught with difficulties of application". (Id. at 772-76). See also R v. H D Lee of Canada Ltd (1980) 57 C.P.R. (2d) 186. ["The term used in the statute is not 'leader' which is defined in Webster as 'an article offered at an attractive special low price to stimulate business', but 'loss-leader' which
distributor to sell a strongly branded product at or close to its cost price in order to attract customers who, once in the store, will buy other items on which substantial profits can be made. Of course, a distributor will profit from such a marketing strategy only to the extent that consumers find the low price so attractive that they will patronize the distributor's store. It is conceivable that successive offerings of a product at very low prices may ultimately affect the value of the product in the consumer's eyes, but more often than not, the strategy is aimed at building traffic in the product itself. A supplier, especially where a product is reasonably new to a market, may well support a distributor's actions to push through large volumes of the product at low prices if the product is likely to receive large exposure and result in higher long-term sales through customer awareness. The use of a product as a loss-leader in this situation is obviously very much in the supplier's interest. It must not be forgotten however that the risk of a reputation being lost depends on there being a reputation to be upheld in the first place. To this extent, many supplier's concerns may well be overstated.

If a supplier is concerned about possible loss-leader selling, it can always adjust its wholesale price upwards, thereby making it less profitable for a distributor to engage in this practice. Alternatively, it can refuse to sell to distributors that are likely to discount its product heavily, given of course that there has been no prior record of dealing. This presumes however that the distributor is not in a position of market power. It is often the case that a distributor has sufficient clout to induce a supplier to supply it with a large volume of products at a low or even unreasonably low price for a special promotion under threat of discontinuing its purchases if supply is not so made. The supplier must then decide whether or not to accede to the threat in order to clearly indicates a meaning of selling at a loss or at least without a profit. (Id. at 197)].
keep the distributor in question as a customer in the long term. If the supplier does accede, it then faces the risk of losing its other distributors who may not be able to compete at the low price, while the distributor in question may itself eventually switch suppliers leaving the original supplier in real difficulties. The problem in refusing to supply is whether or not the price sought by the distributor is in fact below the supplier's fundamental acquisition cost or really just reflects a quantity discount.

Because 'loss-leadering' as such is exceptional and sporadic in nature and because it is unlikely that suppliers are in fact prejudiced in the long-term by such a practice (indeed, they are more likely to benefit), there seems no need to incorporate a defence into the Act along the lines of that in Australia, Canada or the United Kingdom.

(h) Administration and Enforcement

Reference has been made at various times in the foregoing pages to the different rules of analysis advocated by particular commentators depending upon the School to which they belong and the theories they espouse. In the main, the choice of a particular rule comes down to the economic effects which these commentators believe the practice has on competition and, importantly for immediate purposes, the costs and efficiency of administration and enforcement.

At one extreme is the rule of per se illegality adopted by the four jurisdictions under review and advocated by, most notably, Professors Comanor and Pitofsky as well as by small distributors and not so small discounters. The former support the rule on the basis of a mixture of economic theory and social
and political values,\textsuperscript{226} while the latter have a more personal interest, seeing the end of per se treatment resulting in the loss of a significant bargaining tool in their relationships with suppliers.\textsuperscript{227} They base their argument on price competition being the lifeblood of commerce.

It will be recalled from the introduction that a per se rule of illegality deems a practice so typically harmful to competition and so devoid of credible benefits to be presumed unlawful without any proof of purpose or intent and without any inquiry into the effects of the practice. The rule has a number of advantages from an administrative and enforcement standpoint in that it avoids difficult and costly litigation, it provides predictable results for planning purposes, it saves enforcement agencies and courts from engaging in unwieldy economic analysis and last, but not least, it contributes to efficient enforcement.\textsuperscript{228}

At the other extreme is a rule of per se legality supported predominantly by members of the Chicago School who argue that RPM is always beneficial to consumers. Under such a rule, RPM would be lawful, no matter what the market share of the supplier.\textsuperscript{229} The underlying premise is that economic efficiency provides the only workable standard from which an appropriate rule can be

\textsuperscript{226} Both commentators do concede the need for some carefully drawn exceptions such as for new entrants and weak competitors. See Comanor, \textit{supra} note 96 and Pitofsky, \textit{supra} note 97.

\textsuperscript{227} Gerla, \textit{supra} note 113.


\textsuperscript{229} See e.g. Bork \textit{supra} note 88 at 289-91.
The efficiency approach claims the same advantages as a rule of per se illegality, namely clear and predictable rules for decision-making, judicial economy and legal certainty. 231

A rule of reason analysis is favoured by those adopting the middle ground. 232 In the New Zealand context, this would mean subjecting RPM to the more general provisions of the Act, namely sections 27 and 36. The principal advantage of the rule of reason is a recognition that there may be various efficiencies flowing from the use of RPM, and that the pro-competitive effects of the practice in any particular case may be weighed against its anticompetitive effects. There is no doubt that the rule of reason is theoretically the best rule but it has distinct disadvantages from an administrative and enforcement standpoint. Its disadvantages are those which make the per se rules so appealing, namely litigation may become protracted, difficult and expensive because of the extensive economic analysis which must be conducted on each occasion into the competitive effects of the particular practice, planning is somewhat unpredictable because of the development of a number of often conflicting modes of analysis, and enforcement is less efficient. It is the very inability, or at least difficulty, which courts and enforcement agencies would have in arriving at an objective standard by which to determine the reasonableness of a price that has militated against the


adoption of other than a rule of per se illegality in horizontal price fixing cases.

The most well-known statement to this effect was that made by Douglas J. in

United States v. Socony-Vacuum Oil Co. Inc. where he said:233

The reasonableness of prices has no constancy due to the
dynamic quality of business facts underlying business
structures. Those who fixed reasonable prices today would
perpetuate unreasonable prices tomorrow, since those prices
would not be subject to continuous administrative supervision
and readjustment in light of changed conditions. Those who
controlled the prices would control or effectively dominate
the market.

As also said in United States v. Trenton Potteries Co.234

[I]n the absence of express legislation requiring it, we should
hesitate to adopt a construction making the difference
between legal and illegal conduct in the field of business
relations depend upon so uncertain a test as whether prices
are reasonable - a determination which can be satisfactorily
made only after a complete survey of our economic
organization and a choice between rival philosophies.

While such an argument may be appropriate for horizontal price fixing
cases, the greater forces of competition at the distributor level make the argument
less compelling for vertical price fixing cases. Economic and business conditions
also do not vary so constantly as to require the level of monitoring by enforcement
agencies suggested.

A fourth rule falling also between the two extremes is a rule of presumptive
illegality. This rule seeks to balance the interests of suppliers, distributors,
consumers and enforcement agencies. The major premise of the rule is that RPM

233 310 U.S. at 221.

234 273 U.S. at 397-98. See also W. Pengilley, "Comments on Arguments in
Justification of Agreements in Restraint of Trade - The United Kingdom,
more often than not is anticompetitive in nature and that a supplier, as the party responsible for its imposition, should bear the burden of providing evidence to the contrary.\textsuperscript{235}

Of the few commentators who have suggested such a rule of analysis, no consensus seems apparent on how the analysis should be undertaken. One United States commentator proposes that courts make a preliminary finding that the RPM scheme in question has a reasonable chance of passing the rule of reason test, and if so, then a full inquiry according to this rule is to be undertaken.\textsuperscript{236} What this threshold is, is not stated. Even the approach suggested by Scherer, who advocates its use where RPM is adopted by "leading firms in concentrated markets" or when its adoption is "nearly ubiquitous,"\textsuperscript{237} is somewhat unclear. Whether the market power of a supplier is to be assessed or an inquiry made into the use of RPM throughout a particular industry is also not stated.

Putting aside this lack of consensus, a rule of presumptive illegality retains the benefits of the per se rules, namely efficiency and certainty, and also accommodates a rule of reason approach for those special cases in which RPM may be socially beneficial. The difficulty for administrators is to determine when a RPM scheme has a reasonable chance of passing the rule of reason test and/or when the appropriate threshold is reached. Such a determination may often be

\textsuperscript{235} McKibben, \textit{supra} note 209 at 197.

\textsuperscript{236} \textit{Id.} at 199.

\textsuperscript{237} Scherer, \textit{supra} note 74 at 707.
arbitrary and indeed may involve as much time and expense as a full blown analysis.  

A fifth and somewhat hybrid rule which bears special consideration in the New Zealand context is to combine sections 30 and 37 into one. As noted above, it is almost always the case that vertical price fixing involves a contract, arrangement or understanding in much the same way as horizontal price fixing. The joint consideration of horizontal and vertical price fixing could easily be achieved by inserting the words "or resold" after the word "resupplied" in section 30 (1)(b) and deleting the words "in competition with each other". 

Adoption of a rule along these lines has the advantages of the per se rules, yet allows parties willing to bear the appropriate expense, to apply for an authorization where the scheme in question is seen to be of benefit to the public. There is no need for the Commission to make any preliminary determination as to whether the scheme is likely to pass an appropriate test or whether a particular threshold of market power has been reached; a determination is only required after the parties to the contract, arrangement or understanding have decided to make an application for authorization at which time the scheme can be judged against the criteria laid

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238 The U.S. Supreme Court has traditionally shown little interest in rules of presumptive illegality. It rejected the suggestion in Schwinn when Professor Posner, who was then arguing for the U.S. Government, urged a rule of presumptive illegality rather than a rule of per se illegality. However in the horizontal field, rules of presumptive illegality or 'quick looks' are somewhat in vogue. See e.g. Broadcast Music, Inc. v. Columbia Broadcasting Sys. Inc. 441 U.S. 1 (1979).

239 The words "in competition with each other" do not add anything to section 30 and in fact create a risk that some agreements which should be caught may not be. See Jackson, supra note 168.
In considering the procedure for authorization under either a rule of reason test under section 27 or under the hybrid test under section 30, one may note the dilemma which would inevitably be faced by those deciding whether or not to make an application. This arises out of the fact that the Commission occupies the role of both investigator, decisionmaker and enforcer. An application is a tacit admission that an arrangement is anticompetitive. Thus, if an application for an authorization is unsuccessful because the application is unable to meet the criteria laid down by the Act, the applicant then faces the risk of enforcement proceedings being instituted by the Commission, which will of course have been informed of the scheme, or indeed of a private action for damages or injunction. As has been noted:

This prospect may well have the result that rather than apply for an authorization, the inclination of a party to a particular practice may be to 'sit tight' and, in the event of any action under the [Act] as regards the practice, to dispute that it has an anticompetitive effect or that there has otherwise been the wrongdoing complained of.

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240 A similar rule laid down in the Resale Prices Act 1976 (U.K.) requires the Restrictive Practices Court to grant an exemption to a RPM scheme if the listed detriments which might result if the scheme cannot be imposed outweigh the drawbacks of the scheme being imposed. The detriments are (a) substantial reduction in the quality or variety of goods available; (b) substantial reduction in retail outlets; (c) long term price increases; (d) danger to health from public misuse of goods; or (e) cessation or substantial reduction in point-of-sale or post-sales services reasonably necessary to protect the public from injury or to confer other public benefits. See Merkin & Williams, supra note 145 at 230-32.

How serious this risk is is very much a moot point. From the writer's experience, there has been no abuse of position by the Commission that has unduly prejudiced any applicant. There has however been some reluctance to obtain letters of comfort from the Commission because advice given by the Commission is not binding upon it in any later proceedings.

From an administrative standpoint then, the present per se rule of illegality has distinct advantages in terms of efficiency of enforcement and savings in costs to all parties. A good case can however be made out for a more permissive treatment of RPM under a rule that retains the benefits of per se treatment, yet affords the flexibility to consider schemes that may have valid benefits. The present expertise of Commission members and the pool of qualified personnel available to the High Court assure that detailed economic analysis can be carried out in appropriate cases.242

As far as enforcement itself is concerned, one may consider whether the present array of remedies provides the optimal mix and serves the desired functions in RPM cases. The consequences of a contravention of any of the restrictive trade practice provisions of the Act include pecuniary penalties of up to $100,000 for infringements by individuals and up to $300,000 for infringements by

242 Appointees of the Commission, of which one must be a barrister or solicitor of at least 5 years standing, are required to have "knowledge of or experience in industry, commerce, economics, law, accountancy, public administration or consumer affairs" to qualify (Section 9(4)). For appeals against determinations of the Commission, the High Court is required to sit with at least one "lay member", being a person appointed by the Governor General having regard to that person's "knowledge or experience in industry, commerce, economics, law or accountancy" (Section 77).
companies (which may be imposed by the Commission only);\textsuperscript{243} injunctions to restrain conduct in contravention of the Act (which may be sought by the Commission or any person);\textsuperscript{244} and damages for any loss or damage caused by particular conduct (which may be sought by any person suffering loss).\textsuperscript{245} Enforcement action is not criminal and therefore the civil standard of proof applies.

Almost identical enforcement and remedy provisions pertain under the Australian Act although the pecuniary penalties are somewhat lower at up to $50,000 in the case of an individual and up to $250,000 in the case of a body corporate.\textsuperscript{246}

The distinctive feature of the Canadian legislation is the application of a criminal standard to the RPM provisions with fines for both individuals and corporations being at the discretion of the Court and imprisonment of up to five years for individuals.\textsuperscript{247}

\textsuperscript{243} Section 80.

\textsuperscript{244} Sections 81 and 88-90.

\textsuperscript{245} Section 82.

\textsuperscript{246} Section 76. For a discussion of the Australian provisions, see Millar, supra note 43 at 223 et seq. The highest penalty so far imposed in an RPM case is $120,000: Trade Practices Commission v. Pye Industries Sales Pty Ltd. (1978) A.T.P.R. 40-089. Upheld on appeal: (1979) A.T.P.R. 40-124. See generally Miller, id. at 106-07.

\textsuperscript{247} Section 38(8). The highest fine so far imposed is $150,000 in R. v. Levi Strauss of Canada Inc. (1980) 45 C.P.R. (2d) 215 (Ont. Co. Ct.), although the charge in this case involved eight counts. A fine of $75,000 on a single count was imposed in April 1984 on Imperial Oil. See generally G. Kaiser,
Somewhat in contrast to the remedy provisions in the other three jurisdictions are the damage rules in the United States where, by virtue of section 4 of the Clayton Act, a private plaintiff "injured in his business or property by reason of anything forbidden in the antitrust laws may sue and ... and shall recover threefold the damages by him sustained." The government is however limited to recovery of only actual damages, the rationale being that treble damages promote private enforcement of antitrust laws in the public interest. Injunctive relief, while available, is rarely applied for. The somewhat different costs rules and the contingency fee system provide an incentive not only for private plaintiffs but also for lawyers to initiate actions. Class actions, whereby groups of injured may sue in one representative class and which characterize United States law, are rare in regard to RPM, especially where the scheme is not incorporated into a written document.

The possible award of treble damages in an antitrust suit involving RPM in the United States and the significant penalties which may be imposed under the RPM provisions of the other three jurisdictions reflects the seriousness with which RPM is viewed by the various legislatures. The object is clearly one of deterrence, and to a lesser extent compensation.

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Competition Law of Canada (New York, Mathew Bender, 1988) at paras. 4.06 and 14.08.


249 ABA Antitrust Section Monograph No. 13, Treble-Damages Remedy (1986) at 12-16 (hereafter cited as "ABA Monograph No. 13"). Proposals have been put forward to Congress for modification of the current law whereby, subject to a limited number of exceptions, only single damages would be awarded for antitrust offences. Id., at 58-60.
As noted in one Australian case:250

The penalty should constitute a real punishment proportionate to the deliberation with which the defendant contravened the provisions of the Act. It should be sufficiently high to have a deterrent quality, and it should be kept in mind that the Act operates in a commercial environment where deterrence of those minded to contravene its provisions is not likely to be achieved by penalties which are not realistic. It should reflect the will of Parliament that the commercial standards laid down by the Act must be observed, but not so high as to be oppressive.

In analysing the nature and level of penalties and damages necessary to deter RPM, one must bear in mind that a supplier's management will assess the probability of its actions being detected, investigated and punished as against the anticipated returns from engaging in RPM. Obviously if the returns are greater, it makes economic sense to contravene. Factors which are relevant in this regard are the attitude of a supplier's management towards risk, the expected length of time before any penalties or damages are imposed and the size and likelihood of any gains to be made. For penalties and damages to be a sufficient deterrent therefore, they should be set at such a level and imposed within a sufficiently short period of time that a supplier and its management, taking into consideration the probability that their conduct will be detected and punished and their attitude towards risk, will be deterred.

There is a vast literature on the theory of penalties and damages which is well beyond the scope of this thesis to review. It is notable however that Chicago School commentators have also sought to further their efficiency theories in this area. The basic theory requires a damages rule that results in the maximum output of goods and services at the minimum overall cost to society. One uses a cost-benefit analysis for this purpose; that is, when the level of enforcement reaches the theoretical point at which the cost of further enforcement outweighs the savings gained by preventing further violations, then no further enforcement should occur.

In the realm of RPM, are the present remedies the best available in terms of deterrence and compensation concerns? Further, should private remedies be permitted at all or should enforcement action be restricted to the Commission?

Dealing with the second question first, it may be argued that public enforcement is generally less costly, the penalty to be imposed in a government suit is more predictable than in a private suit and a public body is less likely to challenge "efficient" antitrust violations. It is not necessarily the case however

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251 See generally the texts and articles cited in ABA Monograph No. 13, supra note 249 at 24 et.seq.

252 Id. at 24. Economic theory sees deterrence as the only goal of enforcement; compensation of victims is considered to be an economically neutral event adding nothing to the output of goods and services and therefore it has no economic ideal. Id. at 35.


254 Id. at 63.
that public enforcement is less costly when one considers typical government bureaucracy. Further, with limited resources, there is the risk that the Commission will be unable to take action against all infringing parties and, even if it could, the deterrent value would be somewhat lower because appropriate remedies are unlikely to be sought with the same level of enthusiasm. Bureaucracy also poses another risk by causing Commission staff to diverge from an otherwise efficient enforcement policy; that is, actions may be taken only against those parties where the probability of success is high and enforcement against others employing schemes that have significant anticompetitive effects may be subject to considerable delay where evidence is difficult to obtain and the case is otherwise complex.

The advantage of private enforcement as a tool of competition law enforcement is that the self-interest of competitors, affected parties and consumers provides a special deterrent to competition law violations. Private actions also provide a necessary supplement to public enforcement where an enforcement agency lacks the will and/or the resources to take action against contravening parties. On this basis, there seems no reason to discontinue with private enforcement in regard to RPM.

Turning back to the first question, the not insubstantial pecuniary penalties which may be imposed by the Commission would seem to be an adequate deterrent so long as the penalties that are in fact imposed are of sufficient magnitude. There is no reason to believe that the trebling of damages is any more an effective deterrent than the present single damages by increasing the chance of detection

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255 This is typified by the actions of the U.S. Department of Justice and Federal Trade Commission in regard to RPM since the early 1980s.
and heightening management's aversions to risk. The fact that managers themselves may be liable under the Act in addition to the suppliers they represent should be a sufficient deterrent in itself (although it will often be the case that they are compensated in some way if a penalty is imposed). Single damages also decrease the probability of nuisance suits being brought in that there is more incentive to mitigate losses than if there is the chance of receiving more than the actual amount of damages sustained.\footnote{266} The present range of remedies and, in particular, the high maximum pecuniary penalties provide the Commission with flexibility to impose or seek whatever remedy it sees fit depending on the circumstances of each case.

Finally, as regards the applicable standard of proof, there seems no reason to make it any more difficult to establish RPM than on the balance of probabilities. The risk of being fined and sent to prison under a criminal provision may be somewhat more of a deterrent, but, as a remedy, it is somewhat antiquated for a practice that is currently the subject of such divergent opinions as to its pro-and anti-competitive effects.

D. CONCLUSION

In considering the appropriate treatment of RPM, it has been seen that one is faced with very divergent schools of thought and an issue which, probably more than any other, has dominated antitrust literature over the past decade. At one extreme is the Chicago School promoting the view that vertical price restraints

\footnote{266} Professors Breit and Elzinga argue that this perverse incentives effect justifies the abolition of all private antitrust damage actions in the U.S. and their substitution by a greatly increased fine as the exclusive penalty. ABA Monograph No. 13, \textit{supra} note 249 at 37.
should be viewed as almost always, or at least more often than not, beneficial to consumers. On this basis, commentators such as Bork and Posner propound that such restraints should be completely lawful. At the other extreme are commentators like Comanor and Pitofsky who vehemently oppose the abandonment of a rule of per illegality. Both accept that economic concerns should be paramount in antitrust analysis, but believe the present rule should be retained because the practice does not contribute to efficiency and is detrimental to the consumer.

The notion that RPM is always beneficial fails to consider cases in which a supplier sets prices above the profit maximization level of highly efficient distributors and that the use of RPM by a supplier in connection with a strong brand product may be particularly detrimental to competition if consumers are thereby unable to take advantage of lower prices, a number of price/service options and more efficient modes of distribution. For these reasons, a rule of per se legality can be discounted.

The notion that RPM is always detrimental fails to consider cases in which the procompetitive effects of a particular scheme outweigh its anti-competitive effects. The assumption to the contrary under a rule of per se illegality means that various efficiencies and other benefits flowing from the use of RPM in any particular case can not be recognized. One might discount a rule of per se illegality for this very reason if it were not for the significant advantages flowing from the rule in regard to administration and enforcement.

There is obviously no problem with the use of vertical price restraints in a competitive market because the rivalry between suppliers and distributors and the
existence of substitute products means that consumers are not prejudiced in any way by being forced to pay higher prices or to buy certain products. Indeed, as has been seen, it is unlikely that a supplier would ever engage in RPM in this situation because a minimum resale price set above the competitive level will lead to a fall off in sales and hence profits.

But competition to this degree is rarely evident in most markets in New Zealand, typified as it is by a small number of relatively large suppliers in a number of industries. It is in these very concentrated industries where most, if not all, of the suppliers involved will be likely to be employing RPM. It may be employed as a device to facilitate and police horizontal price collusion among themselves, or more likely, one or more of them may have been able to create a strong brand identity through product differentiation. The use of RPM in these circumstances either serves to induce distributors to engage in pre- and post-sales activity (such as demonstrations, advertising or warranty service) to keep the brand strong, or alternatively it may be one of those products where a higher resale price provides certification to consumers as to the quality of the products at hand. There seem no other reasons why a supplier would be interested in maintaining the retail price of its products. In theory, a supplier’s price to a distributor (and hence its profit of each unit sold) remains the same whatever price the distributor sells to the ultimate consumer. Since the lower the distributor’s price, the greater the demand for a product is likely to be, it would in theory be in the supplier’s interest to encourage the reduction of retail prices in order to maximize sales. In short, the supplier should favor lower retail prices because the lower the distributors margin, the greater its profits.
The use of RPM to induce pre- and post sales activity will in most cases be procompetitive but its justification as a means to combat free-riding is undermined given the empirical evidence which shows that the practice is not as widespread as some commentators would have us believe. The need for promotion and marketing of new and innovative products does however lend weight to the need to permit RPM in the case of small and not so small firms without market power.\(^{257}\)

It has been suggested that the level of promotion and services that a supplier believes is most suited for its products can be more adequately achieved by contract, it can offer direct financial rewards for services performed or it can employ a system of non-price vertical restraints.\(^{258}\) Each of these alternatives however has distinct disadvantages. Contracting with a large number of distributors may be plainly impractical, especially if the contracts require detailed specification of the particular types of activity which must be undertaken. Administering the payment of financial rewards may be cumbersome and expensive while non-price vertical restraints are, as will be seen in Part III, only conducive to certain products and where the number of distributors in a certain geographical area is small. While RPM itself may be somewhat of a "blunt instrument" to achieve the promotion and service orientated goals of a supplier, it is easily instituted, relatively simple to administer and enforce and conducive to products handled by a large number of distributors.

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\(^{257}\) It is arguable that the specification of minimum resale prices in this situation is in fact fruitless. As there is no market power associated with the product, any attempt by a distributor to charge a price above that of competitive products will result, in most cases, in an immediate loss of business.

\(^{258}\) Marks & Jacobsen, supra note 193 at 249.
Given the potential justifications for RPM and its insignificant effect on competition when employed by suppliers selling products without strong brands, a suggested approach to the treatment of RPM might be to require the Commission, or other affected party to demonstrate that the supplier in question possesses the required degree of market power (given that a strong brand necessarily gives rise to market power) and then to require the supplier to adduce evidence that the practice restraint is not anticompetitive in nature. The Commission or other affected party would obviously bear the ultimate burden of proof. Under such an approach, restraints involving a contract, arrangement or understanding would be considered under section 27 while strictly unilateral action on the part of a supplier would be considered under section 36.\textsuperscript{259} Proof of any horizontal collusion between suppliers or, on those rare occasions, distributors could be considered under section 30.\textsuperscript{260}

Such an approach also accommodates the interests of discounters to have access to strong brands and the freedom of suppliers to deal with whom they wish and to adopt a marketing strategy that they believe to be in their best interests. Consumers also benefit from the lower prices and more efficient modes of distribution offered by discounters, while having a greater selection of products and services offered by suppliers through the various combinations of price and services they offer.

\textsuperscript{259} The test in section 36 requiring a person to have a "dominant position" in a market is arguably too high to capture anticompetitive practices engaged in by even most large suppliers, but a full discussion of section 36 is beyond the scope of this thesis.

\textsuperscript{260} There is no question that any arrangement between competitors to set minimum prices for the products they sell ought, like all horizontal agreements, to be struck down because it almost in all cases hinders rather than promotes competition and efficient resource allocation.
While this suggested approach is theoretically the most optimal, it suffers the same disadvantages as a rule of reason by not yielding the kind of predictability and judicial efficiency which make a per se rule of illegality so attractive.

The per se rule is so well established and legislative policy so clear, that the prospects for a change in the present treatment of RPM seems remote, at least in the immediate future. A compromise approach then to that of the full rule of reason, and one which would likely be more palatable, is to provide a public benefit exception by way of an authorization procedure under section 58. This could be done either by considering horizontal and vertical restraints under the same provision as was mooted in the previous section or by having a specific provision in section 37 allowing for applications to be made. Those confident enough that the schemes they are engaged in are clearly in the public interest may then have them subjected to a balancing by the Commission of their respective benefits and detriments. As discussed in the previous section, such a system has distinct advantages from an administrative and enforcement viewpoint in terms of reduced costs and increased efficiency. Further justification for such an approach comes from the inability of empirical evidence to date to determine with any certainty the actual consequences of RPM on prices. It would mark a return to the system under the 1975 Act allowing persons intending to carry on the practice of an individual resale price arrangement to apply to the Commission for the approval of their practice. Somewhat surprisingly, there appear to have been only three applications heard during the period 1975-1986, but this in itself should not be seen as conclusive that most suppliers perceived their schemes to be contrary to the public interest. The mandated use of recommended resale prices, both during this period and since 1986, has effectively allowed suppliers to use RPM as part of
their marketing strategies with little apparent opposition from policymakers, distributors or consumers.

RPM is clearly more than just a legal and economic issue with any move towards liberalization having important political and social overtones. It is high time however that a review was undertaken by a panel of economic, industry, political and legal consultants to achieve some sort of consensus on the approach that should be taken. It would seem likely that such a review would show the present treatment to be inconsistent with long term consumer interests, especially in fragmented industries where suppliers do not have market power. Such a review may also find that the present treatment will eventually limit competition in the retail market to the larger and more powerful distributors, many of whom are now operating as discounters. This may well foster price competition in the short term but is is doubtful that economic concentration of business is a purpose the Act was designed to serve. The Act may in other words achieve the very opposite result of what was intended—ruinous competition in the short term and elimination of all but the largest competitors in the long term.
PART III

VERTICAL NON-PRICE RESTRAINTS
A. **GENERAL**

Vertical non-price restraints take a number of forms, including exclusive dealing arrangements, requirements contracts, tying arrangements and restrictions on the territories within which and the customers to whom a distributor may sell. As noted in the introduction, the concern in this thesis is only with the last two of these restraints although they are very often interrelated. In this section, the various types of territorial and customer restrictions will each be described and then their respective business applications, motivations and justifications will each be discussed.

(i) **Territorial Restrictions**

Territorial restrictions come in a number of guises. The normal type involves the exclusive assignment to a particular distributor of a particular territory within which the distributor is the sole authorized distributor of the supplier's brand of products. The restriction may however often only affect the location of a distributor's place of business or area of operation. This type of restriction will usually involve either a location clause, area of primary responsibility or a profit pass over agreement. A location clause specifies the place at which a distributor may carry on its business, whether under its own name or that of the supplier. Such a clause operates to restrict the distributor and is therefore to be contrasted with the usual form of territorial restriction involving the exclusive assignment of a particular territory to a distributor which restricts the supplier - in the latter case, the supplier normally convenants not to authorize any of its other distributors to carry on business in the exclusive territory or to do
so itself. An area of primary responsibility is a particular territory for which the
distributor is specifically responsible, although the distributor may carry on
business outside that territory and other distributors may carry on business within
it. The distributor normally convenants to use its best endeavours to market, sell
and distribute the supplier's products in the territory and if the covenant is
breached or some minimum level of performance is not reached (for example unit
or dollar sales), then the distributor is at risk of having the distribution
arrangement terminated. The obvious contrast with the usual type of territorial
restriction is that in the latter, the distributor is prevented from carrying on
business outside the territory and other distributors are precluded from carrying on
business within the territory. Finally, under a profit pass over agreement, a
distributor who makes a sale outside its assigned territory is required to make a
payment or provide some other form of compensation to the distributor in whose
territory the customer is situated. The payment or other form of compensation is
intended to compensate the other distributor for any costs and expenses it may
have or will incur in promoting and servicing the product sold.

(ii) Customer Restrictions

Like territorial restrictions, the normal type of customer restriction involves
the exclusive assignment of particular customers (for example, government
departments, export accounts or large customers) for which the distributor is the

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1 ABA Antitrust Section, Monograph No. 2, Vertical Restriction Limiting
   Intrabrand Competition (1977) at 3 n.5 (hereinafter cited as "ABA
   Monograph No. 2").

2 Id. at 3 n.6.

3 Id. at 4 n.7.
sole authorized supplier of the supplier's brand of products. The restriction may however be less strict in requiring a distributor to devote its primary efforts to a particular type of customer or potential customer.

(iii) Business Applications

Territorial and customer restrictions are common to all distribution arrangements and are usually employed where the products involved are not manufactured by the distributor (although they are by no means confined to such situations). The type of products involved are normally large specialty items such as cars, furniture and household appliances where a distributor's promotion of a supplier's brand is important. (This contrasts with the convenience type products such as food and drugs which are normally involved where RPM is in use, where a supplier is often trying to achieve as wide and as concentrated a distributional spread as possible). With larger specialty items, consumers are often concerned about the range of services which are provided upon the sale of these types of products and will shop around before making their purchasing decisions. To attract customers therefore, a supplier will want to ensure that its distributors provide a sufficient level of services and will otherwise engage in adequate advertising and promotional activities. If a distributor does not receive some protection from intrabrand competition, it will feel less inclined to engage in extensive advertising and promotion of products because the existence of others in the market makes its direct return uncertain. Territorial and customer restrictions provide this protection.
(iv) **Business Motivations and Justifications**

Like RPM, territorial and customer restrictions have attractions for both suppliers and distributors although different interests are often at play. In regard to territorial restrictions, a supplier's motivation is often to attract superior distributors who are willing and able to make the kind of investment in inventories and service provision that consumers demand, who will provide higher quality maintenance and repair that is important for continued sales of complex durable products and who will increase market penetration through greater promotional and sales efforts. (This is particularly important in the case of new products.) A supplier may want to ensure a certain spread of outlets so that distributors do not concentrate exclusively on the more lucrative areas rather than those which are slower moving and/or remote. In this way, a better ratio between outlets and customers can be achieved with distributors concentrating their efforts in territories for which they are responsible rather than competing against each other.

The justification normally offered by suppliers for these restrictions is that they promote interbrand competition by creating a more efficient system of distribution and a strengthened competitive position against other suppliers. Distributors on the other hand justify such restrictions by arguing that freedom from intrabrand competition allows them to exploit a product more fully through specialization on sales and service, they are more willing to devote time and money to promotional and service efforts because they are not subject to free-riding by others and they are prepared to invest more heavily in inventory and service provision.
In regard to customer restrictions, a supplier may be motivated by the incapacity of some distributors to service large accounts because they lack training or knowhow or the inability of some distributors to meet the competition of other suppliers because these other suppliers can offer lower prices and more efficient servicing for large orders. A supplier may in fact be motivated by self-interest to keep certain lucrative accounts for itself which it has developed at some expense. Further, the specification by a supplier that a distributor only sell to certain customers who themselves will be on-selling may be motivated by concerns similar to those where RPM is involved, namely that the customers be qualified to handle the products concerned and will engage in a sufficient level of pre-and post-sales activity. For the distributor, its interests with regard to customer restrictions are much the same as with territorial restrictions, namely it desires protection from the free-riding of other distributors where it has devoted a great deal of effort to the cultivation of certain customers. Justifications for both suppliers and distributors are basically the same as for territorial restrictions.\(^4\)

As will be noted in the next section, the jurisdictions under review have tended to adopt a more permissive treatment of territorial and customer restrictions than of RPM with prohibition only after an analysis of competitive effects in each case.\(^5\)

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\(^5\) At common law territorial and customer restrictions are dealt with under the doctrine of restraint of trade. The approach taken is to consider first whether the restraint goes further than to afford adequate protection to the party in whose favour it is granted; secondly whether it can be justified as being in the interest of the party restrained; and thirdly whether it must be
B. **Current State of the Law**

(1) **United States**

The law in the United States in this area is marked by a trilogy of cases which have had a significant impact on the treatment of territorial and customer restrictions during the time these cases have held sway and also show the fluidity and considerable cyclical variation in interpretation of section 1 of the Sherman Act.

The first of these cases was *White Motor Co. v. United States*[^6] where the Supreme Court refused to condemn out of hand the territorial and customer restrictions imposed in dealer franchise contracts by the White Motor Company, a truck manufacturer with sales of over $500 million at the time. The Court declined to express an opinion of the legality of such restrictions stating:[^7]

> We do not know enough of the economic and business stuff out of which these arrangements emerge to know whether they merely stifle competition or whether they may be the only practicable means a small company has for breaking into or staying in business. We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a pernicious effect on competition and lack ... any redeeming virtue ... and therefore should be classified as per se violations of the Sherman Act.


[^7]: *372 U.S. at 263.*

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The Court therefore remanded the action to the District Court for an analysis of the restrictions under the rule of reason.8

Nevertheless, only four years later, the Supreme Court in United States v. Arnold, Schwinn & Co.9 obviously believed that it now knew all it needed to know about the impact of territorial restrictions on competition to make a definitive ruling on their legality. Schwinn marketed its range of bicycles through intermediate distributors to franchised retailers under several distribution plans, including both outright sales and consignment arrangements. Each distributor had a defined geographical area within which it had the exclusive right to supply franchised retailers, but in consideration, the distributor was prohibited both from selling to non-franchised retailers and from making sales outside its assigned territory. The Court upheld the territorial and customer restrictions under a rule of reason analysis where the distributors acted as Schwinn’s agents and consignees but found illegal those restrictions on distributors who acted as ordinary wholesalers.10 In a widely quoted passage, Mr. Justice Fortas, who delivered the judgement of the Court, said:11

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8 White Motor was eventually settled by a consent decree and therefore never reached a trial at which the facts could be presented (United States v. White Motor Co. 1964 Trade Cas. 91,71,195 (N.D. Ohio, 1964)).


10 The Court decided that these latter restrictions were illegal because they "would violate the ancient rule against restraints on alienation and open the door to exclusivity of outlets and limitation of territory further than prudence permits (Id. at 380)". The Court did not however say why the authorization of restrictions on distribution was imprudent in the Schwinn context.

11 Id. at 379.
Under the Sherman Act it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it.

The decision in Schwinn and the foregoing statement, particularly the words "without more", were the subject of much criticism which was not settled until 10 years later in the third of the cases, Continental TV Inc. v. GTE Sylvania Inc.\(^1\)

The decision contained an extensive discussion of the analysis adopted by the Supreme Court in Schwinn as well as an examination of relevant economic issues. Sylvania was a manufacturer of television sets which had previously sold its products to independent or company owned distributors who in turn resold to a large and diverse group of retailers. Faced with a declining market share of 1-2% of national television sales, it adopted a new marketing strategy by selling its television sets directly to a smaller and more select group of franchised retailers. An acknowledged purpose of the change was to attract more aggressive and competent retailers who would hopefully improve the company's market position.

While each franchisee was required to sell Sylvania products from only the location or locations at which it was franchised, a franchise did not constitute an exclusive territory and Sylvania retained sole discretion to increase the number of retailers in an area depending upon the success or failure of existing retailers in developing their markets. Further, Sylvania imposed no restrictions on the right of a franchisee to sell the products of competing manufacturers.

\(^{12}\) 433 U.S. 36 (1977). Even before this decision, a number of lower Courts began to interpret Schwinn as not creating a broad per se rule prohibiting all territorial restraints. See e.g. GTE Sylvania Inc. v. Continental T.V. Inc. 537 F. 2d 986 (9th Cir. 1976) at 997 where the Court said: "We see a clear trend against interpreting Schwinn as establishing a per se rule of illegality, indiscriminantly invalidating all vertical territorial restraints without any consideration of their reasonableness in terms of their overall competitive effect".
The case arose from dispute between Sylvania and one of its franchisees, Continental, about the franchising of a retailer in close proximity to Continental’s existing premises, and Sylvania’s refusal to allow Continental to open another outlet in an area Sylvania already considered to be well served by existing retailers. The major claim was that Sylvania had violated section 1 of the Sherman Act by entering into and enforcing franchise agreements that prohibited the sale of Sylvania products from other than specified locations.

The similarity in activities of both Schwinn and Sylvania through the adoption of their respective franchise systems, thereby enabling them to regulate the amount of competition among their franchisees by preventing franchisees from selling franchised products from outlets other than those specified in the franchise agreements, meant that the Supreme Court in Sylvania, if it was unable to distinguish Schwinn, had to overrule it. It in fact took the latter course, being convinced of the need for clarification of the law in this area. The Court was especially critical of the distinction drawn in Schwinn between sale and non-sale transactions to justify the application of a per se rule in one situation and a rule of person in another.

Indeed, one is at a loss to fathom why the Court in Schwinn adopted a per se rule for outright sales yet upheld identical restrictions under a rule of reason for consignment sales. The Court did not show how the restrictions were more

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13 The Court cited numerous scholarly articles in support of its views.

14 433 U.S. at 52-57.
anticompetitive or less justifiable in their operation when they took the form of a
sale rather than a consignment.\(^\text{15}\)

The Court acknowledged that vertical restraints reduce intrabrand
competition by limiting the number of sellers of a particular product competing
for the business of a given group of buyers, but pointed to the distribution
efficiencies which may be achieved by vertical restrictions in the way that they
promote interbrand competition.\(^\text{16}\) Given these "redeeming virtues" and lack of
evidence in this case that the restrictions had or were likely to have a "pernicious
effect on competition", the Court reverted to the standard articulated in *Northern
Pacific Railway* and reiterated in *White Motor*, namely that such restrictions
should not be "conclusively presumed to be unreasonable and therefore illegal
without elaborate inquiry as to the precise harm they have caused or the business
excuse for their use."\(^\text{17}\) The Court stressed that it did not foreclose the possibility
that particular applications of vertical non-price restraints might justify per se
prohibition under *Northern Pacific* but it did make clear that "any departure from
the rule of reason standard must be based upon demonstrable economic effect
rather than as in *Schwinn* upon formalistic line drawing".\(^\text{18}\)

\(^{15}\) As Bork cynically observed: "Antitrust is capable of sustaining meaningless
distinctions and sterile paradoxes, but those of *Schwinn* were too many and
too obvious to persist for long. The precedent suffered a timely and a
deserved demise ...." R. Bork, *The Antitrust Paradox* (New York, Basic

\(^{16}\) The Court placed heavy reliance on the writings of a number of Chicago
economists to show how such restrictions enable manufacturers to compete
more effectively and how consumers may benefit.

\(^{17}\) 356 U.S. at 5. See Part I, note 9 *supra*.

\(^{18}\) 433 U.S. at 59.
One gets the impression that the Supreme Court in *Sylvania* went out of its way to overrule *Schwinn* to re-establish a rule of reason approach in testing vertical non-price restraints and thereby bring the law back to where it was at the start of the trilogy. As Mr. Justice White, who concurred with the majority in dismissing the appeal, pointed out, the Court only needed to hold that a location clause held by a manufacturer with negligible economic power in the product market had a competitive impact less than the *Schwinn* restraints to justify a rule of reason standard. In *Schwinn*, the restrictions wholly foreclosed intrabrand competition by preventing distributors from selling outside their exclusive territories. In contrast, intrabrand competition was preserved in *Sylvania* because there was no restriction on the customers to whom or the territories in which franchisees could sell. Further, *Schwinn* was the dominant manufacturer in the industry with a national market share of 22.5%. This contrasted with the 1-2% national market share held by Sylvania where the dominant manufacturer had a 60-70% share.

Despite these obvious criticisms, *Sylvania* was well received and has been virtually unanimously followed since in requiring a rule of reason analysis for territorial and customer restrictions. The only problem that has been faced by lower courts is that *Sylvania* did not provide any more objective criteria by which to judge whether restrictions would constitute an unreasonable restraint of trade, than the factors set out in *Chicago Board of Trade*.  

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19 Id. at 67-68.

The Competition Act includes within the scope of those practices which are
civilly reviewable that of "market restriction". The practice is defined in section
49(1) (to be renumbered section 77 under the 1985 Revised Statutes) as:

[A]ny practice whereby a supplier of a product as a condition
of supplying the product to a customer, requires that customer
to sell or supply the product only in a defined market, or
exacts a penalty of any kind from the customer if he supplies
any products outside a defined market.

In order to be the subject of a remedial order by the Competition Tribunal
("the Tribunal"), the Director of Investigation and Research ("the Director") must
establish that, because it is engaged in by a major supplier of a product or is
widespread in relation to a product, the practice of market restriction is likely to
substantially lessen competition in relation to the product.\(^\text{21}\)

Several exceptions to section 49(3) are of direct relevance in the present
context. In particular, section 49(4)(a) provides that the Tribunal may not make an
order in respect of market restriction when this practice is engaged in only for a
reasonable period of time to facilitate entry of a new supplier of a product into a
market or of a new product into a market, while section 49(4) also goes on to
provide that no order may be made in respect of market restriction among
enterprises that are affiliated. For the purposes of this latter exception, enterprises
are deemed to be affiliated in situations in which: (a) one company is the
subsidiary of the other or both are subsidiaries of the same company or each of
them is controlled by the same person; (b) two companies are affiliated with the

\(^{21}\) Section 49 (3).
same company at the same time; and (c) a partnership or sole proprietorship and another partnership, sole proprietorship or a company are controlled by the same person.  

In addition, enterprises are deemed to be affiliated in situations where there is an agreement under which one party grants to another the right to use a trade mark or trade name to identify the business of the grantee. The business must however be related to the sale or distribution pursuant to a marketing plan or system prescribed substantially by the grantor, of a multiplicity of products obtained from competing sources of supply and a multiplicity of suppliers, and no one product may dominate the business.

Finally, section 49(6) provides that businesses are also deemed to be affiliated where there is an agreement whereby one person supplies or causes to be supplied to another person an ingredient or ingredients for use in the food and beverage industry. This provision applies only where the second person processes the ingredients by the addition of labour and material into an article of food or drink that he then sells in association with a trade mark that the first person owns or in respect of which the first person is a registered user.

To date there have been no applications by the Director to the Restrictive Trade Practices Commission ("RTPC") or the Tribunal in respect of the practice of

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22 Sections 49(5)(a)-(c).

23 Section 49(5)(d).

24 This is often known as the "soft drink bottler's exemption".
market restriction.\textsuperscript{25} However in the case of Director of Investigation and Research v. Bombardier Ltd.,\textsuperscript{26} which involved an application by the Director to the RTPC for an order requiring Bombardier to cease its practice of exclusive dealing with respect to snowmobile products and to supply a number of dealers it had terminated for selling competing brands, interpretations were given of two of the important phrases contained in the market restriction provision. In determining the factors relevant to the definition of a "major supplier" of a product, the RTPC stated:\textsuperscript{27}

> A major or important supplier is one whose actions are taken to have an appreciable or significant impact on the markets in which it sells. Where available, a firm's market share is a good indication of its importance since its ability to gain market share summarizes its capabilities in a number of dimensions. Other characteristics of a supplier which might also be used in assessing its importance in an industry are its financial strength and its record as an innovator.

On the basis of Bombardier's historical position in the industry, its strong participation in innovation, trail setting and racing and its market share of approximately 30%, the RTPC ruled that it was a major supplier to the North American market.

The Director's application was however dismissed because the exclusive dealing arrangement engaged in by Bombardier was found not to lessen

\textsuperscript{25} One inquiry has however been undertaken by the Director into alleged practices of market restriction, namely Telephone Answering Services Inquiry, although this was later discontinued. See G. Kaiser, Competition Law of Canada (New York, Mathew Bender, 1988) at para. 5.02.

\textsuperscript{26} (1980), 53 C.P.R. (2d) 47.

\textsuperscript{27} Id. at 55.
competition substantially nor was it likely to, either at the retail, distribution or manufacturing levels. In reaching this conclusion, the RTPC considered the ease of entry into the market, the availability of existing and potential dealers, the changes in relative market sales shares and the effect of the practice on competition. The evidence disclosed that entry into the market was easy, suppliers were easily able to recruit new dealers, and that there was an expansion of sales and dealerships by Bombardier's competitors over the period in question. There was also no evidence that the level of sales attained by Bombardier's competitors was insufficient to permit them to support adequate distribution systems now that Bombardier was the only dealer in a number of communities.

These interpretations are likely to be helpful when and if an application is made by the Director in regard to "market restriction".

(3) Australia

Unlike with RPM, the Australian and New Zealand provisions dealing with territorial and customer restrictions differ to some degree, but an extended analysis of the relevant Australian provisions is justified in view of the generally similar treatment accorded such restrictions and the interpretation given to a number of key words and phrases common to both jurisdictions.

Section 47 of the Australian Act prohibits the practice of "exclusive dealing" under which label are included territorial and customer restrictions. Section 47(2)(f) prohibits any corporation making a condition of any supply or offer to supply goods and services that a person not resupply goods (i) to particular persons or classes of persons or to persons other than particular persons or classes of persons; or (ii) in particular places or classes of places or in places other than
particular places or classes of places. A similar prohibition exists in section 47(3)(f) where a corporation refuses to supply or offer to supply goods and services to a person because that person does not agree not to resupply to particular persons or places or classes of persons or places. Conversely, if a person acquires or offers to acquire goods and services on these conditions, it also is deemed to engage in the practice of exclusive dealing.\textsuperscript{28} The term "resupply" is defined in section 4(e) to include a reference to a supply of goods to another person in an altered form or condition, and a supply to another person of goods in which the first mentioned goods have been incorporated. Notwithstanding this definition, the imposition of territorial and customer restrictions in a distribution arrangement where the distributor is responsible for the manufacture of the goods or the provision of services would not appear to be caught because there is no resupply. The same applies where there is a consignment arrangement because the "other person" is acting as an agent.\textsuperscript{29} The term "condition" is defined in section 47(13)(a) to include a reference to any condition the existence or nature of which is ascertainable only by inference from the conduct of persons or from other relevant circumstances. Thus the section is not limited to the imposition of a strict condition of supply but may arise by implication from the circumstances in which the goods and services were supplied.\textsuperscript{30}

\textsuperscript{28} Section 47(4).

\textsuperscript{29} The prohibition also only affects corporations, not persons, the latter being subject to the more general provisions of section 45 relating to contracts, arrangements and understandings. See Donald & Heydon, supra note 4 at 289-90.

By virtue of section 47(10), the prohibition only comes into effect if the conduct in question, together with conduct of the same or a similar kind and engaged in by the corporation or a body corporate related to that corporation, has "the purpose or has or is likely to have the effect of substantially lessening competition". The phrase "substantially lessening competition" and particularly the word "substantially" has provided the Australian courts with some difficulty because of its somewhat imprecise and ambiguous meaning Keely J. said in Cool & Sons Pty Ltd. v. O'Brien Glass Industries Pty Ltd.\textsuperscript{31} that the Act required any lessening of competition to be "real or [of] substance" as distinct from a lessening that is "insubstantial, insignificant or minimal",\textsuperscript{32} while on appeal,\textsuperscript{33} Fox J. deferred from giving the phrase any meaning, preferring to leave it to the "individual assessment" of judges in each case in line with the tendency in the United States when considering the phrase under section 3 of the Clayton Act to leave it "undefined, and commonly, to associate it with the subject matter..."\textsuperscript{34} A much more considered and economically based analysis of the phrase was provided


\textsuperscript{32} Id. at 43,003 Franki J. in Hecar Investments No. 6 Pty Ltd. v. Outboard Marine Australia Pty Ltd. (1982) A.T.P.R. 43,699 adopted a similar definition in arguing that the word "substantially" refers to "an effect on competition which is at least 'real' or 'of substance' or 'of significance'" (Id. at 43,705).

\textsuperscript{33} (1983) A.T.P.R. 44,449.

\textsuperscript{34} Id. at 44,455. In a similar vein, Franki J. said that whether or not conduct has the purpose or effect of substantially competition in a market should be left to one's "own instinctive impressions". Id. at 44,464.
by Smithers J. in Dandy Power Equipment Pty Ltd. v. Mercury Marine Pty Ltd.  \(^{35}\)

where he said:\(^{36}\)

To apply the concept of substantially lessening competition in a market, it is necessary to assess the nature and extent of the market, the probable nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening. To my mind one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what should have been is seen to be a substantial lessening of competition.

Some difficulty has also been experienced with the word "purpose", particularly because of the rather unhelpful definition of this word in section 4F. Again however, Smithers J. in the same decision offered the following reasoned explanation:\(^ {37}\)

[T]here is a real question as to whether the purpose referred to in s.47(10) is the purpose in the mind of the person who engaged in the relevant conduct or is the purpose attributed to the act of engaging in that conduct and to be ascertained from the nature of that act of engaging in that conduct. This is a form of words hardly apt to refer to the subjective purpose of the person performing the relevant act and apt to induce an objective rather than a subjective approach.

Finally in regard to the interpretation of section 47(10), section 47(13) clarifies the market in which the effect of particular conduct on competition is to


\(^{36}\) Id. at 43, 887-88.

be evaluated by providing that a reference to "competition" is deemed to be a reference to "competition in any market" in which the corporation engaging in the conduct or any body corporate related to it deals or would otherwise deal, or in which any person restricted by the conduct in question deals or otherwise would deal, but for the conduct.

Important exemptions from the application of section 47 operate where (a) the conduct is engaged in by and between related corporations (as extensively defined in section 4A)\(^38\); (b) any one of the general exceptions in section 51 relating to the engaging in prohibited conduct in association with the granting or licensing of patents, trademarks, designs or copyrights is applicable; (c) an authorization is obtained under section 90 of the Act; or (d) a notification is lodged under section 93. In regard to the latter two exemptions, an authorization will be granted where the Trade Practices Commission ("TPC") is satisfied that the proposed conduct would result or be likely to result in a benefit to the public that would outweigh any detriment to the public constituted by any lessening of competition resulting or likely to result if the proposed conduct was engaged in.\(^39\)

The effect of a notification is to provide statutory protection for conduct which may otherwise contravene section 47 until such time that the TPC determines that the conduct is likely to have the effect of substantially lessening competition and in all the circumstances either (a) no public benefit has resulted or is likely to

\(^{38}\) Section 47(12).

\(^{39}\) Section 90(6).
result from the conduct, or (b) any public benefit likely to result would not outweigh the detriment to the public constituted by the lessening of competition.40

Unfortunately there have been few decisions in Australia which have specifically had to consider territorial and customer restrictions. Of these few decisions, none have reached the appellate level and all were handed down in the early 1970's. The approach taken in these decisions was similar to that in White Motor whereby restrictions of this nature were not regarded as per se anti-competitive but were allowed if the effect on competition was not substantial. Thus a number of restrictions which related to the whole of Australia were allowed41 as well as to the whole of one or more Australian States.42 In Twyfords (Australia) Pty Ltd.43 for example, exclusive dealing arrangements (incorporating territorial restrictions) entered into by a manufacturer of vitreous china with 10 New South Wales and Australia Capital Territory distributors were not thought to substantially lessen competition because the distributors were not otherwise restricted within the stipulated areas, they did not normally trade outside those areas and the manufacturer had less than 10% of the relevant market. Likewise in Gilbert Lodge & Co. Ltd.44, where a manufacturer of certain "lifting and pulling units" reserved to itself all Australian or State government business, it was held

40 Section 93(3).


42 Id. at 199 n.70.


44 (1974-5) A.T.P.R. (Com.) 8,703.
that the restrictions on the manufacturer's distributors did not have the effect of substantially lessening competition in the relevant market because there was considerable import competition, a large number of substitutable Australian products were available, there were also a large number of alternative suppliers and the restriction on each of the affected distributors was not onerous.\footnote{See also \textit{Mazda Motors Pty Ltd.}, (1975) A.T.P.R. (Com.) 15,905 and \textit{Hoover Australia (Pty.) Ltd.}, (1976-77) A.T.P.R. (Com.) 15,901.}

The approach to be taken in future Australian cases is unlikely to be any different with only those restrictions having a significantly adverse effect on competition as judged by the facts in each particular case being likely to be struck down.

(4) **New Zealand**

(i) **Overview of Current Provisions**

The major provision of the New Zealand Act catching vertical non-price restraints is section 27 which provides as follows:

(1) 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 a market.

(2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(3) Subsection (2) of this section applies in respect of a contract or arrangement entered into, or an understanding arrived at, whether before or after the commencement of this Act.
(4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.

The terms "contract", "arrangement" and "understanding", which describe the type of collusive activity proscribed by section 27, are taken directly from the relevant provisions of the Australian Act. Unfortunately the Act does not specifically define these terms, but it is clear that no formal or legally enforceable agreement need exist, and that the Commission and the Courts will be looking for substance rather than form. The terms "arrangement" and "understanding" are particularly broad and cover, in effect, all circumstances where there can be said to be mutual intention or expectation. As such, there seems little distinction in practice between the conspiracy requirements in section 1 of the Sherman Act and the requirements to satisfy section 27.

Section 27 only prohibits arrangements which have the purpose or have or are likely to have the effect, of substantially lessening competition in a market. In regard to the term "purpose", section 2(5)(a) of the Act provides:

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46 In Top Performance Motors Pty Ltd. v. Ira Berk Ltd. (Oid) Ltd. (1975) 24 F.L.R. 286 at 290, Smithers J. said: "The word 'arrangement' is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons - a plan arranged between them which may not be enforceable at law." See also Re Wellington Fencing Materials Association [1961] NZLR 1121 at 1129-30. As to the term 'understanding' Smithers J. said at 291: "An understanding must involve the meeting of two or more minds. Where the minds of the parties are at one that a proposed transaction between them proceeds on the basis of a maintenance of a particular state of affairs or the adoption of a particular course of conduct, it would seem that there would be an understanding within the meaning of the Act".

47 See e.g. Interstate Circuit, Inc. v. United States 306 U.S. 208 (1939).
A provision of a contract, arrangement or understanding, or a covenant shall be deemed to have had, or to have, a particular purpose if -

(i) the provision was or is included in the contract, arrangement or understanding, or the covenant was or is required to be given for that purpose, or purposes that included or include that purpose; and

(ii) that purpose was or is a substantial purpose.

(Emphasis added.)

In turn, the word "substantial" is defined in section 2(1) to mean "real or of substance".

Although the definitions are somewhat circuitous, it is reasonably clear that the "purpose" test in section 27 will only be satisfied where a particular practice has the real or substantial purpose of substantially lessening competition in a market. A mere coincidental or, for that matter, incidental purpose will not suffice. The test is objective.48

In regard to the phrase "has or is likely to have the effect", the Act does not appear to be addressing intention or any other mental state, but appears to be looking purely at the consequences of a particular practice. Such consequences must however be the "likely" consequences of a particular activity. Recent case law in New Zealand in a similar respect has held that the word "likely" should be

48 Fisher and Paykel Ltd., Decision No. 225, 4 April 1989 at 22, adopting the approach preferred by Smithers J. in Dandy Power, supra note 37.
equated with the word "probable". It is reasonably clear, once again, that a theoretical or remote possibility of a reduction in competition is not enough.

Turning next to the phrase "substantially lessening competition", the key word here is "competition". The concept of competition is central to the Act as well as to competition policy and economics generally. The problem is that it lacks a definition agreeable to most antitrust scholars and economists. As one commentator has noted, "there is probably no concept in all of economics that is at once more fundamental and pervasive, yet less satisfactorily developed than the concept of 'competition'".50

Section 3(1) of the Act adopts a hybrid concept of 'workable and effective competition' as the definition of "competition", undoubtedly a recognition by Parliament first, that perfect competition51 is neither possible nor a desirable goal for real-life policy making (especially in light of New Zealand's concentrated and

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51 Perfect competition in an industry arises where there are a large number of competing firms each selling a homogenous product and whose individual market shares are so small that none of them are able to influence the market price of the product by individually varying the quantity sold. Perfect competition is to be contrasted with monopoly, oligopolistic and monopolistic competition where there is only one or a small number of firms in the industry and each has the ability to influence price by varying the quantity sold. See F.M. Scherer, Industrial Market Structure and Economic Performance 2nd ed. (Boston, Houghton Mifflin Co., 1980) at 9-12.
fairly small economy), and second, that competition is dynamic in nature and should not therefore be viewed as a static structural notion.

Donald and Heydon, in their leading text on the Australian Act, provide the following useful definition of 'workable competition'.

We suggest that workable competition means a market framework in which the presence of other participants (or the existence of potential new entrants) is sufficient to ensure that each participant is constrained to act efficiently and in its planning to take account of those other participants or likely entrants as unknown quantities. To that end there must be an opportunity for each participant or new entrant to achieve an equal footing with the efficient participants in the market by having equivalent access to the means of entry, sources of supply outlets for product, information, expertise and finance. Workable competition exists when there is an opportunity for sufficient influences to exist in any market, which must be taken into account by each participant and which constrain its behaviour. (Emphasis added)

The meaning of 'effective competition' which term was used in the objects clause of the 1975 Act, was examined by the Commission in Visionhire Holdings Ltd./Sanyo Rentals Ltd. The Commission in that decision did not find it necessary to examine the term in detail, but said.

52 Fisher and Paykel Ltd., supra note 48 at 25: "The Commission accepts that it should not take a 'snapshot' view of competition, that it is a dynamic process, and, in particular, that [a practice] should be seen in this context and that the Commission should consider present market facts carefully in such light".

53 Donald & Heydon, supra note 4 at 91.


55 Id. at 290.
[B]roadly it envisages a market structure in which there is an absence of power in any relevant market to raise and/or decrease prices to exclude entry by others to such a market.

While the Visionhire decision has been referred to and affirmed on numerous occasions since\(^6\), the classic statement on 'effective competition' remains that of the U.S. Attorney General's National Committee to Study Antitrust Laws where it was said:\(^7\)

The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new or potential entrants into the field, would keep this power in check by offering or threatening to offer effective inducements, so long as the profits to be anticipated in the industry are sufficiently attractive in comparison with those in other employment, when all risks and other deterrents are taken into account.

What can be taken from these definitions is that for workable and effective competition to exist there must be active rivalry between market participants. Rivalry is not confined to just price but also involves service, technology, information, quality, consistency of product and so on. As was said in Re Queensland Co-operative Milling Association Ltd. ("QCMA"):\(^8\)

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\(^7\) The Report of the Attorney General’s National Committee to Study Antitrust Laws (1955) at 320.

\(^8\) (1976) 1 A.T.P.R. 17,223 at 17,246.
In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.

Participants include not only those in the market but also those who have the capacity to enter. In this regard, the critical determinant is the conditions of entry to the relevant market.

The term "substantial", as noted above, is defined in section 2 to mean "real or of substance". The Australian experience, as also noted above, has found this term to be "imprecise", "ambiguous" and of "intractably indefinite import". It was said in the Whakatu/Advanced Closure Authorisation that the word "substantially" can be used in either a relative or absolute sense. The Commission adopted the views expressed in Radio 2UE Sydney Pty Ltd. v. Stereo F.M. Pty Ltd. on the equivalent Australian provision that the relative sense is the correct one, that is: what is the extent to which competition is lessened by the practice over which the Commission has jurisdiction relative to actual and potential competition in the relevant market or markets? The Commission went on to say that regard should be had to all of the surrounding circumstances in making a judgement as to the degree of market power created by the practice, the test being objective rather than subjective. The Commission also adopted the views expressed

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61 See also Fisher and Paykel Ltd., supra note 48 at 23-24.
in *Cool & Sons Pty. Ltd. v. O'Brien Glass Industries Ltd.*\(^{62}\), again in relation to the equivalent Australian provision, that "real or of substance" are intended to mean "not insignificant, not ephemeral, not nominal or minimal". It is submitted that this interpretation is correct, given what appears to be a conscious choice by Parliament to adopt a special definition of the term "substantial" repeating the very words "real or of substance" used in the judgement of Keely J. in *Cool & Sons Pty Ltd. v. O'Brien Glass Industries Ltd.*\(^{63}\).

Section 3(2) of the Act defines the term "lessening of competition" to include the "hindering or preventing of competition". It is notable that clause 3(2) of the draft Bill defined "lessening of competition" as "the lessening, preventing or hindering of price competition or any other single element of competition". The modification to the clause upon enactment makes it clear that all elements of competition and not just price competition are to be taken into account. That regard must be had to restrictions upon potential entrants in a market is reinforced by section 3(3) which provides that "the effect on competition shall be determined by reference to all factors that affect competition in that market from goods and services supplied by persons not resident or carrying on business in New Zealand."\(^{64}\)

It is the ability of newcomers to enter a market (in addition to the ability of existing competitors to expand) that gives rise to potential competition as a discipline upon the actions of an incumbent. In the assessment of market

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\(^{63}\) See text accompanying note 31 *supra*.

\(^{64}\) On the need to have regard to potential competition from imports, see *Fletcher Metals Ltd. v. Commerce Commission*, Wellington Registry, M600/85,28 April 1986.
constraints on incumbent firms, the concern is not so much with the identity of potential competitors but whether or not firms can enter or expand in a market.

Whether or not there is a substantial lessening of competition in a market will depend upon the circumstances of each case and can only be determined by careful economic analysis to ascertain the extent to which the conduct at issue has affected all of the interrelationships between the participants in the market. However one can generalize that there must be an increase in market power resulting from the practice in question which is at least real and of substance.

Turning finally to the term "market", economists have found, like with the concept of competition, great difficulty in providing an authoritative definition given its multidimensional nature. Market definition is of fundamental importance in relation to virtually all competition issues under the Act because it is a necessary predicate to the determination of whether or not a restrictive trade practice exists. The delineation of the relevant market is also an important first step in the assessment of whether or not there exists "workable and effective competition".

A "market" is defined in section 3(1) of the Act to mean:

A market for goods and services within New Zealand that may be distinguished as a matter of fact and commercial common sense.

The definition echoes a statement made by the Commission in Edmonds Food Industries Limited /W.F. Tucker & Co.\(^6\) wherein the Commission offered the

\(^{6}\) Decision No. 84, 21 June 1984.
following analysis, based on the Australian decision in QCMA\(^66\), of the factors which are relevant to market definition:\(^67\)

A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. In delineating the relevant market in any particular case there is a value judgment which must be made which involves, for example, an assessment of pertinent market realities such as technology, distance, cost and price incentives an assessment of the degree of substitutability of products; an appreciation of the fact that a market is dynamic and that potential competition is relevant; and an evaluation of industry viewpoints and public tastes and attitudes. Particularly important in this process is industry recognition (both by supplier and purchaser) and recognition by the consumer. Ultimately the judgment as to the appropriate market - and its delineation by function, product and area - is a question of fact which must be made on the basis of commercial common sense in the circumstances of each case. (Emphasis added).

In Auckland Regional Authority v. Mutual Rental Cars (Auckland Airport) Ltd. and Ors\(^68\) counsel submitted that the reference to "fact and commercial common sense" in section 3(1) meant that the Court should give more weight to the views of businessmen in the market place when defining the relevant boundaries of the market. Mr. Justice Barker replied:\(^69\)

[T]hat submission is simplistic; the reference in the Act to commercial common sense (as distinct from any other kind of common sense) as the yardstick by which to determine a market is another and more straightforward way of

\(^{66}\) (1976) 1 A.T.P.R. 17,223 at 17,247.

\(^{67}\) Decision No. 84 at 5.

\(^{68}\) July 31st, 1987, High Court of Auckland, CP 137/86.

\(^{69}\) Id. at 51.
articulating the Australian definition [which defines the term 'market' in section 4E as "a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services that are substitutable for, or otherwise competitive with, the first mentioned goods or services]. The matters in the Australian definition must enter into the Court's assessment of 'fact and common sense'. The assessment must be made from a consideration of the composition of and the forces in the market. The perceptions of the participants can only be part of the necessary information available.  

It seems clear therefore that while the views of businessmen will be relevant, commercial commonsense requires the more traditional use of statutory interpretation and review of authorities as well as economic analysis of the evidence.

The multidimensional nature of a market noted in Edmonds in terms of product, function and area is consistent with the approach taken in other

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70 In the result, Barker J. found that "as a 'matter of fact and commercial common sense', there is a market for rental car services at Auckland Airport. Cf. Trade Practices Commission v. Ansett Transport Industries (Operations) Pty Ltd. (1978) A.T.P.R. 17,705 where, in determining whether Avis was dominant in the car rental business, the Court did not consider a separate market for services at airports, but held that the geographic market was nationwide. That case however considered a proposed merger or takeover with the focus being on whether the merged company would dominate the market. In Budget on the other hand, the concern was with the ARA's letting of contracts for Auckland Airport only. See also Aspen Highlands Skiing Corp. v. Aspen Skiing Co. 738 F.2d 1509 (10th Cir. 1984) in which the operator of 3 or 4 ski facilities in Aspen, Colorado had terminated the use of a convenient joint ticket in conjunction with its smaller rival. With the focus of attention on the conduct at Aspen, it appears to have been accepted that the Aspen Ski Resort was not in competition with other ski resorts in the United States.

71 The product dimension identifies products which are substitutable for each other and is normally the most critical assessment in determining the outcome of a case. See eg. United States v. E.I. du Pont de Nemours and Co. 351 U.S. 377 (1956) and United States v. Continental Can Co. et al. 378 U.S. 441 (1964).
jurisdictions. In the most recent New Zealand decision in this area, the High Court and Court of Appeal rejected a claim that a market existed in respect of a single album, finding instead that the relevant product and geographic market was the New Zealand album market. Emphasis was placed on demand and supply substitutability in regard to product market definition, but little was said in regard to geographic market definition. The definition of a "market" in section 3(1) is decidedly unhelpful, requiring the Courts and the Commission to largely determine in their own minds what factors should be taken into account. What is notable

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72 The functional dimension identifies the level in the production and distribution chain under consideration.

73 The area dimension identifies the geographic area or areas within which sellers of goods and services operate or to which buyers can turn for the supply of such goods and services. Several factors influence the determination of a geographic market such as the pattern of demand, cost of transportation, mobility of buyers and convenience but, as always, the matter largely depends on the facts of each case.

In the United States, for example, the method for determining these markets basically follows the approach set forth in the Department of Justice's Merger Guidelines issued in 1982 and 1984 wherein customer and supplier responses to hypothetical increases in price are examined. There is a vast amount of literature in this area which is well beyond the scope of this thesis to review. See however W. Cann, Jr., "The New Merger Guidelines - Is the Department of Justice Enforcing the Law?" 21 Amer. Bus. L.J. 1 (1983) and G. Werden, "Market Delineation and the Justice Department's Merger Guidelines", (1983) Duke L.J. 514. In Australia, the approach taken is well set out in In Re Tooth & Co. Ltd., In Re Toohey's Ltd. (1979) A.T.P.R. 18,174.

74 Tru Tone Ltd et. al. v. Festival Records Retail Marketing Ltd February 7th 1988 C.L. 31/87 and September 19th, 1988, CA 85/88.

75 See also Mark Lyons Pty Ltd v. Bursill Sportsgear Pty Ltd (1987) A.T.P.R. 48,789 where the Court rejected the applicant's claim that the relevant product market was the Saloman brand of skiboots. The Court also rejected the defendants submission that it was for sportsgear or alternatively skigear but found instead that the relevant market was the Australian skiboot market.
however is that neither the Courts nor the Commission have adopted the concept of 'submarkets' as has been the case in the United States and Australia. The submarket concept appears to have been used by the courts in these jurisdictions to avoid choosing among possible larger markets in which the extent of competition would normally be assessed. The risk is that submarkets may be overnarrowly defined and therefore a clear case of liability will not be established. A number of decisions in the United States have been subject to criticism for this very reason.

(ii) Exemptions

While the Australian Act contains four exemptions to the prohibition against exclusive dealing in section 47, the New Zealand Act limits the number of exemptions to just three. The most important of these is the power given to the Commission under section 58(1) to authorize the entering into and performance of contracts, arrangements or understandings to which, inter alia, section 27 applies. While such authorization remains in force, conduct prohibited by section 27 is deemed lawful if it is in accordance with the terms of the authorization.

The critical statutory provision governing applications for authorization is section 61(6) which provides:

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77 See M. Brunt, "Market Definition Issues in Australia and New Zealand" (Paper presented at a Commerce Act Workshop May 1988, Wellington). A submarket refers to an area of competition that is narrower than a market.

The Commission shall not make a determination granting an authorization under section 58(1)(a) to (d) of this Act unless it is satisfied that-

(a) The entering into of the contract or arrangement or the arriving at the understanding; or

(b) The giving effect to the provision of the contract, arrangement or understanding; or

(c) The giving or the requiring of the giving of the covenant; or

(d) The carrying out or enforcing of the terms of the covenant-

as the case may be, to which the application relates, will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition that would result, or would be likely to result or is deemed to result therefrom. (Emphasis added)

By virtue of section 63(1), the Commission may, in certain limited circumstances, grant a provisional authorization. The jurisdiction arises where the Commission is not satisfied that the entering into of a contract or arrangement, or the arriving at an understanding will result or be likely to result in a benefit to the public which would outweigh the lessening of competition. The Commission is also prepared to give its view on the legality of contemplated practices which are in breach of Part II of the Act by way of "letters of comfort". There is however no security in obtaining such a letter in that it does not constitute an authorization, nor is the Commission bound by its observations. Action can therefore still be taken against the conduct in question and there is the added risk that a request for a letter of comfort may serve simply to attract the attention of the Commission which would not have been concerned without the approach.
Despite the enumeration of a large number of factors in section 21 of the 1975 Act to assist the Commission in determining whether a trade practice was contrary to the public interest, the term "public benefit" is not defined in the present Act. The Commission however took the opportunity in the Whakatu decision to make certain observations concerning the 'public benefit' concept and the balancing of public benefit against competitive effects. In particular, the following points were made:\(^7\)

(a) The balancing of the public benefit flowing from a practice against the degree of lessening of competition caused by that practice involves testing the detriment to the public arising from the lessening of competition as against the benefit found. Such balancing of benefit and detriment then enables a judgement to be made as to where the public interest lies, namely, between the desirability of encouraging competition and the fostering of other public benefits seen to flow from the practice;

(b) A benefit is something of value to the public and includes, for example, economies of scale even though the cost savings arising therefrom are not passed on to the consumer in the form of lower prices, at least in the short term. The weighting of various benefits does however differ according to their nature, impact and circumstances;

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(c) The term "public" refers to the New Zealand public and extends beyond simply consumers to various trade interests such as manufacturers, wholesalers and retailers as well as to users, investors and so on;

(d) The effect of the practice must be sufficiently widespread or indiscriminate such that it is likely to provide a benefit to a whole range of persons rather than just a number of individuals. In other words, the benefit must be truly public rather than private in nature;

(e) The claimed benefit or detriment must flow from the practice;

(f) The likely benefit from a practice need not be more probable than not, just that there be a tendency or real possibility of a particular benefit; and

(g) The onus of proof to show that the public benefit outweighs the lessening of competition lies on the applicant.

The above points made by the Commission are obviously extremely general but the very breadth in wording of the Act makes it clear that there is virtually no limitation on the nature of any public benefit which may be claimed, nor the competitive detriment to the public which may result from any lessening of competition. Anything of benefit to the country which results in a more competitive trading environment is likely to be seen as relevant. As was noted by the Australian Trade Practices Tribunal in OCMA, public benefit is likely to be seen as.\(^8\)

\(^8\) (1976) 25 F.L.R. 169 at 182-83.
... anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress.

The extent to which non-economic factors may be taken into account under the Act is difficult to say. Unlike under the 1975 Act, where section 80 directed the Commission to take into account non-economic factors such as employment creation and regional development, it is arguable that because the Act is exclusively directed towards the achievement of economic efficiency, that non-economic social goals should not be given any weight. Support for this view can be derived from the Long Title to the Act and section 26, which section requires the Commission to have regard to the economic policies of the government as communicated from time to time. If non-economic factors are to be given any weight, then there is reason to believe that economic factors are more likely to be favoured.  

Despite all this, it is difficult to conceive of too many authorizations being granted for territorial and customer restrictions unless it can be shown that significant efficiencies and cost savings result from the particular restriction which will be passed on to the public in the form of lower prices.

One may contrast the primacy given to economic factors such as efficiency and progress when assessing public benefit under the Act with the more political concerns such as employment, investment and export trade when granting consent under the Overseas Investment Regulations 1985. The same situation is faced in Canada with the different criteria under the Competition Act (for example, the efficiency defence under the present section 68) and the Investment Canada Act (for example, Canadian participation, compatibility with federal and provincial industrial policy and compatibility with cultural policy). Many of the factors under both are the same but the criteria under the Regulations and the Investment Canada Act are more likely to vary over time because of the fluctuating concerns and priorities of successive governments.
The other but less important exemptions are found in section 44(1)(b) which renders inapplicable section 27 where the entering into of a contract or arrangement or arriving at an understanding is between interconnected bodies corporate (as defined in section 2(7)) and in section 45(1) which renders inapplicable section 27 where the offending provision in the relevant contract, arrangement or understanding relates to the "use, licence, or assignment of rights under or existing by virtue of any copyright, patent, protected plant variety, registered design, or trade mark ... ". Section 45(2) (a) provides that a provision in a contract, arrangement or understanding meets this latter test if, inter alia:

...it controls the nature, extent, territory or period of the exercise of those rights or the type, quality or quantity of goods or services to which those rights relate. (Emphasis added).

Section 45 clearly exempts territorial restrictions from section 27 while it appears that customer restrictions are also exempt as being a control on the "nature" or "extent" of the various rights aforementioned. It is unclear why customer restrictions are not specifically mentioned, but at the same time there is little else to which the words could relate. There is no decision in regard to the equivalent Australian provision to assist in this regard. Section 45 is however clearly wider than its Australian equivalent which only protects a licensor in regard to the "kinds, qualities or standards" of goods subject to the industrial intellectual property rights mentioned in section 51(3).

(iii) Commission's Approach

There is also unfortunately not yet any decision in New Zealand which has considered territorial and customer restrictions, either under the 1975 or the present Act. The only indication of the likely approach to be taken by the
Commission is found in its Report on Motor Vehicle Franchise Agreements\(^{82}\) wherein the Commission was called upon to consider complaints from various dealers that allotted territories were totally at the manufacturers' discretion, they were ill-defined and could be amended by manufacturers upon notice. The Commission found that such restrictions gave dealers a positive incentive to invest, having regard to their perceived geographical advantage, and that, "if anything, this type of restriction is likely to promote the competition which the dealer provides."\(^{83}\) In regard to location clauses, the Commission recognized that manufacturers have a legitimate interest in regard to where their dealers carry on business and ensuring that they have an appropriate network of outlets which meet requisite standards. While the Commission acknowledged that location clauses may sometimes have an anticompetitive effect, beyond that necessary to protect a manufacturer's legitimate interests, there was no evidence that manufacturers had acted capriciously in the case of any change of location by any dealer, nor had they unreasonably refused consent to any proposed change of location by any dealer. Most importantly, there was no evidence that such clauses had an adverse effect on prices and competition as claimed by the dealers. The Commission therefore did not find it necessary to render any opinion on the matter.

One can assume that the Courts and the Commission will adopt an approach similar to that used in decisions of their Australian counterparts regarding practices falling within the more general provisions of section 45 rather than the more specific provisions of section 47. Little regard is likely to be had to the early

\(^{82}\) Report of the Commerce Commission following an Inquiry into the Terms of Motor Vehicle Franchise Agreements (1986).

\(^{83}\) Id. at 22.
Australian decisions on territorial and customer restrictions but more to the developing trend in the United States since Sylvania. As such, careful consideration will be given to economic and business justifications with a balancing of intrabrand and interbrand competition under a full rule of reason analysis. It is theoretically possible that such an analysis may also take place under section 36 where a supplier imposing territorial or customer restrictions is in a dominant position in a market, but it would seem highly unlikely that a supplier would ever be found to have abused a position of dominance because such restrictions are so rarely imposed for any of the proscribed purposes mentioned in that section. To the writer's knowledge, there has never been a case in any of the other three jurisdictions where a monopoly provision has been applied to strike down a territorial or customer restriction.

C. Evaluation of the Law

(1) Economic Issues

(a) Cartels

The traditional cartel theories advanced to explain the anticompetitive effects of RPM are also used to explain territorial and customer restrictions. For much the same reasons however that the cartel theories do not provide a plausible explanation for RPM, so also are the theories largely inadequate with respect to territorial and customer restrictions.

Thus, such restrictions are said to be indicative of a supplier cartel whereby suppliers in the same market collude to divide the market up between themselves in order to protect their monopoly position. By so doing, suppliers in each area or customer class have the capacity to set artificially high prices without fear of
competitive market forces. As is the case with RPM, the conditions necessary for such a cartel to exist, namely markets with only a small number of suppliers, high barriers to entry and relatively homogeneous products with no close substitutes, are in most cases difficulty to satisfy. These conditions are clearly not met where a supplier selling a differentiated product unilaterally imposes such restrictions.84

So also are they said to be indicative of a distributor cartel with a supplier acting as cartel manager of a market divided up by the member distributors. In this way, each distributor becomes a monopolist in a particular area or customer class with the capacity to charge monopoly prices. Again, necessary conditions for such a cartel to exist are difficult to satisfy. In particular, barriers to entry in distribution are normally not high and the usually large number of distributors in a market militates against their having any real power to prevent entry. Further, the usually large number of distributors and their disparate interests make any distributor cartel difficult to organize, administer and police. Such a cartel therefore often has to go public which makes it easy to detect and at greater risk to scrutiny.85 Finally, the prevalence of substitute products normally erodes any attempt by distributors to set up a cartel because other distributors may enter and undercut. A supplier in fact has no interest in enforcing and policing such an arrangement because any upward movement in the cartel price detrimentally

84 B. Dunlop, D. McQueen and M. Trebilcock, Canadian Competition Policy: A Legal and Economic Analysis (Toronto, Canada Law Book Inc., 1987) at 258 (hereinafter cited as "Dunlop").

85 R. Bork, supra note 15 at 292-93.
affects its sales and profits. It is only where a supplier is faced with a group of distributors with monopsony power that it will be forced to cooperate.\footnote{86} 

(b) \textbf{Barriers to Entry}

Beyond the traditional cartel theories, it is also often argued that barriers to entry can be created and strengthened by territorial and customer restrictions. As such, a supplier can impose disproportionately high costs on its competitors and make entry into effective competition at the distribution level difficult.\footnote{87} This may happen in a number of ways. First, a supplier may achieve effective foreclosure of its competitors and potential competitors by tying up existing distributors with restraints, thereby forcing its competitors to offer sufficient price incentives to induce new entry into the distribution market, rather than simply luring away existing distributors.\footnote{88} Second, where there is effective foreclosure, a new entrant, supplier of a new product or expanding supplier faces increased capital costs, both in absolute and relative terms, because it must enter or expand at both the production and distribution levels.\footnote{89} Third, intensive advertising can lead to product differentiation\footnote{90} requiring any new entrant to bear increased

\footnote{86} Dunlop, \textit{supra} note 84 at 258.


\footnote{88} \textit{Id.} at 817.

\footnote{89} \textit{Id.} at 818-20.

\footnote{90} "Products are differentiated when, owing to differences in physical attributes, ancillary service, geographic location, information, and/or subjective image, one firm's products are clearly preferred by at least some buyers over rival products at a given price." Scherer, \textit{supra} note 51 at 11.
promotional costs to combat existing consumer sovereignty as well as to create some of its own.\textsuperscript{91}

With respect to the first case, it may be argued that foreclosure can not be achieved by territorial and customer restrictions alone because a potential new entrant can itself offer these restrictions as an inducement to the opening of new distributorships to handle its products.\textsuperscript{92} But if all suppliers in the market are using either or both of these restrictions, then it may be difficult for potential new entrants and those wishing to expand to secure capable distributors for their networks because there may not be made available and/or it may be overly expensive to bid them away. Further, foreclosure is likely where there is substantial market power at the supplier or distributor level and restrictions are used in conjunction with other non-price vertical restraints such as exclusive dealing.\textsuperscript{93} Foreclosure as a strategy is therefore theoretically achievable and profitable in the way that it deters entry by imposing greater costs on competitors.

With respect to the second case, there is no doubt that a new entrant entering at two levels must raise more capital than would be necessary for entry at one level only. The greater capital required will be more difficult to obtain for a new entrant than an existing supplier, and in turn is likely to be more expensive

\textsuperscript{91} Strasser, \textit{supra} note 87 at 820-21.


\textsuperscript{93} Strasser, \textit{supra} note 87 at 818.
because of the greater risk involved. To this extent, new entry and indeed expansion may be discouraged.94

Finally, with respect to third case, product differentiation may give rise to low consumer substitutability promoted by those differentiating their products and enhanced market power giving the differentiator freedom to raise the price of its products above that of competing brands while still retaining a substantial portion of its business.95 This is true however only when the differentiation created by advertising is designed to result in a distinctive image; even then, advertising may enhance competition by providing information of value to consumers such as product availability, price and quality.96 Where the differentiation exists because the product is functionally different, has certain physical characteristics or performs in a certain manner, the differentiation will generally be pro-competitive because it enhances product quality and variety and promotes supplier rivalry.97

To the extent that territorial and customer restrictions do create and strengthen barriers to entry, they are a source of market power. However this is only one of many factors in the overall assessment because interbrand competition may be effective to counter their anticompetitive effects.

94 Id. at 820.


96 See Sylvania, 433 U.S. at 55.

97 Strasser, supra note 87 at 821.
(c) **Price Discrimination**

A number of commentators argue that territorial and customer restrictions can facilitate price discrimination.\(^9^8\) Mathewson and Winter for example identify three situations in which price discrimination may exist, namely price discrimination by territory, within a territory and across customer classes.\(^9^9\) Three conditions must however be met for price discrimination to exist: first, a discriminator must have some degree of market power with respect to the product it produces as otherwise interbrand competition will quickly undermine any attempt to price discriminate; secondly, the discriminator must be able to segregate its customers into groups with different price elasticities of demand\(^1^0^0\) so that it can charge different prices to high intensity and low intensity demanders; and thirdly, there must be some constraints on the ability of low price customers to resell to high-price customers.\(^1^0^1\) To the extent that territorial and customer

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\(^9^8\) Price discrimination involves the sale of a product to different groups of consumers at different margins. The differential margins will often depend upon the quantity sold and the cost of servicing, as well as the nature of the product.

\(^9^9\) F. Mathewson and R. Winter, "The Economics of Selected Vertical Restrictions" (University of Toronto, Law and Economics Workshop Series, 1984) at 42-43.

\(^1^0^0\) Elasticity of demand measures the responsiveness of consumers in terms of quantity purchased to a change in the price of a product. Cross-elasticity of demand measures the responsiveness of consumers to that product when there is a change in the price of other products.

\(^1^0^1\) Scherer, *supra* note 51 at 315.
restrictions increase market power and decrease intrabrand competition, then such
restrictions help satisfy these conditions.\textsuperscript{102}

Price discrimination is usually condemned because it redistributes income
away from consumers to those discriminating, thus reducing social welfare. The
income distribution effects of price discrimination are however very much a
matter for value judgements over which there is wide disagreement in much the
same manner as the argument whether resources are allocated more or less
efficiently in situations where discrimination is practised.\textsuperscript{103} The fact that price
discrimination can only be practised profitably if the discriminator possesses
market power lends itself to the analysis to be proposed shortly in terms of its
effects on market structure and competition generally. Beyond this, it is not
possible to say whether the facilitation of price discrimination is good or bad from
an economic standpoint.\textsuperscript{104}

(d) Free Riding

As with the traditional cartel theories, the special services theory is also
advanced as an explanation for both RPM and territorial and customer restrictions.

\textsuperscript{102} Strasser, supra note 87 at 828-29.

\textsuperscript{103} Scherer, supra note 51 at 319-20. Price discrimination may be beneficial for
example if it facilitates an expansion of output permitting the realization
of substantial scale economies which are then passed on to consumers in less
elastic markets in the form of lower prices. \textit{Id.} at 320 n.11.

\textsuperscript{104} Scherer notes that systematic price discrimination tends to preserve and
strengthen non-competitive market structures, while unsystematic price-
discrimination tends to break up these structures and thus can have a pro-
competitive effect. \textit{Id.} at 323-25.
to represent them fully and adequately and to undertake promotional activities such as advertising and post-sales services. To provide distributors with the necessary incentive to engage in such activities, the theory suggests that a supplier must assign a distributor a sufficiently large territory or customer class (in much the same manner that a supplier assures a distributor of a sufficiently high margin under a RPM scheme) so as to cover the distributor's initial set up costs as well as ongoing expenses of providing point-of-sale information, servicing and advertising. In the absence of a guaranteed market (whether it be a territory or customer class), the theory predicts that distributors will be reluctant to engage in product promotion and servicing for fear of 'free-riding' and 'cream-skimming' by other distributors. As noted above in regard to RPM, the risk for a distributor is that if it makes a large investment in promotion and a product gains consumer acceptance, then competing distributors who have not made the initial promotional investment or incurred the same risk as the first distributor will compete the retail price to a level that will prevent the first distributor from recouping its investment with a return commensurate with the risk borne.

The theory was specifically recognized in Sylvania and is endorsed by the Chicago School in holding to the view that a supplier does not impose a territorial or customer restriction with the intention of restricting output but of creating


107 433 U.S. at 55.
distributive efficiency and being more competitive. It is argued that if output expands, the restriction must have made the supplier's product more attractive to consumers; their increased purchases are also a sign that consumer welfare is enhanced.

There is no doubt that in specific market situations, territorial and customer restrictions do induce distributor investment and thereby enhance competition. As is the case with RPM however, it must be questioned whether the imposition of these restrictions is in fact the most efficient means of accomplishing the service and promotion orientated goals of a supplier. The assignment of exclusive territories or customer classes would only appear efficient where the products in question are relatively expensive and the required investment in promotion and servicing is relatively high. With more expensive items, consumers are normally more willing to shop around, necessitating only a small number of distributors while fewer distributors allows for economies of scale in promotion and servicing. With less expensive items, consumers are normally less willing to travel any distance to compare prices and services and therefore a greater number of distributors is required, while less promotion and servicing is also normally necessary. In the latter case, it is unfeasible to have a whole host of exclusive territories in a confined area. Less restrictive alternatives such as location clauses and areas of primary responsibility, as well as RPM, are more efficient because of

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108 The most obvious efficiency is said to be the purchase of increased sales and service efforts. See Bork, supra note 15 at 290 and 430-34.

109 It is on this basis that both Bork and Posner advocate that such restrictions be completely lawful. See Bork, supra note 15 at 289-90 and R. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality", 48 U. Chi. L. Rev. 6 (1981) at 21-23.
their greater flexibility. To this extent, RPM and territorial and customer restrictions are very much substitutes for each other under the special services theory.

A further problem with the theory is that assumes distributors will engage in precisely the right kind and level of promotional activity and servicing. It is unrealistic to expect this to happen in most market situations unless the supplier has some means of enforcing the distributor's express or implied commitment to provide the appropriate kind and level of promotion and servicing. Pitofsky argues that this can be achieved through cooperative advertising arrangements in which both the supplier and distributor in effect contract to pay a portion of expenses for a specified form of advertising while post-sale servicing and repairs can be handled directly by the supplier (or if this is not feasible, can be priced separately with suppliers paying distributors for all or part of the service performed). While the free rider theory is generally inapplicable when a product and the associated services can be sold separately (particularly services provided subsequent to sale), Pitofsky's argument fails to recognize that some promotion and services are difficult to isolate and separately quantify to the supplier's product (for example, general location advertising, showroom maintenance and salespersons' salaries).

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110 For an example of the combined use of RPM and exclusive territories, see Adolph Coors Co. v. F.T.C. 497 F. 2d 1178 (10th Cir., 1974). For a detailed discussion of this case, see B. Klein and K. Murphy, "Vertical Restraints as Contract Enforcement Mechanisms", 31 J. Law. & Econ. 265 (1988) at 280 et seq.

Still further, the theory assumes that distribution markets are close to perfectly competitive so that distributors will engage in promotion and servicing up to a level that reduces their expected monopoly profits from the restrictions to zero.\textsuperscript{112} If competition is less than perfect, which is more often than not likely to be the case, they can pocket all or at least part of these profits. On this point, Comanor argues that non-price vertical restraints may in fact have more detrimental implications for economic efficiency than vertical price restraints.\textsuperscript{113} He points to the fact that explicit price restraints lead competition to shift to other fronts, namely non-price competition in the form of displays, services and so on. Explicit non-price restraints on the other hand confine rival distributors to separate market areas and thereby limit competition of all kinds among rivals. With non-price competition, all of the higher revenues resulting from the restraints go to support additional distribution services, whereas with limited price as well as service competition, some distributor profits may well remain because there is less assurance that all of the increased profits will be used to pay for the additional distribution services.\textsuperscript{114} Comanor goes on to argue that a supplier wishing to attain a specific level of services through non-price restraints must therefore generally create market conditions in which retail prices are higher and quantities of output are lower than when the same result is attained through the imposition of price restrictions.

\begin{itemize}
\item \textsuperscript{112} Posner, \textit{supra} note 105 at 160-61 states: "Competition among potential dealers to obtain an exclusive franchise will lead them to offer successively more extensive presale services until, at the margin, the cost of these services will equal the price increment that the dealer can command for the manufacturer's product by virtue of being free from the competition of other dealers."
\item \textsuperscript{114} \textit{Id.} at 994 n. 61. See also W. Comanor, "Vertical Arrangements and Antitrust Analysis", 62 N.Y.U.L.Rev. 1153 (1987) at 1160.
\end{itemize}
restraints. From this it follows that non-price restraints are, if anything, more likely to impose greater costs on consumers than price restraints and therefore antitrust prohibitions are more warranted.

The conclusion reached by this economic analysis is somewhat at odds with existing competition law policies which place greater legal prohibitions on price than non-price restraints. Comanor does however seek to differentiate between established and new products. His analysis suggests that vertical restraints that concern established products are more likely to reduce consumer welfare because large numbers of consumers are already familiar with such products and are therefore unlikely to place much value on acquiring further information about them. As such, Comanor advocates the application of a strict antitrust standard in the form of a direct per se prohibition or a modified rule of reason under which a defendant would be required to demonstrate that the restraints have benefitted consumers generally. In the case of new products, or products of new entrants into the market, his analysis suggests that vertical restraints are less likely to lessen consumer welfare because their novelty should create greater demand for information. In these circumstances, Comanor advocates that such restraints should be permitted or at least treated more leniently under a rule of reason analysis.

There is no doubt that a new entrant or a new product has a greater need for promotion and pre-and post-sales services and less ability to provide them

115 Id.

116 Id. at 1001-02.

117 Id. at 1002.
without vertical restraints. With a new entrant or new product (particularly where
the product is technically complex and/or requires a great deal of pre-selling
activity), distributor effort in the form of promotion and pre-sales services is
essential to gain consumer acceptance. Likewise, post-sales services are important
to assure the consuming public of the integrity of an entrant and value of a
product. The novelty of a new product invariably makes it difficult to find
distributors willing to undertake the appropriate investment in time and money.
Vertical restraints help provide this inducement and are also a less expensive way
for a new entrant to finance its entry into the market. The enhanced competition
provided by a new product and entrant justifiably requires a more permissive
treatment under competition laws.¹¹⁸

Comanor has also questioned the assumed coincidence of supplier and
consumer interests underlying the Chicago School view to justify the legality of
territorial and customer restrictions on the basis that it fails to acknowledge the
importance of differences among consumers regarding their preferences for
distributor provided services. Where such differences exists, Comanor argues,
suppliers' and consumers' interests do not necessarily coincide.¹¹⁹

The basis of Comanor's criticism is that because distributor provided
services change the nature of a product in much the same manner as do changes in
quality, the profitability of increasing the level of distribution services through
vertical restraints similarly depends entirely on the preferences of marginal

¹¹⁸ See generally Strasser, supra note 87 at 800.

¹¹⁹ Comanor, supra note 112 at 989-90.
consumers. The Chicago view is that the value which marginal consumers place on extra services is the same as that of infra-marginal consumers and therefore suppliers will find it profitable to impose restraints that increase the volume of these services regardless of the preferences of infra-marginal consumers. Comanor states:

Yet societal gains or losses from changes in the product depend on the preferences of all consumers, not merely those at the margin. To the extent that such alterations fail to reflect the preferences of infra-marginal consumers, the interests of consumers in general may not be served. Given this point, one can no longer rely on the automatic link between the interests of producers and consumers. If marginal consumers value dealer-provided services less than infra-marginal consumers do, the level of such services will be too low. By contrast, if marginal consumers value these services more highly, the level of distribution services will be excessive and the imposition of vertical restraints to promote such services would be inefficient.

Marginal consumers are those whose valuation of a product approximates its price and who are therefore relatively sensitive to any product improvement that may disrupt the equilibrium between subjective valuation and market price. Infra-marginal consumers on the other hand place a value on a product substantially higher than its price. Such consumers are therefore relatively insensitive to any price increase needed to fund a change in product quality. Id. at 991.

Comanor’s views on this point are very much the same as those of Scherer who, as noted above, argues that under certain conditions, the competition generated by a number of suppliers adopting a high margin policy through the use of RPM to induce the provision of services by its distributors can lead to too much variety being offered and too much money being spent on services. See text accompanying Part II, note 100, supra.
Comanor's analysis has itself been criticized for concentrating solely on the possibility that consumer surplus may decline and thus ignoring the potential increase in producer surplus. Klein and Murphy state:\textsuperscript{123}

When the manufacturer's margin is large, and hence one is likely to observe the use of vertical restraints as part of an arrangement to insure the supply of promotional services, it is also likely that such arrangements will be efficiency enhancing because the increase in sales to the marginal consumers implies a large increase in producer surplus. Moreover, there may be a substantial increase in consumer surplus to the now inframarginal - previously marginal - consumers who learned about the product and are now receiving substantial benefits.

A lack of interbrand competition may well result in consumers being sold more services than they wish and paying a higher price, as Comanor suggests. Where there is effective interbrand competition however, the market should theoretically operate to bid out the provision of any services which consumers do not demand with a consequent reduction in price. Any distributor continuing to charge the higher price will find itself losing sales and market share.

The level of intrabrand and interbrand competition in a market and the degree to which both intrabrand and interbrand competition is affected by territorial and customer restrictions is in fact at the heart of all the issues raised in this section and the root cause of the debate amongst economists as to how these restrictions should be treated. It is generally accepted that territorial and customer restrictions, assuming they are effective, do reduce intrabrand competition by preventing distributors who sell the same brand from competing with one another for the same customers, but may promote interbrand competition by encouraging

\textsuperscript{123} Klein & Murphy, \textit{supra} note 109 at 291.
non-price competition and creating more competitive market structures. The more exclusive the nature of the restrictions, the more likely intrabrand competition will be eliminated. Exclusive territories for instance allow only one distributor to sell a supplier’s product in the designated area of sale and in that area only, while areas of primary responsibility allow distributors to compete anywhere after they satisfy their responsibility to service a local area and profit passover clauses allow competition anywhere after payment of an appropriate fee to the local distributor to compensate for promotional work. But even if restrictions are exclusive so that a distributor has a monopoly on its supplier’s brand in a particular territory or to a particular customer class, the presence of interbrand rivals will provide a check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product. If interbrand competition is substantial, the competitive consequences of a territorial or customer restriction should be minor and hence there is an incentive to cut prices. From an economic standpoint, the real question then is the extent to which interbrand competition exists and may be affected when determining if any intrabrand restriction should be permitted. Factors relevant to this determination have been touched upon in this section and will be discussed in more detail in the formulation of an appropriate test in Part IIIC (2)(c).

(2) Legal and Policy Issues

(a) Legislative Policy

As mentioned in the introduction, the New Zealand Act is largely modelled on its Australian counterpart. What is particularly notable in this section of the thesis however is that New Zealand did not adopt section 47 of the Australian Act dealing with those practices termed "exclusive dealing", including requirements
contracts, exclusive dealing, tying arrangements and, importantly for present
purposes, territorial and customer restrictions. No clear statement appears to have
been made regarding the omission (although a detailed study of select committee
hearings may well reveal the reasons therefor). It is arguable that the absence of a
specific provision in the New Zealand Act similar to section 47 can be construed as
indicating that the Act does not, nor was it intended to, cover these practices. It is
also arguable that because the Australian Act contains a separate and distinct
provision dealing with contracts, arrangements and understandings which
substantially lessen competition, namely section 45 (the equivalent of section 27),
exclusive dealing practices are outside the ambit of the more general provision.\(^\text{124}\)

On the other hand, it is arguable that there is nothing in the Act itself to
suggest why distribution practices such as those mentioned should not be caught by
the more general provisions of the Act. The reason for the absence of a specific
provision dealing with distribution practices on this argument would be that
Parliament was concerned not to prohibit such practices per se, but to create a
situation in which such practices would be at risk only if they substantially
lessened competition.\(^\text{125}\) Further, it is arguable that Parliament wanted to avoid a
provision as complex as that of section 47, replete as it is with double negatives
and numerous alternatives, when the same result could be achieved by a more
straightforward provision like section 27.

\(^{124}\) For a discussion of the interrelationship between sections 45 and 47 of the
Australian Act, see F. Callaway, Section 45 or 47?", (1980) 54 A.L.J. 200.

\(^{125}\) See D. Williams, G. Ricketts and F. Quin, "The Commerce Act", (Paper
presented at a New Zealand Law Society Seminar April/May 1986) at 32-33.
It is submitted that the latter view is the more persuasive and that territorial and customer restrictions will, if at all, be caught by section 27 and, to a lesser extent, by section 36 of the Act. This assumption was made in discussing the current law in New Zealand and will be so made throughout the rest of this Part.

(b) Distinguishing Price from Non-price Vertical Restraints

It has been noted in earlier sections that there is a functional similarity between price and non-price vertical restraints while the economic consequences of the two are also similar. Inevitably, therefore, many non-price vertical restraints have some effect on prices whatever may have been the purpose in imposing the restraints. Yet, as has also been noted, there is a marked difference in treatment between the two types of restraints in all four jurisdictions. The need to distinguish price from non-price restraints is therefore of critical importance. This is particularly the case at the horizontal level where section 30 of the Act only requires that a contract arrangement or understanding "have or be likely to have the effect ... of fixing, controlling or maintaining" the price for goods of services. Read literally, even an activity that has an indirect effect on price will be deemed to have the effect of substantially lessening competition under the section and will therefore be per se illegal (subject to the very limited right of authorization mentioned above). So also at the vertical level, a withholding of

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126 Obviously there is debate between the various schools as to these consequences, the traditionalists arguing that they facilitate collusion, barriers to entry and price and product discrimination, while the Chicago School argues that they are aimed at controlling free-riding by preventing or limiting price cutting.

127 This interpretation is particularly relevant if the alternative of subsuming section 37 within section 30 were to be adopted.
supplies for one of the reasons specified in sections 37(3)(d) and (e) (as supplemented by section 40) will be deemed to constitute RPM, and will therefore be per se illegal. How then does one make this distinction?

An attempt to distinguish price from non-price vertical restraints was made by the U.S. Department of Justice in the Vertical Restraint Guidelines ("the Guidelines")\textsuperscript{128} issued in 1985. The Guidelines state that before characterizing a practice as a price restraint, "there must be an agreement between a supplier and its distributors as to resale prices". The Guidelines then continue:\textsuperscript{129}

\begin{quote}
If a supplier adopts a bona fide distribution program embodying non-price restraints, these Guidelines will apply unless there is direct or circumstantial evidence (other than effects on price) establishing an explicit agreement as to the specific prices at which goods would be resold.
\end{quote}

Further, if a supplier adopts a bona fide distribution program embodying both price and non-price restraints, the non-price restraints are plausibly designed to create efficiencies and the price restraint is merely ancillary to the non-price restraints, then the Department will analyze the entire program under the rule of reason. If however, there is evidence of an agreement between a supplier and its distributors to set resale prices, then this will be viewed as RPM and therefore per se illegal.\textsuperscript{130}

\begin{footnotes}
\item[129] Id. at 10. (Emphasis in original). For various views on the Guidelines, see "Vertical Restraints Guidelines Panel Discussion", 54 Antitrust L.J. 319 (1985).
\item[130] Statement of Charles F. Rule, Acting Assistant Attorney General (Antitrust Division) before the Committee on the Judiciary United States Senate concerning the Guidelines (July 16, 1985) at 9-10.
\end{footnotes}
One can have no real quibble with the approach taken in the Guidelines regarding non-price restraints such that a rule of reason analysis should apply where non-price restraints are central to a distribution program and price related restraints are being used to enhance any efficiencies flowing from the former. The problem lies with the requirement that there be an explicit agreement as to specific prices. This requirement is allegedly based on the Supreme Court's holding in *Monsanto* that there must be evidence of an agreement between a supplier and its distributors as to resale prices before a practice will be characterized as a resale-price restraint.\(^{131}\)

But few, if any, RPM schemes are instituted formally between suppliers and distributors, principally because of the harsh treatment accorded such schemes. (The extremely harsh treatment accorded to horizontal price fixing, particularly under section 1 of the Sherman Act where no formal agreement is necessary to constitute an unlawful conspiracy but where a conspiracy may be found merely in a course of dealings or an exchange of words, has already been noted above). To exclude from the realm of any RPM law any agreement not explicitly made would effectively result in all RPM schemes being subject to the rule of reason. Certainly there is the risk that if the only test is whether or not there is an effect on price, which is the case with virtually every non-price vertical restraint, then, in effect, everything becomes RPM. The Commission and the Courts can be

\(^{131}\) 104 S.Ct. 1464 (1984) at 1470-71. It is notable however that the Court never indicated that such an agreement must be explicit or that prices must be specific. Cf. *Business Electronics Corp. v. Sharp Electronics Corp.* 108 S. Ct. 1515 (1988) wherein the Supreme Court held that per se condemnation is to be narrowly applied and that vertical agreements between a manufacturer and its distributors are subject to a rule of reason analysis unless the agreement sets a particular price or price level. (Id. at 1525) See E. Gellhorn and K. Fenton, "Vertical Restraints During the Reagan Era: A Program in Search of a Policy", 33 Antitrust Bull. 543 (1988) at 556-60.
presumed however to have the ability to establish the underlying purpose of a so-called non-price restraint and to see whether it is intended to maintain resale prices.

Two alternative approaches have been suggested to make the necessary distinction. The first is to limit the category of price restraints to those arrangements which 'on their face' attempt to set specific resale prices. But as one commentator has pointed out:

> Any attempt to distinguish price from non-price arrangements by asking whether they facially set specific prices or ranges of prices... is obviously formalistic. The facial approach also fails to clarify whether agreements or other actions designed only to affect prices can be used as evidence of an agreement to fix specific prices or ranges.

The second alternative is to adopt an approach similar to that taken in recent U.S. horizontal price fixing cases which look to output reduction, competition restriction and efficiency creation as the most important factors in the characterization process. If there is the potential for efficiency creation, then an arrangement is judged under the rule of reason even if it has an output

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132 This is the approach taken in the Department of Justice's Amicus Curiae Brief in Monsanto in arguing that Monsanto's marketing program did not 'on its face' pertain to price. (Brief of the U.S. Department of Justice, Monsanto Co. v. Spray-Rite Service Corp. No. 82-914, 1983 at 15). See W. Liebeler, "1983 Economic Review of Antitrust Developments: The Distinction Between Price and Nonprice Distribution Restrictions", 31 U.C.L.A. L. Rev 384 (1983).

133 Liebeler, id. at 392 and 392 n.48.

restricting effect. It is only where there is no potential for efficiency creation 
that the per se rule comes into play, and then only if the arrangement always, or 
almost always, tends to decrease output and restrict competition.\(^{135}\) Despite the 
obvious Chicago School underpinnings to this approach, an efficiency-based 
characterization does have some appeal in terms of its administrative efficiency. 
Problems arise however in requiring a Court or the Commission to make a decision 
\textit{at first glance} whether or not an arrangement has efficiency enhancing potential. 
This assessment is by no means easy to make. There is then the obvious criticism 
that an arrangement will only be struck down if it "always or almost always" 
detrimentally affects output and competition. No balancing of pro-and anti-
competitive effects appears necessary nor does the degree of output reduction and 
competition restriction appear relevant with this approach.

If price and non-price vertical restraints are to be treated differently, there 
inevitably must be some formalistic line drawing to separate the two. This can 
obviously be avoided if both types of restraint are subjected to the rule of reason. 
As noted in the conclusion to the previous section however, this solution appears 
unlikely to be palatable. In the meantime, one can only rely on the ability of the 
Courts and the Commission to carry out the appropriate task.

(c) \textbf{Less Restrictive Alternatives}

A number of commentators argue that a restriction which could be achieved 
by a less restrictive alternative, which is itself not anticompetitive and has alleged

\(^{135}\) See Liebeler, \textit{supra} note 132 at 395-96 and F. Spinella, Jr., "Categorization 
and Presumptions in Horizontal Antitrust Cases", 22 N.E.L. Rev. 295 (1987) 
at 296-98.
procompetitive effects, should be declared illegal. The thrust of their argument is that legitimate business purposes can be achieved by more moderate vertical restraints that involve no restriction on intrabrand competition. In regard to the use of exclusive territories for example, which totally eliminate intrabrand competition, this would mean considering whether a supplier could have imposed either a location clause, area of primary responsibility or profit pass-over agreement instead to achieve its desired business goals while at the same time ensuring the existence of some intrabrand competition among its distributors.

More specifically, it has been suggested that location clauses can better prevent 'cream-skimming' on small items than exclusive territories because consumers are habitually unwilling to shop around for such items and therefore seek out outlets in close proximity. Similarly, it has been suggested that areas of primary responsibility and profit pass-over agreements can prevent 'cream-skimming' on large items as well as induce pre- and post-sale services. However, exclusive territories are rarely used in the first situation for the reasons noted earlier, while there is some doubt as to the effectiveness and efficiency of the suggested restrictions in the second situation. In particular, the freedom which an area of primary responsibility gives a distributor to sell outside a designated territory means that a distributor will often concentrate its efforts only in the


137 Strausser, supra note 87 at 803-04.

138 Id, at 804 and 810-11.

139 See text accompanying note 110 supra.
most profitable localities in that area and then will target other profitable localities where other distributors may also be operating. This result will invariably diverge from what a supplier sees as the optimum level of sales effort for an area.\textsuperscript{140} Further, it is often very difficult to accurately calculate the per sale cost of pre- and post-sale services when a profit pass-over agreement is in use, let alone to enforce the agreement on every sale. Additional costs are therefore inevitable in undertaking such calculations and enforcement.\textsuperscript{141}

\textbf{The overriding disadvantage of the less restrictive alternative test is the risk and uncertainty faced by a supplier in implementing a distribution arrangement.} The supplier must have the foresight to judge what type of restriction a Court or the Commission will later determine to be the alternative which meets its needs with the least restraint. An incorrect judgment will render the restriction illegal and put the distribution arrangement in jeopardy. As was pointed out in \textit{American Motor Inns v. Holiday Inns Inc.}:\textsuperscript{142}

\begin{quote}
Application of the rigid "no less restrictive alternative" test would place an undue burden on the ordinary conduct of business. Entrepreneurs ... would then be made guarantors that the imaginations of lawyers could not conjure up some method of achieving the business purpose in question which would result in a somewhat lesser restriction of trade. And courts would be placed in the position of second-guessing business judgements as to what arrangements would or would
\end{quote}

\textsuperscript{140} Bork, \textit{supra} note 105 at 467-69.


\textsuperscript{142} 521 F.2d 1230 (3rd Cir. 1975) at 1249-50. See also M. Handler, \textit{Twenty Five Years of Antitrust} (1973) at 707: "[T]here will almost always be a less restrictive alternative, and indeed further alternatives to each alternative ad infinitum." (Quoted in ABA Monograph No. 2 \textit{supra} note 1 at 60).
not provide 'adequate' protection for legitimate commercial interests.

A similar view was taken in Sylvania at the Court of Appeals level where it was said that a least restrictive alternative test "would place an unreasonable and impractical burden on a manufacturer desiring to impose some vertical restraint in order to promote its position vis a vis its competitors".\textsuperscript{143}

Despite this expressed hostility to the application of the test for vertical restraints, it is notable that the same is not the case for horizontal restraints where the Courts, particularly in the United States, have frequently applied the less restrictive alternative test and the associated 'reasonably necessary' test.\textsuperscript{144} The most common example is where the sale of a business is involved. In this situation, the Courts have traditionally held that a restraint, as well as having to support a protectable interest and being reasonable in the public interest, must be reasonable as between the parties. Any restraint therefore that proscribes the activities of the party restrained any more than necessary, covers a wider geographical area than necessary or extends in time longer than necessary will be struck down.\textsuperscript{145} Relatively few problems have been experienced in applying the test to this

\textsuperscript{143} 694 F.2d 1132 (9th Cir. 1982) at 1138 n. 11.

\textsuperscript{144} Spinella, supra note 135 at 309. The less restrictive alternative analysis had its genesis in the United States in the 1898 decision of United States v. Addyston Pipe & Steel Co. 85 F. 271 (6th Cir. 1898) where it was held that an ancillary restraint should be struck down if it "exceeds the necessity presented by the main purpose of the contract". (Id. at 282)

situation and indeed it seems no more difficult an analysis to undertake than balancing pro- and anti-competitive effects under the rule of reason. Further, uncertainty for a supplier as to the legality of a restriction would appear to be no greater under the less restrictive alternative test and it may well be questioned whether the adoption of such a test is likely to prove more of a discouragement to supplier investment than the standard rule of reason test (although admittedly a less restrictive alternative test will more often than not result in a stricter treatment of restrictions).

On balance, doubts as to the effectiveness of some types of restrictions to achieve the distributional efficiencies which a supplier invariably seeks when imposing territorial and customer restrictions and the higher costs of administration and enforcement rule out a less restrictive alternative test as itself a viable alternative.\textsuperscript{146} Certainly there seems no justification in declaring an exclusive territorial restriction illegal while permitting less restrictive alternatives unless it can be clearly demonstrated that the former has a greater anticompetitive than procompetitive effect while the reverse is the case with the latter.

\textsuperscript{146} It is acknowledged that the existence of less restrictive alternatives may however be a matter for consideration in authorization proceedings that is, an authorization may be refused if the application fails to establish that the claimed benefits could not have been achieved otherwise than by means of the anticompetitive conduct. This view is supported by statements made in Fisher and Paybel Ltd., supra note 48, that since the purpose of the Act is to promote competition, if the same benefits can be produced by a less restrictive alternative, then the Commission will be loath to grant the privilege of authorization to a restrictive trade practice otherwise proscribed by the Act. (Id. at 28).
(d) Distribution Arrangements Involving Industrial and Intellectual Property Rights

A great many distribution arrangements incorporating a territorial or customer restriction involve the grant of some industrial and intellectual property right (hereafter for convenience termed "intellectual property right") in the form of a patent, trademark, copyright or registered design. The distribution arrangement may, for example, involve the licensing of some patented process under which the patentee grants a licensee the right to manufacture and sell a particular product to certain customers (with the patentee reserving certain customers to itself) or the licensing of a trademark under which a franchisor grants a franchisee the right to use a particular mark in connection with a franchised business in a certain area. The licence granted may be exclusive or non-exclusive as with any other territorial and customer restriction not subject to an intellectual property right.

The grant of an intellectual property right in a distribution arrangement raises a basic philosophical question about the relationship between industrial and intellectual property law (hereafter for convenience termed "intellectual property law") and competition law. Intellectual property law is primarily designed to protect the holder of an intellectual property right from the use by others of such rights for defined periods. A patent for example prohibits anyone other than the patentee from putting into use any invention for a term of 16 years, while copyright confers upon the author of any original literary, dramatic, musical, or

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artistic work the sole right to publish, perform or reproduce the same and to restrain others from so doing for terms of up to 75 years.\textsuperscript{148}

There are two basic policy reasons for the grant of these rights under statute. First, it provides an inventor, creator, author, or designer with an incentive to invest the time, money and energy necessary to discover, create and develop an invention, mark, work or design. Secondly, it encourages their disclosure in situations where they might otherwise remain unknown to the public. Thus, these statutory rights reward an inventor, creator, author or designer by protecting their investment in inherently high risk inventions and easily pirated subject matter, while their availability for use and enjoyment is obviously of benefit to the public. The underlying policy of competition law on the other hand is to restrain monopolies and promote competition by removing unnecessary restrictions imposed or agreed to by certain parties.\textsuperscript{149}

As such, there may be seen to be a potential conflict in the way that one grants rights of monopoly while the other prohibits monopolistic activities.\textsuperscript{150}

Attempts made to resolve this conflict have suggested the use of a cost/benefit

\textsuperscript{148} Copyright Act 1962, sections 7 and 8. See also Trade Marks Act 1953 sections 10 and 29 and Designs Act 1953, sections 11 and 12.

\textsuperscript{149} For a perceptive analysis of these and other policy goals, see J.T. McCarthy, "Intellectual Property and Trade Practices Policy: Coexistence or Conflict? The American Experience", (1985) 13 A.B.L.R. 198.

\textsuperscript{150} At the same time, there may be seen to be some consistency in the way that intellectual property law also promotes competition by stimulating product and process development and inducing competition amongst firms to handle these new products and processes.
economic analysis. One such analysis as it relates to territorial restrictions in patent licences requires an assessment as to whether the total benefits of territorial restrictions (being the incentives to potential innovators) exceed the total costs (being the detriment to the economy) arising from their imposition. If the ratio of benefits to costs is greater than one, then the restriction should be allowed. If not, it should be disallowed.

It was noted above that section 45 of the New Zealand Act, like its Australian and Canadian equivalents, specifically exempts from the prohibition in section 27, but not sections 36, 37 and 38, any contract, arrangement or understanding relating to the "use, licence, or assignment of rights under or existing by virtue of any copyright, patent, protected plant variety, registered design or trademark". The effect of this provision is to make it per se legal for any party to enter into a contract incorporating a territorial or customer restriction and relating to one of these intellectual property rights notwithstanding the anticompetitive effects of the restriction. Given the policy conflict between


153 Section 45 (1)(a). Section 36 has its own exempting subsection which provides that a person does not use a dominant position in a market for an improper purpose "by reason only that that person enforces or seeks to enforce any right under or existing by virtue of any copyright, patent, protected plant variety, registered design or trademark". (Section 36(2)). See also Canadian Competition Act, section 51(5) (to be renumbered section 79(5)). Cf. Section 46 of the Australian Act which contains no such exemption.
intellectual property law and competition law, one may argue that Parliament has made a clear choice to favour the former in the belief that this will stimulate innovation, promote the diffusion of new technology and enhance intrabrand competition all to the benefit of consumers and the country as a whole. It is also arguable that this attitude reflects a decreased concern about the anticompetitive effects of territorial and customer restrictions where intellectual property rights are involved. If protection is not granted, this may be damaging to the dissemination of new technology and works and prejudice competition between new and existing products.\textsuperscript{154}

One may question why the holder of an intellectual property right deserves this special protection when the very grant of the right gives the holder a monopoly, whether it be absolute or limited, and thus an advantage over its competitors. Further, one may question whether the special protection granted in fact stimulates innovation or licensing activity to any material degree. Even with the protection provided by the exemption, the holder of an intellectual property right will rarely have a sufficient degree of market power to be of antitrust concern. It is only where, for example, a patent involves particularly novel technology that few, if any, close substitutes are likely to exist and barriers to entry are likely to be high that any significant degree of market power may be obtained. A territorial or customer restriction imposed in this situation is unlikely to be imposed for the purpose of foreclosing competitors or having other anticompetitive effects but of diffusing risk, defraying development costs, increasing a supplier's reward from licence fees and royalty payments not otherwise attainable, exploiting territories in which and customers to whom a supplier

\textsuperscript{154} See Cheffins, \textit{supra} note 152 at 65-70.
may not otherwise have been able to operate and sell and generally effecting a more efficient and profitable distribution of its products.\textsuperscript{155} These advantages should be sufficient incentive for inventors and authors to continue to innovate and create.

From this it follows that distribution arrangements involving an intellectual property right should also be subject to treatment under the more general provisions of the Act as is the case in the United States where exclusive rights and territorial restrictions are most frequently analyzed under the rule of reason by discerning whether their overall effect is procompetitive or anticompetitive.\textsuperscript{156} In this way, factors such as the height of barriers to entry, the availability of close substitutes and the degree of market power in general can be taken into account in any case. Where is it desirable that a monopoly be maintained because new technology is involved and the significant costs and risks incurred in development justify appropriate compensation, then this is a matter which can always be considered under the public benefit provisions of the Act. Parties with any concern about infringing the Act can always apply for authorization of their own accord. One would expect that in situations involving new technology which

\textsuperscript{155} Id. at 76-77

\textsuperscript{156} A similar view was expressed in Canada in 1977 as part of proposals to amend section 29 of the Combines Investigation Act. The proposals were based on the Economic Council of Canada Report on Intellectual and Industrial Property (Ottawa, Information Canada, 1971) which suggested that where the existence of unjustifiable anticompetitive practices is proven, competition policy legislation should override that of intellectual and industrial property legislation by providing for remedies which lead to the discontinuance of uncompetitive practices related to the ownership of intellectual property rights. The draft Bill, which empowered the Competition Board to issue a remedial order where it found anyone exercising an intellectual property right or interest in a manner not expressly authorized by the pertinent statutes and which was likely to affect competition adversely in a market, never however became law.
provide significant consumer benefits, favourable considerable would be afforded by the Commission as being the sort of cases which are the proper subject matter of authorization.

Solutions such as limiting the exemption to those parties who do not possess a significant degree of market power and/or requiring certain parties to apply for an individual exemption are unfeasible as the European Commission found in preparing the Block Exemption for Patent Licences. The Commission wanted to limit most automatic territorial exemptions to small and medium sized companies (on the basis that only these companies needed the incentive to develop technology provided by exclusive rights and territorial restrictions) but found maximum turnover and market share detriments difficult to apply and imprecise.

Subjecting treatment of distribution arrangements involving intellectual property rights to the more general provisions of the Act is also administratively more efficient than a system under which an exemption is limited in one of the manners suggested and/or an individual exemption must be applied for. Giving parties the discretion as to whether they seek authorization from the Commission is further no worse than the present system of effective per se legality. An acknowledged disadvantage of the suggested approach over the present system is that to determine the legality of restrictions on a case by case basis creates uncertainty and may make some parties think twice before entering into

157 Regulation 2349/84. For a brief discussion of the history and application of the Block Exemption, see Cheffins, supra note 152 at 53-54 and 59-61.

158 Cheffins, id, at 79-80 and 82.
distribution arrangements.\textsuperscript{159} Whatever the arguments surrounding the present system, it is certainly more predictable.

The conflict between intellectual property law and competition law is not an easy one to solve and it is far beyond the scope of this thesis to even attempt this difficult task. As one commentator has stated:\textsuperscript{160}

[T]here is no 'objective truth' to be found in the tension and conflict between intellectual property and antitrust. While many legal scholars have sought to find a 'unified field theory' which will serve as a legal tool to resolve all such conflicts, no one has yet succeeded. It is probably delusive to even search for such a thing. The huge body of legal precedent in the United States on the proper and improper use of intellectual property rights creates a delusive mirage that there is some rule of immutable logic at work, if only we could discover what it is. But I think that all that is at work is the personal preference as to societal and economic values of the judges who decide the cases.

Both laws can however operate in harmony so long as neither is applied too aggressively. To do otherwise means that the fundamental policies of both are defeated. In examining any distribution arrangement (whether or not it involves intellectual property rights), one is faced with the same questions regarding the competitive effects of the restrictions incorporated therein. Parliament has obviously made a clear policy choice to exempt arrangements involving intellectual property rights from the purview of section 27, but it would seem arguable that a more consistent approach to all distribution arrangements should be adopted.

\textsuperscript{159} This is said by some commentators to be one of the major disadvantages of the U.S. approach. See Cheffins, \textit{supra} note 152 at 83 n. 146.

\textsuperscript{160} McCarthy, \textit{supra} note 149 at 199.
(e) **Administration and Enforcement**

In the corresponding section in Part II, various rules of analysis were discussed in regard to RPM in terms of their administrative efficiency and appropriateness. The advantages and disadvantages for each hold equal validity in regard to territorial and customer restrictions. One need however only really consider a rule of reason analysis in this section given the weight of scholarly support in its favour\(^{161}\) and because such restrictions are neither so typically anticompetitive nor procompetitive as to justify application of one of the per se rules. Rather, they may be anti-competitive or pro-competitive depending upon a whole range of factors to be discussed shortly.

It will be recalled that the primary advantage of the rule of reason is the ability of the relevant adjudicative body to weigh the pro- and anti-competitive effects of a restraint in any particular case, while its primary disadvantages are the need to undertake an extensive economic analysis in each case and the ability of judges to in fact undertake this task. On this latter point, one commentator has noted in regard to the Australian Act:\(^{162}\)

> The difficulty with the rule of reason is the intimate blend of economic and legal reasoning that is required - the blending of economic and legal concepts - in the application of the statute by way of economic analysis and legal argument to the facts of the case. Since however the scene of action is a court of law, the conundrum is how to get economics into the court.

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\(^{161}\) See Strasser, *supra* note 87 at 830 n.255.

For the Commission, the conundrum is not serious given the skills and experience it can count on from amongst its members and the lack of any procedural impediments in receiving economic evidence. The Courts themselves have shown an increasing willingness to admit evidence and hear arguments of an economic nature, while being able to call upon experts as lay members to assist the Court in its proceedings.

In advocating a rule of reason as that which is most appropriate, one is faced with a very open-ended provision in the form of section 27. A set of guidelines to assist the Commission in its administration and enforcement of territorial and customer restrictions under the Act as well as to provide parties to a distribution arrangement with some means of judging the legality of their conduct would seem to be of some benefit in this situation. In this regard, it is appropriate to consider two of the approaches suggested by high ranking bodies in the United States.

The first is that adopted in the Vertical Restraints Guidelines issued by the Department of Justice in 1985. The Guidelines were designed to express the Department’s enforcement policy in regard to vertical non-price restraints as well as to clarify the existing law in this area. It is beyond the scope of this thesis to discuss the content of the Guidelines in any detail suffice to say that they embrace

163 Sections 9(4) and 98-99.

164 See eg. Tru-Tone, Part II, note 200 supra.

165 Section 77.

166 See Panel Discussion, supra note 129 at 321-22 (per Charles F. Rule).
the consumer welfare approach to vertical non-price restraints by assuming that there is always a procompetitive explanation for their imposition and that suppliers who impose non-price vertical restraints will generally be acting in the best interests of consumers. In so doing, any restraints which are not "airtight" are deemed per se legal notwithstanding that there may be no procompetitive effects and a substantial elimination of intrabrand competition.\textsuperscript{167} What is relevant for present purposes is the two-step approach used for evaluating those restraints which are subject to the Guidelines.

Under the first step, the Department uses a "market structure screen" to eliminate from further consideration any restraint which is deemed unlikely to have anticompetitive effects.\textsuperscript{168} For this purpose,\textsuperscript{169} the Department calculates the market share of each firm that is party to a distribution arrangement containing the non-price vertical restraint and then sums the values for all firms at the same level of distribution. This calculation produces what is termed the "Vertical Restraints Index" ("VRI"). The Department also calculates the proportion of each market involved in the restraint which it terms "the coverage ratio". The use of a restraint will not be challenged if (1) a firm employing a restraint has a market share of 10\% or less; (2) the VRI and the coverage ratio are below 1200 and 60\% respectively in the relevant market; (3) the VRI is below 1200 in the supplier and

\textsuperscript{167} For a discussion of the content of the Guidelines, see Panel Discussion, supra note 129.

\textsuperscript{168} Vertical Restraints Guidelines, supra note 128 at 23-25.

\textsuperscript{169} The following is based on Statement of Charles F. Rule, Acting Assistant Attorney General Antitrust Division, before the Committee on the Judiciary, United States Senate concerning the Justice Department's Vertical Restraints Guidelines (July 16th, 1985) at 12-17.
distributor markets; or (4) the coverage ratio is below 60% in both markets. The rationale in (1) is that a firm with a small market share is unlikely to possess market power of its own accord nor is it likely to be major participant in any cartel. The rationale in (2), (3) and (4) is that "neither collusion nor anti-competitive exclusion is plausible" in these situations, "because either the primary and/or secondary markets do not meet the minimum structural conditions for a restraint to have anticompetitive effects".\textsuperscript{170}

Under the second step, a restraint which does not pass the screen is considered under a structured rule of reason. Factors relevant to the competitive effect of a restraint include the ease or difficulty of entry into a market, market concentration, the conduciveness of the market to collusion, the exclusionary nature of the restraint, evidence of collusion or exclusion, the type of firms using the restraint and procompetitive efficiencies. Only if these factors suggest that a restraint is anticompetitive will it be challenged.\textsuperscript{171}

While this structural analysis is obviously aimed at simplifying the rule of reason approach, the inevitable criticism is that the tests are very static in nature. Apart from the somewhat arbitrary choice of figures for the market screen no account can be taken of market share changes over time nor of any changes in the market itself. Further, the factors requiring consideration under the second step concentrate on structural matters and thus largely ignore behavioural concerns. Still further, high values under the VRI will result if most of the suppliers in an industry are using the same restraint, the very situation in which one would expect

\textsuperscript{170} \textit{Id.} at 14.

\textsuperscript{171} Vertical Restraints Guidelines, \textit{supra} note 128 at 31-32.
this to be the case if the restraint is efficiency-enhancing.\textsuperscript{172} These are only some of the many reasons that the Guidelines have been the subject of heavy criticism.\textsuperscript{173} The Guidelines have also proved to be of little relevance given the Department's already permissive enforcement policy towards vertical non-price restraints.

The second approach is that adopted in the Vertical Restraints Guidelines issued by the National Association of Attorneys General ("NAAG")\textsuperscript{174} in response to the Department of Justice's Vertical Restraints Guidelines. Again it is beyond the scope of this thesis to discuss the NAAG Guidelines in any detail, suffice to say that the Guidelines, while acknowledging that vertical non-price restraints have the potential for increasing efficiency, require the existence or likelihood of pro-competitive benefits to be demonstrated.\textsuperscript{175} As such, the NAAG advocate that any inquiry regarding the legality of a non-price vertical restraint depends upon a whole range of market factors. The NAAG Guidelines require a consideration of such factors as market concentration, coverage, scale economies, barriers to entry, and so on.

\textsuperscript{172} See Panel Discussion, \textit{supra} note 129 at 355-57 and Gellhorn & Fenton, \textit{supra} note 131 at 568-69.

\textsuperscript{173} Criticism of the Guidelines was in fact expressed by the U.S. House of Representatives Committee on the Judiciary who, in recommending that House Resolution 303 be passed, stated that the Guidelines "do not have the force of law, do not accurately state current antitrust law, and shall not be considered by the courts of the United States as binding or persuasive ..." (Report of the House Judiciary Committee, 99th Congress, 1st Session, No. 99-399).

\textsuperscript{174} The National Association of Attorneys General, Vertical Restraints Guidelines (December 4th, 1985) 49 Antitrust & Trade Regulation Report 996 (12-5-85).

\textsuperscript{175} \textit{Id.} at para. 3.2.
collusion, output restriction and the rigidity and longevity of the restraint.\textsuperscript{176}

Consideration is also to be given to the role that dealer pressure may have played in the decision to institute the restraints, the extent to which additional services are in fact provided once the restraint has been imposed, the effect of the restraint on 'consumer choice' in the area of price and quality options and the intent of the parties imposing the restraint.\textsuperscript{177} The NAAG approach, while less simple and efficient to administer and enforce, clearly provides a much fairer and more comprehensive approach to the assessment of individual vertical non-price restraints within a market setting. Its virtues arise from the fact that restraints are viewed in light of their actual intent, consumer impact, and the particular facts presented in each case.

The Commission has itself recently attempted to formulate its own vertical restraints guidelines.\textsuperscript{178} Like the Department of Justice's Vertical Restraints Guidelines, the Commission's Guidelines start off with the general proposition that vertical restraints may promote competition by allowing a manufacturer to achieve efficiencies in the distribution of its products and by permitting firms to

\textsuperscript{176} Id. at paras 4.6-4.13.

\textsuperscript{177} Id. at paras 4.4, 4.5 4.14 and 4.15.

\textsuperscript{178} See \textit{Fisher and Paykel Ltd}, supra note 48 at 15-22. The Guidelines were an attempt to define the principles which should apply to the practice of exclusive dealing and to more accurately reflect the Department of Justice's Vertical Restraints Guidelines as appropriate to New Zealand. (Id. at 14) The decision itself involved an application for authorization by Fisher and Paykel Ltd for an exclusive dealing clause in its franchise agreements. The Commission had no difficulty in deciding that the lessening of competition was substantial (based on the conditions set out in the Guidelines) and that the likely detriments therefrom clearly outweighed the benefits found. The Commission therefore declined the application. The franchise agreements did not contain any territorial or customer restrictions which might otherwise have been the subject of discussion.
compete through different methods of distribution.\textsuperscript{179} Thereafter, the Guidelines concern themselves almost solely with exclusive dealing, although they do note in passing, again as in the Department of Justice's Vertical Restraints Guidelines, that vertical restraints "may facilitate collusion among competitors or may be used to exclude or have the effect of excluding rivals."\textsuperscript{180}

The Commission's Guidelines recognize a supplier must have significant market power (as judged by the criteria mentioned therein) if that supplier is to significantly lessen competition through its use of a vertical restraint. In this regard however, the Commission sensibly did not feel itself bound to establish quantitative criteria as to market shares and concentration ratios, noting that there is in fact debate as to whether the U.S. criteria are appropriate for that country, let alone for New Zealand. The Commission stated that it has resisted quantitative criteria to date in assessing competitive impacts in the belief that it does not have sufficient experience or data to provide such criteria for New Zealand at this time.\textsuperscript{181}

The Commission's Guidelines are the poorer for not dealing with all vertical non-price restraints and it is therefore hoped that broader-based guidelines will be promulgated, preferably outside the constraints of any decision, which provide a framework to describe the conditions which must exist before vertical non-price restraints have anticompetitive effects and the factors which assist in the analysis

\textsuperscript{179} \textit{Id.} at 15.

\textsuperscript{180} \textit{Id.}

\textsuperscript{181} \textit{Id.} at 19-20.
thereof. Such guidelines should not however replace the statutory tests and the judgements which must be made pursuant to section 27 (in assessing whether there is a "substantial lessening of competition").

In this regard, one may consider whether the statutory provisions in the other three jurisdictions provide any more an effective means of administration and enforcement of vertical non-price restraints than the present provisions. It is clear at least that section 1 of the Sherman Act provides no real alternative, being as open-ended as section 27 and resulting in the fluidity of interpretation noted earlier in the section on the current state of the law in the United States. The Canadian alternative justifies much closer consideration because it specifically addresses the practice of territorial and customer restrictions. This alternative appeals because it also adopts a "substantially lessening of competition test", recognizes that the imposition of a "market restriction" is only ever likely to be anticompetitive when engaged in by a supplier with a significant degree of market power, and offers a generally accepted defence for those suppliers new to the market or introducing new products. Finally in regard to section 47 of the Australian Act, the convoluted drafting style of the relevant provisions in this section, the conflict between sections 45 and 47, and the problems with the interpretation of key phrases noted earlier discount the Australian approach as a viable alternative. The notification procedure in section 93 of the Australian Act also appears to be of little effectiveness and only increases further the administrative burden on the Trade Practices Commission.

Whichever alternative is chosen, it is essential that there exists an adequate framework within which to judge any vertical non-price restraint. It is submitted
that the Structure/Conduct/Performance Paradigm advocated by many economists in the field of industrial organization and employed by the Trade Practices Commission ("TPC") and Trade Practices Tribunal ("TPT") in Australia provides such a framework. The theoretical foundation of the Paradigm is that the structure of a given market strongly influences the kind of conduct that entities within the market are likely to pursue and that conduct in turn strongly influences performance. As such, there is a causal link between structure and conduct and conduct and performance.

The usual approach in the industrial organization literature is to emphasize market power. Market power is essentially the ability of a firm to control its production and selling policies independently of market constraints and thus to earn excess profits. Most firms have some degree of market power because their products are not perfectly substitutable with the products of others and because there may be barriers to entry of new firms such as cost advantages through access to superior production methods and essential inputs, scale economies of production, distribution, purchasing and capital, and product differentiation and brand loyalty. Market power is discretionary to the extent that a firm has the freedom whether or not to exercise this power, and so not to maximize profits. In the absence of effective competition, the antithesis of undue market power, controls on costs sometimes become lax and so firms often tolerate and maintain what is termed "X-inefficiency". Further, the lure of excess profits often induces

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182 The Paradigm was first conceived by Edward S. Mason at Harvard during the 1930's and has been extended by numerous scholars since. See eg. Scherer, supra note 51 at 4-7.

183 The usual formulations of 'monopoly power' in the U.S. are either "the power to reduce output and increase price" or "the power to raise prices and exclude entry".
firms to incur wasteful expenditures so as to maintain and strengthen monopoly positions.\textsuperscript{184}

In assessing market power, this essentially involves a consideration of market structure through an analysis of market shares, market concentration and market entry conditions.\textsuperscript{185} The conditions of entry to a market is without doubt the most important element of market structure for it is the case with which firms may enter and stay in a market which establishes the possibility of market concentration over time and it is the threat of new firms and new capacity to a market which operates as the ultimate regulator of competitive conduct.\textsuperscript{186} The greater the difficulty in achieving successful entry into a market, the fewer the constraints upon incumbent firms and the more likely the market will exhibit signs of anticompetitive conduct. Assessing the conditions of entry helps determine the likely level of potential competition which is essential if the final picture of the

\textsuperscript{184} Scherer, \textit{supra} note 51 at 464-71.

\textsuperscript{185} Factors relevant for determining whether a competitive market structure exists or not were set out in \textit{OCMA} and included the number and size distribution of independent sellers, the ease or difficulty of entering a market, product differentiation, vertical integration and the nature of any arrangements between firms restricting their ability to function as independent entities (1976) A.T.P.R. at 17,246. These factors were cited with approval in the \textit{Visionhire} and \textit{Air New Zealand} decisions.

\textsuperscript{186} \textit{OCMA}, \textit{id.} at 17,246. A condition of entry is basically any requirement which must be met by a firm to gain entry to a market. Some conditions of entry represent more of a demand on new entrants than others and hence are likely to effect a longer delay in new entry. Time lags delaying entry to the market can help an incumbent firm maintain and enhance its market power. Conditions of entry which are more demanding of new entrants than those experienced by an incumbent will normally give rise to a relatively greater time for the incumbent to maintain and enhance its position in the market. This then results in a longer time lag before new entry or expansion actually occurs and greater market power for the incumbent with consequential detrimental effects on competition in the market. \textit{Fisher and Paykel Ltd}, \textit{supra} note 48 at 30-31.
structure of a market is to take due account of dynamic forces as well as static conditions.\(^{187}\)

In one form or another, market share and concentration figures are used as threshold tests in all major systems of competition law. In regard to market share, the usual measure employed is the percentage share of sales made by a firm in the market, but care is needed in interpretation for it may overstate a firm's market power where there are no or low barriers to entry and the threat of potential competition is great. In regard to market concentration, the usual measure employed is a concentration ratio based on the percentage share of output, capacity, sales or assets accounted for by the leading firms operating in the market. But this must be supplemented by information on the circumstances of concentration such as size distribution, disparateness or mobility of market shares.\(^{188}\) Market share or concentration figures alone are however not sufficient in themselves to determine the anticompetitive effects of a restraint. They are merely useful as a preliminary screen in any analysis to discard those restraints posing no threat to competition.

\(^{187}\) The presence of potential entrants to a market has been accepted by writers on the subject of industrial organization for many years. It has however become more popular in recent years with the development of the 'contestable markets' hypothesis which sets out to demonstrate that in the absence of both entry and exit barriers, either the actuality or the threat of new entry will cause economic performance in an industry to come very close to that predicted by the model of perfect competition. See W. Baumol, C. Panzar and D. Willig, *Contestable Markets and the Theory of Industry Structure* (New York, Harcourt, Brace, Johanovich, 1982).

Consideration of any of these elements of market structure requires as an essential first step a clear definition of the relevant market. One can only analyze market share and concentration if one knows which firms to include in the calculation. Likewise, one can only analyze conditions of entry if one knows what is being entered. In defining the market, it is important to first identify those firms whose activities clearly constrain the activity of the firm in question - and secondly, how potential entrants, whether identifiable or not, constrain the strategy of that firm. In other words, one should consider all those factors which a firm takes into account in determining its business policies and practices. The definition must take into account the dimensions of product, function, area and time. In particular, the product dimension should involve identification of those products which are reasonably interchangeable with the product in question (demand substitutability) as well as the capacity of other firms to produce the product (supply substitutability). The area dimension should determine the geographical area within which consumers can practically turn from one source of supply to another and suppliers can practically switch from one production plan to another. In this regard, both cross-elasticity of demand and supply are relevant. Finally, in dealing with the time dimension, special care should be taken in adopting either a static or dynamic view. The longer the period allowed for likely consumer and supplier adjustment, the wider will be the market definition. A

The identification of the relevant market when assessing the state of competition and the likely competitive effects of a restraint is also appropriate when considering public benefit and detriment for the purposes of an authorization. This is so even though there is no reference to "market" in section 61(6). See In re Tooth & Co. Ltd., In re Tooheys Ltd. (1979) A.T.P.R. 18,174 at 18,194.

dynamic view is however preferable because it recognizes that the market is a field of actual or potential rivalry between firms.\(^{191}\)

Analysis of the conduct and performance aspects of a market are crucially important in addition to any inferences of market power gleaned from market share, market concentration, conditions of entry and other structural considerations. As the TPC stated in its Second Annual Report:\(^{192}\)

The Commission takes the view that in reaching a decision on a particular application, it must have regard to all three elements of the market - structure, conduct and performance - if it is to assess the effects on competition correctly. As has been shown in this chapter, there can be no question of basing decisions on structural considerations only to the exclusion of behavioural considerations, or visa versa. Conduct or performance evidence has meaning only if it is considered in the context of the structural characteristics of the market. Structure must therefore be the start, but not the finish, of any assessment of the effects on competition.

Conduct and performance evaluation usually requires detailed information about the competitive behaviour of firms in the market over a relatively long period of time and is naturally more difficult to obtain. Matters for consideration should include however the extent to which a firm is constrained by the conduct of competitors and potential competitors; the capacity of the firm in question to determine prices in, or to exclude entry to, the relevant market without inhibition; the capacity of consumers to influence the market, the capacity or willingness of distributors to meet the present or future requirements of consumers or to respond

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\(^{191}\) See *In Re Tooth & Co Ltd; In re Tooheys Ltd*, (1979) A.T.P.R. 18,174 at 18,194.

to variations in those requirements, cost structures, profitability and efficiency as well as prices, terms, standards and service.\textsuperscript{193}

All these factors then should be considered when analyzing the effect of any vertical non-price restraint on competition. The framework suggested provides a useful guide to those adjudicating as well as those party to any restraint. In particular, it focuses the adjudicating body on the areas of concern which should be central in determining the competitive effect of any restraint. In confining the focus to reasonably precise and manageable issues, unnecessary economic evidence can be ignored, thus making for shorter trials and hearings, a more manageable record for review, easier enforcement overall and a greater certainty in the law. Greater certainty results because the parties involved and their advisors are aware of factors seen as important in analyzing any restraint. Theoretically, this makes it easier for them to evaluate restraints independently and accordingly makes it less likely that restraints will be used in situations in which they will not be upheld.\textsuperscript{194}

Obviously such an analytical structure should not be fixed in stone but developed as knowledge of particular industries increases and economic theory and research shows that particular factors should be given more or less weight in the determination of pro- and anti-competitive effects of each restraint.\textsuperscript{195}

\textsuperscript{193} See \textit{Outboard Marine Australia Pty Ltd. v. Hecar Investments No. 6 Ltd.} (1982) A.T.P.R. 43, 980 at 43, 988-89 and \textit{News Ltd/INL}, \textsuperscript{supra} note 192 at 7.

\textsuperscript{194} \textit{Strasser}, \textsuperscript{supra} note 87 at 839-40.

\textsuperscript{195} \textit{Id.} at 840.
As far as enforcement itself is concerned, little more than was said in Part II\(^1\) can be added to here. The penalties are an adequate deterrent so long as the Commission prosecutes with due diligence, while private actions should clearly remain available for distributors aggrieved with the force and degree to which restrictions are imposed and policed.

D. **CONCLUSION**

Unlike RPM, the schools of thought regarding the economic implications and suggested treatment of territorial and customer restrictions are far less divergent. The differences in opinion lie in whether "airtight" or "exclusive" restrictions are so anticompetitive that they should be accorded per se illegal treatment or a rule of reason analysis, while for less restrictive alternatives it is whether their procompetitive potential justifies per se legal treatment or a rule of reason analysis. Naturally those taking the more traditional viewpoint, such as Comanor and Pitofsky, opt for the strict treatment in each case while those adhering to the consumer welfare model, advocate the more liberal treatment in each case. Those in the middle seek a rule of reason analysis for all restrictions whatever their nature so as to enable an appropriate balancing of pro- and anti-competitive effects on competition.

It is this writer's contention that the middle course is the correct approach to take. A per se rule of illegality is clearly only appropriate when the restraints in question are almost always anticompetitive that there is no justification for their use. But, as has been seen, suppliers who impose territorial and customer restrictions as part of their distribution arrangements invariably do have legitimate

\(^1\) See text accompanying Part II, notes 242-46 *supra*. 
motives and justifications for so doing and therefore the restrictions can be procompetitive by enhancing efficiency, providing effective competition amongst rival suppliers and distributors and generally improving the competitive structure of the market. In particular, the restrictions can attract competent and aggressive distributors, encourage promotional activity and the provision of pre- and post-sale services, stimulate distributor investments, reduce supplier risk, defray supplier development and expansion costs, increase market coverage, maximize market penetration and improve distributor loyalty. At the same time, the restrictions can still be anticompetitive in the way that they may facilitate collusion amongst supplier and distributors (although rare), create and strengthen barriers to entry and facilitate price discrimination. Whether these pro- and anti-competitive effects are present in any particular case can only be determined by appropriate analysis under a rule of reason. To ascribe legal status to particular types of restrictions on the basis that they are always efficiency-enhancing or to do likewise where certain defined thresholds are not met is shortsighted and imprecise.

In advocating a rule of reason analysis, this analysis must be undertaken within a framework that provides for effective and efficient administration and enforcement as well as conformity to the given policy of existing legislation. The Structure/Conduct/Performance Paradigm provides such a framework within which to examine the effect of a restraint on competition and the state of competition in the relevant market. The starting point is to examine the structure of the relevant market through an analysis of market share, market concentration and conditions of entry. These first two elements play an important role, but of greater importance is the ease or difficulty of new entry to the market and the availability of substitutes. If barriers to entry are high and there are no close
substitutes, a restriction can be used to eliminate intrabrand competition between distributors. If the restriction is exclusive, the supplier and its distributors will each have significant market power because there is no effective competition. If however barriers to entry are low and there are close substitutes, the restriction will not confer market power on the supplier and its distributors, regardless of the degree of exclusivity, because they will face competition from other suppliers and distributors. It is in the first of these situations that antitrust concern is obviously the greatest.

Beyond these structural factors, it is important to consider behavioural factors such as the profitability and efficiency of the industry, the potential for innovation and product development, the combined use of other restraints (particularly exclusive dealing), the characteristics of the product and the demands of consumers.

If a new product is involved, particularly if it incorporates novel technology, or a supplier is new to a market, the use of restrictions to facilitate entry but which have substantial anti-competitive effects should be given favourable consideration and an authorization granted. (This assumes that the restrictions are of benefit to the public and less restrictive alternatives could not employed to achieve the same result.) In cases where it can be shown that the net effect of the restraint in question is to promote competition, there can be no 'substantial lessening of competition' in terms of section 27 and it should not therefore be necessary to proceed to an examination of public benefit.197

197 A similar approach is adopted in the Soft Drink Interbrand Competition Act of 1980, 15 U.S.C. 3501-3503 (1982), which relies on the standard of "substantial and effective competition" to distinguish competitive harmful and benign uses of exclusive territories and which has proved effective in
By utilizing the framework suggested and focusing on the factors mentioned, it is then easier to assess the pro- and anti-competitive effects of a restriction and so evaluate whether, on balance, there is a reduction in competition and, if there is, whether such a reduction is substantial. Guidelines along the lines of those issued by the NAAG would be a helpful supplement to the Commission in its administration and enforcement of the Act, while giving affected parties something against which to judge their conduct. A specific provision dealing with "market restriction" along the lines of section 49 of the Canadian Competition Act would also be helpful in defining with greater clarity the type of vertical non-price restraints which are the proper subject matter of the Act. In this regard, consideration might also be given to narrowing the exception for distribution arrangements involving intellectual property rights.

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The legal treatment of vertical restraints restricting distribution has proved to be one of the most contentious areas of modern competition law. The conflict has centered around the importance of economic efficiency as against a concern for the protection of small businesses and the freedom of sellers to choose their own methods of distribution. The law, particularly in the United States, has been characterized by an increasing application of theoretical micro-economic analysis brought about by an extensive body of economic literature questioning the presumed anticompetitive effects attributable to vertical restraints and suggesting that such restraints should be accorded per se legal status where their predominant effect is to enhance economic efficiency. Those advocating this view, generally known as the Chicago School, argue that efficiencies (which result from the imposition of vertical restraints) can benefit the consumer—either by leading to lower costs (and thereby lower prices) or by increasing the overall value of the product to the consumer.\(^1\) The interests of the supplier and the consumer are therefore seen to be in total correspondence.\(^2\) Vertical antitrust enforcement in the United States is increasingly reflecting the values inherent in the efficiency approach by largely restricting its concerns to economies of scale, efficiency enhancement, free-riders and interbrand competition.\(^3\)

Supplier and consumer interests do not however necessarily correspond and suppliers do not always act rationally in their imposition of vertical restraints. In

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its assumption that suppliers are rational profit maximizers and that business
decisions merely reflect efficiency pursuits, the Chicago School approach fails to
recognize that decisions are often based on "ego gratification, power enhancement,
the need for compromise, and the presence of misinformation." Few suppliers
specifically calculate a profit maximizing price and rely instead on judgement.
Relevant information costs money, is not always available and, even if it is, may
be misinterpreted. When decisions must be reached, uncertainty inevitably remains.
Further, many suppliers are content so long as profits are reasonably adequate and
market share stable. As two commentators have noted:

[Real world markets and methods of business decisionmaking
often cannot be fully explained by economic theory ... particularly as extrapolated and expanded by subsequent
economic analysis. What goes on in the marketplace is a
process of trial and error: businesses often stumble upon,
rather than, plan, successful distribution and marketing
techniques, and as these fortunate businesses prosper, they
encourage others to follow (in an almost Darwinian fashion).
Businesses are guided in this process by instinct, not
econometrics. They also frequently employ a mix of
distributional practices (often in combination) that cannot be
confined within neatly labelled boxes. In this milieu,
successful practices are often initiated for the 'wrong reason,'
but those who nonetheless recognize their value are likely to
be the competitive victors.

Economic theory does help to explain the motivation and justification for
supplier actions under various market models, but competition analysis must go

4 Id. at 539.

5 L. Sullivan, "Antitrust, Microeconomics, and Politics: Reflections on Some

6 E. Gellhorn and K. Fenton, "Vertical Restraints during the Reagan
Administration: A Program in Search of a Policy", 33 Antitrust Bull. 543
(1988) at at 546-47 (Citation omitted).
further and take account of business reality. When determining ultimate legality, the focus in any case should be on the purpose and effects of a vertical restraint rather than on subsequently identified economic justifications.\(^7\)

New Zealand is endowed with provisions that allow such a focus to be made in regard to vertical non-price restraints yet, like the other three jurisdictions under review, perpetuates a distinction between price and non-price vertical restraints. It has been shown that all vertical restraints, if effective, have some effect on price. Just as an agreement between a supplier and its distributors to set a resale price limits price competition for the supplier's products, so also does an agreement to establish exclusive territories similarly limit price competition. Given these similar economic consequences, one would expect similar legal standards to apply. However, the traditional concern of price being the lifeblood of commerce has seen vertical price restraints being accorded per se illegal status regardless of their actual effects in the market place, while vertical non-price restraints are accorded a thorough analysis of their competitive effects under the rule of reason. The Courts in the United States have begun to place increasing importance on whether a particular agreement in fact constitutes a price restraint so as to avoid the legal consequences flowing from such a characterization. This has not been evident in New Zealand, or for that matter Australia and Canada because of the separate provisions dealing with the two types of restraint.

Whether or not a rule of reason analysis ultimately becomes applicable for vertical price restraints (which appears unlikely in New Zealand or Australia, at least in the immediate future), the methodology employed for analyzing both types

\(^7\) Id. at 547.
of restraint is in need of refinement. For vertical price restraints, a simplification of the presently detailed provisions seems in order. As has been suggested, a provision along the lines of section 30 whereby horizontal price restraints are analyzed according to whether they have "the purpose or effect of ... fixing, controlling or maintaining ... the price of goods or services" would be a much better alternative than the present total prohibition. Even a provision allowing for authorization would accommodate the legitimate motives of those wishing to institute RPM where the effect is not to substantially lessen competition in a market or is otherwise in the public interest. Indeed, as has sought to be shown, the real concern is only with those large suppliers selling nationally advertised brands which have strong consumer appeal and where there are few close substitutes because these suppliers normally already have significant power and therefore have much to gain through the institution of a RPM scheme. Smaller suppliers with weak brands will either be trying to increase the level of non-price competition for their products (for example, promotion, advertising, pre- and post-sale services) or to attain quality certification for their products. Still others may totally misconceive its use and will be forced to modify their actions if competition results in their losing sales through the imposition prices which are too high.

As regards the use of a rule of reason analysis for vertical non-price restraints, the practical application of a balancing of pro-and anti-competitive effects is cumbersome and administratively inefficient. As noted in a relatively recent United States decision: 8

8 Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983) (per Judge Breyer).
While technical economic discussion helps to inform the antitrust laws, those laws cannot precisely replicate the economists' (sometimes conflicting) views. For, unlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to service.

What is needed is an intellectually coherent framework for analyzing vertical restraints as well as established criteria by which to assess the effect of a particular restraint on competition. Such a framework and criteria should provide (1) clear guidance to those responsible for administration and enforcement as well as to those in business and (2) simple rules which can be easily applied under the constraints of investigation and litigation.

It has been suggested that the starting point for this analysis should be a market power test which identifies the ability of the parties employing the restraint to in fact increase prices or otherwise decrease competition. In the absence of such market power, antitrust scrutiny can quickly end for there can be no harm to competition or consumers. Only if significant market power is proven is it then necessary for the adjudicating body to consider whether a restraint is sufficiently efficiency-enhancing and thus pro-competitive to outweigh possible anti-competitive effects. Such a methodology narrows the broad range inquiry called for by the traditional rule of reason by requiring the party attacking a vertical restraint to first establish the market power of the defendant before analyzing the competitive effects of a restraint (which may itself enhance market

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9 Gellhorn & Fenton, supra note 6 at 572.
power). It is submitted that this approach is to be commended because it recognizes that without market power, a supplier's use of non-price restraints can have no adverse effects on interbrand competition and should therefore be presumed lawful.\textsuperscript{10}

In applying the screening process, exclusive reliance should not be placed on market share and concentration as determinative of market power, but factors relating to the competitive characteristics of the relevant market such as the ease or difficulty of new entry and the availability of substitutes for both suppliers and customers should also be taken into account. The overriding concern is whether the restraint operates effectively to inhibit the entry of new suppliers of essentially similar products, to foreclose the market to suppliers of new products or to inhibit the introduction of new modes of distribution. In other words, restraints ought not to substantially reduce the extent to which markets are contestable - contestable through the innovative behaviour of incumbent firms or by entry of new firms.

In the weighing process, behavioural factors become particularly important. Here the focus should be on the reasons for the use of the restraint, its use throughout the rest of the industry, its impact on prices, production, quality and service and the response of competitors and consumers. If there is evidence of collusion, this should clearly negate any efficiency-enhancing rationale. If, however, the competitive structure of the relevant market remains healthy, even though individual competitors may have suffered, there seems no reason why the restraint should not be permitted.

\textsuperscript{10} Id. at 565.
Guidelines should be promulgated covering all vertical non-price restraints which describe the conditions which must exist before such restraints have anticompetitive effects and list the factors in the analysis thereof. Quantitative criteria would appear inappropriate at this time until the Commission has more experience in this area. More significantly, a specific provision along the lines of section 49 of the Canadian Competition Act should be adopted in regard to territorial and customer restrictions prohibiting a supplier of a product from requiring a distributor to sell or supply the product only in a defined market (or from exacting a penalty of any kind from the distributor if it supplies any product outside a defined market) where the effect is to substantially lessen competition. The right to seek authorization on public benefit grounds should be available, together with exemptions where (1) the practice is engaged in only for a reasonable period of time to facilitate entry of a new supplier or new product and (2) the practice is between related companies.

Neither the Commission nor the Courts have yet had occasion to consider any significant case concerning the types vertical restraints which are the subject of this thesis, but when either does, it is important that a clear legal standard be propounded. As regards policy, any lead in this regard must come from Parliament. It is clear that the traditional price/non-price dichotomy is neither a rational nor workable distinction for competition law analysis. No bright line can be drawn between price and non-price activities, particularly given the price effects which inevitably flow from such restraints as exclusive territorial and customer restrictions. Per se rules of illegality are only appropriate for carefully defined types of conduct where it is generally accepted that such conduct is almost

11 Id. at 571.
always anticompetitive and the risk of condemning pro-competitive conduct is very low. In the present context, a per se rule should generally only apply where there is proof of -

(1) a contract, arrangement or understanding between a supplier and a distributor to fix, maintain or control the price at which a product is resold;

(2) a threat, promise, inducement or other means used by a supplier to fix, maintain or control the price at which a product is resold; and

(3) a withholding of supply for the reason that a distributor has resold or is likely to resell a product at a price different from that sought to be fixed, maintained or controlled by a supplier.

This last category should not impinge upon the right of a supplier to withhold supply for some other legitimate reason such as poor sales performance, poor payment record and so on or if there has been no prior course of dealing. In the interests of commercial reality, it is probably appropriate that an exemption be available for the making of suggestions of the price at which products may be resold if it is made clear that there is no obligation to accept any suggestion and a distributor will in no way suffer in its business relations if it fails to do so. An exemption should also be available for related companies of a supplier, but not for agents acting as consignees. In all other cases, a structured rule of reason should apply in accordance with the criteria mentioned above.

Vertical restraints in the distribution process may not attract the same attention as multi-million dollar mergers, but they do deserve a higher priority in
New Zealand than at present, given the widespread effects such restraints have upon consumers in terms of their buying choices and decisions.
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