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EXCLUSIVE DEALING

THE FIRST BITE INTO THE FRANCHISING APPLE

SHOULD IT BE ILLEGAL UNDER THE COMMERCE ACT 1986?

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PREFACE

Beginning my research into this topic it seemed that the New Zealand legislature had "got it wrong" in omitting provisions on exclusive dealing. This view was largely influenced by my initial focus on the Australian provisions and Australian writers. With research complete I am of the opposite view. Thus the paper justifies the approach of the Commerce Act 1986. In doing so it reviews the regulation of exclusive dealing practices and examines the reasons why New Zealand has opted not to follow overseas legislative practice.

The paper is also intended to provoke consideration of the potential effects of competition law on franchising. This practice is central to the structure of many New Zealand Businesses.[1] Often franchises involve an exclusive dealing arrangement ("EDA"). Therefore it may prove extremely difficult to displace one without upsetting the other.

I was informed, when considering this topic, that "it would be naive to think that little had been written about this area." However, the paper presents the material available with (it is hoped) a fresh perspective. It provides a marketing analysis of competition which has not been used before and reviews existing arguments on the competitive effects of exclusive dealing. Included is a discussion of the Application for Authorisation by Fisher and Paykel[2] (the "F&P" case). This is the first New Zealand decision on exclusive dealing per se - as such it has implications for current business practice.

In drawing together the material for this paper within the time constraints, I received assistance from a number of people. I should like to thank Yvonne van Roy, Stephen Kos and Richard Fletcher for their help, information and ideas.

INTRODUCTION

The Commerce Commission Draft Determination on the F&P case was released on 13 July. This decision examined an exclusive dealing clause.[3] The tenor of the draft is against granting an authorisation for this restrictive practice. On the evidence revealed, it seems unlikely that this view will change.[4] However, this is merely the first bite of the apple. Finding exclusive dealing distasteful, the Commission may look for more of the franchising worm. It remains to be seen whether the unappetising effects of that one bite are compensated by the sweetness of the remaining fruit.

This paper examines the practice of exclusive dealing. Particularly the focus is upon whether New Zealand should adopt specific legislation prohibiting exclusive dealing as has occurred in other jurisdictions, most notably Australia and the USA. However, as the paper's title suggests, exclusive dealing is a central element in most franchising arrangements. A secondary theme is therefore the effect of exclusive dealing decisions on franchising. The Commerce Commission's decisions on exclusive dealing and franchising generally will have a significant impact on the many corporate and unincorporated bodies who are involved in these practices. In this, as in other areas, competition law[5] is increasingly important for legal practitioners and company officials. However, the Commerce Act 1986 ("the Act") does not expressly deal with either exclusive dealing or franchising. This has been criticised with one writer stating that "non-adoption of exclusive dealing [provisions]...is an unfortunate omission..."[6]

Section one examines the development of competition law. It analyses the way legislation has changed and the emphasis of various statutes. Most importantly it looks at the rationale behind competition law. The focus of the Commerce Act 1986 is upon market competition, not justice between individual traders. This directly effects the way exclusive dealing practices are regulated.

Section two defines exclusive dealing and its relationship to franchising.

Section three examines New Zealand's present law - the Commerce Act 1986. Sections relevant to exclusive dealing are examined with an analysis of the fundamental terms of each provision. New Zealand and overseas case law is drawn upon to assist in this task. Arguments on the effectiveness of these sections are also discussed.

Section four contains an examination of the approach taken in Australia and the USA regarding exclusive dealing practices. The Australian discussion focusses on decisions under the Trade Practices Act 1974. This is particularly relevant as the Commerce Act 1986 was modelled on this Australian legislation. Under the TPA certain facets of exclusive dealing are made illegal.[7] Therefore, a fundamental question is whether New Zealand should adopt similar provisions particularly in light of the Australia/New Zealand Closer Economic Relations trade agreement ("CER")and the desire for greater harmonisation of commercial law between the two countries. Arguably exclusive dealing provisions may be proscribed under the Commerce Act 1986 if they are imposed by persons in a dominant position in the market (s36) or if they substantially lessen competition (ss27 & 28). This section examines whether these sections alone are sufficient to effectively regulate this practice.

The United States material traces the development of exclusive dealing practice in that country. Although the USA does not provide a comparable market it is relevant to New Zealand as a source of advanced case material, particularly in the changing economic analysis of exclusive dealing. It is also a useful guide to future Australian case law as the Australian decisions have increasingly moved towards a more American approach in their analysis of competition law questions.

Section five is an analysis of the Commerce Act provisions which regulate exclusive dealing and the case law to date on these provisions.

Section six examines the extensive economic material which is increasingly of vital importance to exclusive dealing decisions. An initial evaluation is made of the traditional explanations for the

practice. Further analysis examines the competitive effects of exclusive dealing.

Section seven outlines a new approach for analysing competition. Porter's "Five Forces" Model provides a further avenue for assessing the competitive effects of exclusive dealing and is used here to assess the F&P case facts.

Section eight examines the F&P draft determination in more detail both on the law and regarding the economic analysis.

The conclusion outlines the writer's reasons why the New Zealand legislature has 'got it right' and the advantages of this approach over that taken overseas.

Further, it is intended that by providing the whole spectrum of information necessary for the analysis of exclusive dealing in one paper, readers may be able to reach their own conclusions with greater ease.

SECTION ONE : COMPETITION LAW

Background Information

In New Zealand "competition law"[8] as such has come into greater public focus with the redirected thrust of the Commerce Act 1986. This explains the perception of competition law as relatively new and topical. However, it belies the fact that New Zealand antitrust law dates back to 1908.[9] The initial New Zealand legislation was rather piecemeal and often as much concerned with the protection of domestic markets from overseas encroachment as with maintaining competition. Thus, although in form the legislation dealt with competition matters, the intent of the Act was not the promotion of this ideal. The Trade Practices Act 1958 marked the first broad move towards controlling restrictive trade practices in New Zealand and provided the direction for the development of competition law until the 1986 Act. The 1958 Act was based on the UK equivalent[10] and adopted its pragmatic "case by case" approach. Emphasis at this stage was on the form of the practices examined. In 1975 the first Commerce Act consolidated the Trade Practices Act and the Control of Prices Act 1947. The emphasis on form was again retained. Over the period from 1958 to 1975 there had been an increase in the number and type of trade practices restricted by the law. However the policy behind the law was still more focussed upon individual cases and justice between the parties, rather than the wider goal of market competition which resulted from the 1986 Commerce Act. Thus the focus of the earlier legislation was again not solely on competition.[11] In understanding the changes which occurred in the 1986 Act some assistance is gained by examining the structure of its predecessor.

The Commerce Act 1975

The Commerce Act 1975 was divided into six parts. As with the present Act Part II dealt with Trade Practices. This proscribed four classes of trade practices:

(i) *Prohibited trade practices;* these were absolutely unlawful. Practices included: collective tendering, profiteering, mandatory trade-ins, and third-line forcing[12] which may be an element of EDAs.

(ii) *Approvable trade practices;* these were collective pricing and resale price maintenance arrangements. Such practices could not be carried on until approved by the Commission. Transitional authority was given to many collective pricing arrangements under the Trade Practices Amendment Act 1972, a few up until 1985. The requirements of this class were similar to the authorisation process which exists under the present Commerce Act. It is under this head that EDA authorisation would be sought. For instance, as has occurred in the F&P case[13].

(iii) *Examinable trade practices;* such practices could be carried on until made the subject of a Commission prohibition or modification order. These practices included - collective boycotts; collective pricing arrangements not subject to prior approval; collective pricing arrangements on prices or terms; collective arrangements on terms, market division, restrictions on resources, production and supply, and enforcement of restrictive agreements; unjustifiable exclusions from trade associations; excessive royalties, and directed lending. Many of these practices may be elements of an EDA.

(iv) *Other;* these could become examinable following a recommendation to the Minister by the Commission.[14]

Central to the scheme of the "examinable and approvable" trade practice provisions of the 1975 Act, was the public interest test outlined in s21. Certain effects of a trade practice were deemed to be contrary to the public interest, such as increasing or maintaining prices or costs or preventing, reducing or limiting competition or supply to consumers. These effects could be offset by finding that demonstrable public benefits arose from the practice or that an adverse effect was "not unreasonable". The Commission was also to be guided by a range of general objects prescribed in s2A of the Act. The burden of proof was on the

Examiner to establish the existence of the trade practices and the effects. It was then for the parties to the restrictive trade practice to convince the Commission of demonstrable public benefits, or alternatively that any adverse effect was "not unreasonable". However, because of the procedure required by the Act it rarely arose that the Commerce Commission formed the opinion that a practice was contrary to the public interest. Under the 1975 Act only approvable trade practices (category (ii)) required a Commerce Commission decision. All others could be handled by the Examiner. Unless the Examiner reported to the Commission that a practice was contrary to the public interest the Commission was not involved. This control of restrictive trade practices (including EDAs) was largely the province of the Examiner with the Commission taking on an "inquisitional role of a quasi-judicial tribunal".[15]

Commission decisions involving considerable time and expense and (often unwanted) publicity were avoided by seeking agreement with the Examiner or at least a recommendation of approval in the case of approvable trade practices. Thus the system actually worked in a manner which denied the Commission much opportunity to exercise an enforcement role.

The Commerce Act 1986

The 1975 Act was replaced by the present legislation. Five general changes are notable for this paper. The new focus of the legislation was solely upon the promotion of competition. The long title of the Commerce Act providing that it was:

> An Act to promote competition within markets in New Zealand and to repeal the Commerce Act 1975.

This is consistent with the market deregulation aims of the present Labour Government who introduced the Act and with the terms of the CER agreement.

The second major change is in the onus requirements under the Act. Now practices covered by the Act are prohibited and it is for the person operating the practice to argue that it has pro-competitive or other public benefits. This has lead to the Commission becoming much more involved in enforcement.

Thirdly, the trade practices regime has moved from listing the restrictive practices and an emphasis on form to one which examines the economic substance and effect of the practices concerned.[16] This is particularly important for exclusive dealing and franchising arrangements as the determination of the competitive effects often depends on an economic analysis of complex market situations. Fourthly, there is a change in the remedies available. Where previously breaches of trade practices provisions resulted in fines or injunctions, new private remedies are available. Injunctions regarding restrictive trade practices may be gained in the High Court under s81 by the Commission[17] or any person. Under s80 the Commission may receive pecuniary penalties, with s82 providing for damages claims for persons suffering "any loss or damage".

The last point relates to the application of the Act. Although the Act included some transitional provisions[18], s27 has applied to all contracts since 1 March 1988. Thus all EDAs since that date have been subject to the provisions of the Commerce Act.

The basic rationale behind the competition focus in the Act is that controls on anti-competitive practices will result in greater market efficiency and resource allocation. This in turn will be passed on to the community in social benefits such as lower prices and/or better services. However, it is arguable whether market regulation through the law can compel greater competition. Indeed it is argued that:[19]

> changes will tend to occur in the form in which the competitive inclinations are expressed. If this is so, then giving primacy to competition may prove to some extent incompatible with an overriding efficiency objective.[20]

Therein lies the importance of the way the Commerce Commission applies the Act for in areas such as exclusive dealing and franchising, there

may appear to be clear anti-competitive effects. The degree to which the Courts and the Commission follow the philosophy behind the Act will have a substantial impact upon trading practices throughout New Zealand. In the case of EDAs this will require recognition of the pro-competitive effects and public benefits of these practices, particularly in situations where there may be some 'harm' done to a specific trader. The focus of the Act is the promotion of competition with the ultimate goal of increased social benefits and efficient resource allocation.[21] That this goal may be clouded by the desire for justice in individual cases[22] merely accentuates the importance that the Commission and the Courts **exclusively** deal with the effects on competition in the market when making decisions in this area.

The Government seems to perceive competition law as complementary to the deregulation of industry. To achieve the goal of efficient resource allocation, it is clearly not perceived as sufficient to let the competitive forces of the market take their course. This risks the development of market power (the ability to act independently of other market participants)[23] which may "substantially lessen competition." This may seem contradictory, but it is clearly necessary to have some "regulation" to provide a framework for activity, even in a deregulated market. Competition law provides that framework.

Generally the Commerce Act, although it "regulates" competition, does not seek to govern the behaviour of market participants. It is this type of more active control which is seen by some writers[24] as "regulatory". Admittedly parts of the legislation such as that which deals with price control are regulatory in the sense outlined, but on the whole the Act aims only to establish the boundaries of conduct for firms in the market.

This distinction between passive regulation and active regulatory provisions may seem semantic but it highlights the policy basis of the Act. This policy may be undermined by decisions of the Courts or Commission. The danger is that in deciding individual cases boundaries may be set which actually undermine the Act's efficiency objective and its social benefits.

Although free competition has been seen as the most effective way of ensuring efficient resource allocation and pricing, other social benefits have been relevant in the past. This flexibility exists in the present Act which permits the authorisation of most anti-competitive practices.[25] This reflects the pragmatic approach[26] which the New Zealand legislature has taken in providing for a balancing process which may take account of a variety of benefits. It also reflects the statements made by the Commission Chairman on the introduction of the new Act:[27]

> "[c]ompetition, while being a worthwhile objective, may not be the sole objective to be pursued."

In the area of exclusive dealing this is especially pertinent. The anti-competitive effects of this practice may be quite obvious and it is only by examining the total market situation that a correct legal conclusion can be reached. Further, one must keep in mind that the ultimate goal **is** efficient allocation as a means of providing increased consumer welfare. The promotion of competition for its own sake may not achieve this result.

Because of its pervasive effects competition law has links with other branches of the law. Particularly in the context of this paper, it is an additional restriction on the trading activities of corporations and unincorporate bodies. As many practices come under the auspices of the Commerce Act 1986, growing attention by practitioners and company officials must be paid to the way they organise the affairs of companies. For those incorporated bodies involved in practices which may be restrictive such as franchising or exclusive dealing, an additional constraint is added to the burdens of compliance with commercial, contract and company law.

One final point on the development of competition law in New Zealand relates to the reaction of the business community whom it most directly effects. As in the USA and Australia,[28] some New Zealand businesses have voiced negative comments regarding the competition law provisions of the Commerce Act. It would seem that although greater freedom to trade without restriction is called for, it is not desired

if it increases the competitive pace of the market. So for instance, Ford Motor Co (NZ) believed that the New Zealand consumer would "lose out" under the Commerce Act and receive "shoddy service"[29]; the Agricultural Chemical and Animal Remedies Manufacturers Association believed that consumers may be serviced by inexperienced and untrained sellers as a result of the Act[30]; a restructuring of the motor vehicle industry to consumer detriment was predicted as a result of the legislation[31]; and that the Act is claimed to be based on "outdated theory"[32]. These comments are typical of those voiced by businesses in response to the introduction of the Commerce Act. In other specific areas comments have not occurred as those areas are as yet unchallenged under the Act. This has been true of exclusive dealing up until the F&P case. With a direct attack on its exclusive dealing arrangements F&P stated[33] that the company's franchise system was under threat with the Commerce Act being passed and that: "We will be fighting to retain it [the existing franchise system] - our competitors are trying to use the law to do what they can't do commercially." This seems rather ironic as F&P's strong position in the market is in part the result of many years of import protection by the law.

Thus, although the aim of competition law is more efficient trading and greater consumer welfare, for those whom the law directly effects, these positive policy aims are ignored. The individual business tends only to see as far as the threat to its profitability. As the interpretation of the Act is still at an early stage, it is possible that the Courts may also take a narrow approach. That the Commerce Act focusses on competition is clear. The degree to which this focus will be obscured by desires for individual justice is still developing. For exclusive dealing cases a clarity of focus is imperative. Therefore the decisions of the Courts and the Commission, particularly at an initial stage, will determine the future of exclusive dealing and, to the extent they are linked, franchising.

SECTION 2 : EXCLUSIVE DEALING : DEFINITION AND RELATIONSHIP TO FRANCHISING

An exclusive dealing contract exists when one firm contracts to buy or sell a particular product solely from/to another firm. Exclusive dealing is seen most frequently when a dealer agrees to buy some line of goods exclusively from a single manufacturer. However, exclusive arrangements also occur between a manufacturer and its input suppliers.[34] For example, requirements contracts, where a buyer agrees to purchase all of her[35] requirements of some input from a single source and the supplier agrees to make such quantities available, are also a form of exclusive dealing. The practice is thus a vertical one. Arrangements relate to parties operating at different market levels. Thus in the first example above a dealer in the retail market for a good contracts to buy goods exclusively from a party who is in the manufacturing market for that good. These different market levels are known as "functional markets". Thus generally EDAs are between parties who are not in direct competition. The practice may relate to product, customer and/or territorial exclusivity; and may include such devices as:

(a) Vertical resale price maintenance - this refers to attempts by a party in one functional market (usually a manufacturer) to control the prices set by a party in another functional market (e.g. retailer). A common method used is to issue recommended retail price lists with a disclaimer emphasising that they are only 'recommended'. However significant pressure can be brought to bear on individual dealers who choose not to follow such lists.

(b) Territorial restrictions - these involve contractual agreements defining the areas in which dealers may sell their products. As part of the agreement to purchase solely from one manufacturer a dealer may have his sales territory limited. This particularly occurs where there are a number of dealers in one area contracted with the same manufacturer.

This paper will focus on the situation where a manufacturer imposes conditions on a retailer or distributor. For this purpose, Marvel's[36]

simple definition of exclusive dealing is sufficient: "a contractual requirement by which retailers or distributors promise they will not handle the goods of competing producers." The F&P case also fits neatly into this framework and will therefore be used as a case-study. In the writer's opinion (and it would seem according to the Commission) the facts of the case do not provide a balance of pro and anti-competitive effects. As will be discussed later, F&P seems to have a dominant market position and the use of EDAs assists the maintenance of that position without providing significant benefits. However the case is typical of the way exclusive dealing is used within franchising arrangements. It also shows that distinctions between exclusive dealing and franchising may be blurred when examining the effect of these practices on competition.

Franchising

The practice of franchising covers a wide variety of activities and generally is not known to the law. For instance, franchising may not require an express contract; there is no agency and normally no fiduciary relationship between franchisor and franchisee. As Toohey J put it[37], "a franchisee is something more than a middleman and less than an agent"[38]. Thus definitions are difficult.[39] Simply put a franchise is a grant of a right to deal in goods or services over which the franchisor has some control. It may be a right to sell a product manufactured by the franchisor or use their name, trademarks or image. Franchises may often be accompanied by a patent or other licence of intellectual property rights[40] or may simply involve a particular method of doing business[41]. Sometimes there may be no 'grantor' of rights or express franchisor, merely a group of independent businesses conducting themselves under a single name or following a similar system. However, according to Harkin's definition a franchise contains three elements:[42]

1. an original idea;
2. some distinctive embodiment of that idea (for instance the golden "M" of McDonalds); and
3. one or more products or services around which the idea is woven.

A fourth element, although obvious, should be added:

4. an ongoing concern.

This relates to franchises being more than single transactions. What the franchisor is offering is a relationship in which it takes a continuing interest in the manner in which the franchisee conducts her business. The relationship may be extremely wide, extending in some cases (as in McDonalds) to specifying the interior design, providing training, supplying specific accounting systems and other details of the collective "image" desired.

Exclusive dealing is a common element in franchising arrangements. It may take the form of some or all of the following:

(a) Prohibiting the franchisee from dealing in rival products.

(b) Requiring that the franchisee purchase only from the franchiser (and in some cases, third parties)

(c) The franchisor undertaking not to sell to others in a territory or outside the territory

(d) Requiring the franchisee to sell one product only when with another product. For example that Big Macs must be sold in the McDonalds polystyrene containers (tied sales).

(e) Requiring the franchisee to stock a full inventory of goods.

But as stated, a franchise is merely the grant of certain rights. it need not involve an exclusive dealing arrangement at all.[43] Without going into the economic arguments at this point[44] exclusive dealing is more likely to arise in franchising arrangements where the connection between the "intangible goods" relating to the franchise image and the franchise is more tenuous. In these situations it is difficult to charge a rental or fee for the franchise and exclusive dealing is arguably utilised to safeguard manufacturer investments particularly the promotion of the "image" which is an element of the franchising package.

The Commerce Act does not expressly provide for either franchising or exclusive dealing. Indeed, it has been suggested by Pengilley[45] that the omission of a special section on exclusive dealing in the New Zealand Act meant such arrangements were outside the ambit of the Commerce Act[46]. However, it is submitted that exclusive dealing could fit under sections 27, 28 and 36 of the Act and this view has been

confirmed in the Commerce Commission's Draft Determination on the <u>F&P</u> case.

SECTION 3 : THE PRESENT NEW ZEALAND LAW : THE COMMERCE ACT AND EXCLUSIVE DEALING

The present Commerce Act aligns the New Zealand and Australian legislative regimes in many areas of commercial and corporate law. As stated, the new trade practice provisions of Part II replace the previously central concept of public interest (in the old Act) with a primary inquiry as to whether or not particular conduct adversely affects competition. This broad promotion of competition is reflected in the Act and those sections relevant to exclusive dealing will be examined here.

Sections 27 and 28 of the Act prohibit contracts, covenants, arrangements or understandings which have the purpose or have or are likely to have the effect of substantially lessening competition in a market.[47] If the Commerce Commission determines that an exclusive dealing arrangement contravenes sections 27 or 28 it may grant an authorisation if it is satisfied the trade practice will result, or is likely to result, in a benefit to the public which would outweigh the lessening of competition that would result or is likely to result from that practice (see particularly ss58 and 61).

If either party is held to be in a dominant position in the market and is acting for one of the purposes in s36 then the practice is prohibited. These purposes are:

(a) restricting the entry of another person into a market; or

(b) preventing or deterring any person from engaging in competitive conduct; or

(c) eliminating any person from the market in question or any other market.

These sections contain a number of basic concepts. Some of these are defined in the Act. All must be understood for an adequate understanding of the effect of the Act on exclusive dealing. As such, many have been subject to judicial interpretation in New Zealand and overseas, though often with regard to areas other than competition law.

Fundamental Terms

1. "Contract, arrangement or understanding" (s27)

Contract formation poses few problems largely because of the vast number of authorities and material on the subject.[48] It is an agreement enforceable at law but note that s2(6)(a) extends the meaning to include leases and licences of land and buildings. However, the other two terms have received less frequent judicial consideration. For present purposes, it is sufficient to note that the Courts have set aside formalities in looking at business conduct. In the case of Wellington Fencing Materials Association[49] an arrangement is "...apt to describe something less than a binding contract, something in the nature of an understanding between two or more persons...a plan arranged between them which may not be enforceable at law." The usefulness of this statement is reduced because the terms in s27 are not defined separately. It does show that an arrangement may exist, whatever form of communication is used, between the parties and further, that in some cases an arrangement may grow up over time.[50] However a more useful test of arrangement comes from the English courts. In British Basic Slag Ltd v Registrar of Restrictive Trading Agreements[51] Lord Diplock modified an earlier test[52] and held that:

> "...all that is required...to constitute an arrangement in law is that the parties to it shall have communicated with one another in some way, and that as a result of the communication each has intentionally aroused in the other an expectation that he will act in a certain way."

Because of the informal requirements the so-called "wink and nod"[53] agreement clearly falls within the Act. However, there is no arrangement or understanding if one merely follows the prices of another, though if challenged the price leader and follower would need to demonstrate that no communication occurred.

In assessing price leadership certain factors are useful in determining whether such conduct results from some arrangement between competitors. These factors result from a number of decisions, but particularly from the British Slag[54] and Re Master Grocers Federation[55] cases. The factors include:

(a) Whether or not there is an independent business rationale for the action taken. If the action is clearly consistent with a person's best interests then no inference of an arrangement is possible. (Dalglish J. : Master Grocers)[56]

(b) The existence of any motives for entering into such an arrangement.

(c) Broad price indicators such as:

- General similarity in pricing conduct, particularly in the timing and amount of any changes
- High prices, particularly where contrary to economic factors – may be links to output restrictions particularly in monopolistic situations where the level of supply is kept at a level below societies optimal (desired) output. Thus an agreement to restrict output which results in product scarcity may also result in higher prices.

(d) Increased standardisation of products.

(e) Refusal to quote customers after price increases by other suppliers.

2. "Substantially lessening competition" (ss27 and 28)

In these sections the lessening of competition must be outweighed by "a benefit to the public" which "in all the circumstances" will result from the practice.[57] Under s 2(1) of the Act "substantial" is defined as being "real or of substance". In itself this extension of the definition adds little. However, judicial interpretation has provided additional guidelines.

The phrase is used in the 1974 Australian Act[58] and has received considerable judicial interpretation. In the Tillmanns Butcheries[59] case, substantial was held to mean "more than trivial or minimal". Similar epithets and synonyms such as "big"[60] do not take one very far. The cases do indicate that substantial does not require a very significant lessening of competition but further precision is often difficult because of the limitation of many judgments to their own factual situation and because of the wording of the statutory definition. However, there is a useful analysis in the text by Donald and Heydon.[61] There it was stated that a substantial lessening of competition must:

> be interpreted to refer to *a reduction in the factors* which make a market workably competitive. It should not be interpreted to strike down conduct which happens to damage one firm; that loss may merely be the result of the success of the very competitive endeavour which the Act wishes to promote. Even if a market development leads to the exit from business of many small firms, the major participants may be left as competitive as before, each effectively constraining the others to act efficiently and each having the scale to act efficiently. In the application of the Act it must be recognised that short term restrictions are often part of longer term growth and that without them markets cannot grow...the assessment of substantial effects on competition can never be simply a quantitative assessment. It must involve qualitative judgments about the impact of conduct on the market in general.

This statement focusses broadly on competition in the market rather than examining the actions of specific competitors. It is this broad overview which is vital. From the quotation two factors are particularly important:

(i) that analysis must be upon the **degree** that competition is reduced, not the proportionate reduction relative to the previous level of total competition; and

(ii) that market definition is central. Market delineation will directly affect the way the lessening of competition is perceived.[62]

These factors are also mentioned in the first New Zealand case @ this phrase which is discussed below.

The New Zealand authorities in examining "substantially lessening competition" have built upon the definition of overseas authorities particularly those of the Australian Trade Practices Tribunal. The first New Zealand decision was in Whakatu/Advanced Meats[63]. In that case the phrase "substantially lessening competition in a market" was closely examined and the Commerce Commission made a number of comments which are useful to the present discussion.

Firstly it was emphasised that the test of "substantial lessening" related to the competition in a market(s) affected by the particular practice under consideration. The delineation of the market was therefore of importance. Guidance as to the appropriate market definition was taken from the Edmonds Food Industries Ltd v W F Tucker & Co Ltd case[64] which laid down guidelines to market delineation (see

later summary) and stated that:

> "Ultimately the judgement 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..."

This statement formed the basis for the s3(1) definition of the market in the 1986 Act. The statement was itself based to some degree on the Australian decision of Re Queensland Co-operative Milling Association Ltd ("QCMA")[65] in which the importance of substitution was stressed- "substitution between one product and another, and between one source of supply and another, in response to changing prices."[66] So a market is "the field of actual and 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."[67]

The Whakatu/Advanced Meats[68] decision made a further relevant point which relates to the degree of precision possible. In discussing the Tillmann Butcheries case, the Commission said[69]:

> "Accordingly, it seems reasonable to assume that 'real or of substance' in New Zealand was intended to mean not insignificant, not ephemeral, not nominal or minimal. Of course, as Deane J says, such a test conceals a lack of precision. In this respect, the evaluation of the question of degree, based on the criterion of "not insignificant, ephemeral, nominal or minimal", must be a matter of judgment for the appropriate adjudicating body."

The Commission perceived this choice of wording by the legislature as a desire to "cast the net widely"[70]. Thus, in the writer's opinion, any lack of precision exists to provide freedom for bodies deciding on restrictive trade matters to define the boundaries of appropriate competitive practice. This has advantages in this area as significant problems may arise in trying to precisely define concepts which must apply to a range of practices. However in not laying down more definitive criteria, the legislature leave open the possibility that decisions will distort their policy objectives particularly as mentioned where this objective conflicts with an apparent injustice to an individual trader. Indeed, this possibility is in part responsible for the decision by the Australian legislature opting for provisions covering specific difficult areas such as exclusive dealing.[71]

Several further points are relevant before discussing the two most important concepts in the Act (being "competition" and "market").

Section 3(5) of the Act permits that, for the purposes of s27, assessment may be made of the other provisions of the contract, arrangement or understanding in question; or of the provisions of any other contract, arrangement or understanding, together with the specific provision in question. Any of these combinations together "shall be deemed to have or to be likely to have the effect of substantially lessening competition in a market"[72]. Similar provisions exist regarding "covenants" under s3(6) and "engaging in conduct" under s3(7).

3. "Competition"

This term is relevant to all of the sections which may proscribe exclusive dealing or franchising. It is defined in s3(1) of the Act as meaning "workable or effective competition"[73] and must be considered in relation to markets in New Zealand. Under s3(3) allowance is made for the effects on competition of importers, both actual and potential. This definition seems to deny a belief in the model of perfect competition[74] which assumes as an ideal a market of many buyers and sellers with perfect knowledge of market events, complete mobility and identical costs (for example the costs of transactions or taxation). The New Zealand definition focusses on achieving a more practical reality. As the evaluation of competition inherently involves the economic analysis of a given situation the economic writing on what constitutes "workable or effective competition" is extensive.[75] Particularly useful are comments by Donald and Heydon.[76] They see some merit in the model of perfect competition[77] if one relaxes the assumptions to a degree and thus allows the reality of "oligopolistic markets in order to keep the good attainable." That is, perfect competition may provide a guide to the level of competition when one allows the reality of few sellers (oligopoly) to be considered under the model. Although the degree to which a market tends towards perfect competition may provide some clue to the level of competition, in itself this model may distort perceptions of what the competitive ideal should be. As Donald and Heydon add:[78]

> 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.

Thus, as will be discussed later, it is submitted that workable or

effective competition may exist without numerous sellers.[79] This fact is accommodated in the New Zealand definition with its focus on the reality of competition in a market. Further guidance regarding the term "competition" can be gleaned from John Collinge's words on introducing the 1986 Act.[80]

> "Effective competition is, in essence, whether new or potential entry is reasonably practicable in a given market. That, in essence, is the same judgment which a businessman makes in deciding whether to enter a market. Any trade practice which restricts such entry has the potential to substantially reduce competition in terms of the Act."

The chairman goes on to state that competition has different meanings for different people or organisations. Competition policies may mean "more freedom for some and less freedom for others. The ultimate goal is, however, more competition overall." This pragmatic view provides a yard-stick for assessing what type of competition best fits the conditions of the market economy under consideration. In New Zealand it is important to bear in mind the unique commercial setting of this country particularly the size and structure of the market and the legal framework which exists here. Thus:[81]

> Competition is not an easy concept. It is highly judgmental, multi-faceted and dynamic. It means different things from different perspectives. It may not be the best policy in all cases. Balanced judgments between competing facts, interests and policies are constantly required.

However, the Commission and the Courts have devised some factors useful in assessing whether there is "workable and effective competition". Some of these factors were outlined in the Air New Zealand v Commerce Commission case.[82] There the Chief Justice made reference to the QCMA[83] case and the factors which the Australian Trade Practices Tribunal saw as relevant. Likewise in the earlier Commerce Commission decision in the Visionhire Holdings Ltd/Sanyo case[84] reference was made to that Australian judgment. In QCMA the Tribunal saw competition as an ongoing process that could not be analysed on a static point in time basis. Competition was seen as a factor of the market structure and five factors were held to be particularly important. These were:

(1) the number and size distribution of independent sellers, especially the degree of market concentration;

(2) the height of barriers to entry, i.e. the ease with which new firms may enter and secure a viable market;

(3) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion;

(4) the character of "vertical relationships" with customers and with suppliers and the extent of vertical integration; and

(5) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.

The Tribunal in the QCMA case noted that of these factors, barriers to entry was the most significant. However, identifying the appropriate test and factors which help the assessment of "workable and effective competition" conveys only half of the meaning of the term "competition". Equally important is the realisation of the aim of this test. As stated, a competition goal for its own sake may be counter productive in terms of the social benefit goals desired. Again, the QCMA case can provide a good statement of the policy objective:

> "in identifying the existence of competition in particular industries or markets, we must focus upon the economic role as a device for controlling the disposition of society's resources."[85]

Thus effective competition describes a contestable[86] market which should be permitted to operate without interference while it is efficiently allocating resources.

Although in the writer's view the New Zealand decisions have not always fully reflected this policy,[87] adjudicating bodies have built on the interpretation of the Australian authorities. In the Whakatu/-Advanced Meats case[88], the Commerce Commission provided guidance for future decisions. Some of the Commission's observations have been mentioned above, however a summary of the main points on competition is useful:

1. Competition can only be assessed in terms of a particular market.
2. Such a market may have several elements: generally these are assessed in terms of the geographical, functional and product components of the market (see "market" discussion below).
3. In defining "effective competition" the Commission made reference to Visionhire/Sanyo[89] (discussed above) and other merger or takeover cases. Although these did not deal with a substantial lessening of competition (s27) the Commission stated that

effective competition is "consistently applied throughout the Act".[90] Therefore the discussions have equal application in the field of exclusive dealing.

4. The antithesis of competition is market power.[91] Thus increases in the ability of one firm to act independently of others in the market represents a reduction in competition. Again reference was made to the Visionhire/Sanyo decision. The factors outlined in the latter case provide a guide to determining changes in market power which may effect competition in the market.

4. "Market" (ss 27, 28 and 36)

This is the most vital concept discussed here. As stated a market definition is necessary to the analysis of the other concepts. This point was made by Justice Brennan in the US Supreme Court with regard to equivalent legislation in the area of monopolies:[92]

> Determination of the relevant market is a necessary predicate to finding a violation of the Clayton Act because a threatened monopoly must be one which will substantially lessen competition within the area of effective competition. "Substantially" can be determined only in terms of the market affected.

The term "market" is defined in s 3(1) of the Act to mean "a market for goods or services within New Zealand that may be distinguished as a matter of fact and commercial common sense."[93] As this definition suggests individual cases must be decided on their specific facts. Although other authorities can provide assistance the final decision must depend on the circumstances to be assessed. From the case law the most important factor in determining the market is substitution. This may be relevant in any of the three market dimensions:

(a) the product market;

(b) the functional market; and

(c) the geographical market.

Substitution refers to the ability of buyers and sellers in each of these dimensions of the market to switch their source(s) of supply. "Whether such substitution is feasible or likely, depends ultimately on consumer attitudes, technology, distance, [time constraints], and cost and price incentives."[94] Most particularly substitution will effect the choice of product, but in the long run with sufficient

price changes one may also alter the level at which one is supplied: e.g. moving from wholesale purchasing to manufacturing (a change in the functional market); or changing the location of sales (effects the geographical market). However, in deciding restrictive practice matters, the capacity to switch the source(s) of supply must be an economically viable alternative. For instance, it is possible that an Australian company could import beer into New Zealand and distribute it by purchasing on-licence facilities throughout the country. But as an economic alternative it is an unlikely possibility. Thus the market is that field where substitution is possible. It represents the area in which literally firms must be competitive to avoid the substitution of other products and/or suppliers.

In the Edmonds/Tucker case[95] the Commission referred to a number of other factors relevant in determining the appropriate market definition. These are summarised below:

1. Technology
2. Distances involved (particularly for distribution to customers)
3. Cost and price incentives
4. Substitutability (and associated switching costs)
5. Evaluation of any market trends/growth
6. Potential competition
7. Evaluation of industry viewpoints
8. Public tastes and attitudes
9. Public knowledge

These factors do not seem exhaustive as the Commission added that "[u]ltimately 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...". Thus the Commission provides an extensive guide to defining the market but keeps the focus upon individual cases. Further factors may therefore be relevant to different market circumstances.

Market definition is of great importance when dealing with exclusive dealing issues. Because exclusive dealing arrangements reduce the avenues open to competitors they may form powerful barriers to entry and/or constrain existing competition (this will be discussed further

below). Therefore a wider market definition results in more outlets or sources of supply for competitors being considered relevant. This provides a consequent reduction in the overall anti-competitive effects of the exclusive dealing practice.

The use by the Commission of three market dimensions was adopted in the Nathans/McKenzies merger case.[96] These 'dimensions' assist in defining where competition occurs and thus what the market as a whole should be.

The product market dimension examines the goods and/or services which are substitutable for and competitive with those in question. Obviously the wider the range of competitive substitutes, then the wider the product market definition and the less likelihood that the practice will be held to "substantially lessen competition" or that the parties hold a "dominant position".

Functional markets are defined according to their horizontal level. For example, manufacturing or retailing. Although normally parties operating in different functional levels cannot be said to be in competition this distinction may become blurred especially when arrangements such as exclusive dealing or franchising are involved. Again, the separation of markets will depend on the particular facts of the case. However, the vertical nature of these arrangements means that they do not fit neatly within the market definition.

Geographical markets examine the area in which buyers and sellers are willing to operate. People may be willing to travel a much greater distance to get a good deal on a new car than for a haircut.[97] Thus factors such as local patterns of demand, convenience and transport costs will be important. However, it should be noted that generally the Commission has defined the geographic market as the whole of New Zealand and has been reluctant to sub-divide this.[98]

An example which shows the importance of market delineation is seen in Air New Zealand v The Commerce Commission and Anor.[99] In this appeal the Chief Justice revoked a majority decision of the Commission refusing consent to Air New Zealand to acquire up to 77% of Mount Cook

Group Ltd. In so doing, His Honour rejected the view of three members of the Commission that Air New Zealand and Mount Cook were potential competitors in the same market described as the domestic air services market. It was held that the minority view of the Chairman of the Commission was correct, namely, that Air New Zealand and Mount Cook were operating in different markets viz, the tourist air services market (Mount Cook) and the main trunk and provincial air services market (Air New Zealand).

A final point is that made in QCMA that the concepts of "market" and "competition" should not be regarded as totally separate. One cannot be adequately determined without an examination of the other. As the New Zealand authorities have also pointed out, the level of competition can only be assessed in its market context. This market definition will itself be determined by the field of competition. This market 'field' will result from a number of factors, particularly the extent that substitution is possible between different competitors.

5. "Dominant position in a market" (ss 36, 66 and 67)

For the purposes of this paper, the last concept to be examined only concerns s36. As stated, exclusive dealing and franchising arrangements may fall within this provision so an understanding of what constitutes a "dominant position" is essential. That is particularly so given the small and relatively isolated nature of the New Zealand market and the structure of the industries within it.

Section 36 is broadly modelled on s46 of the Australian legislation. However, the basic test in the New Zealand provision is different. New Zealand's "dominant position" test stems from the European Economic Community Treaty, Article 86. As such the Australian authorities are of less significance than elsewhere. Indeed the extended definition of "dominant position in a market" in s 3(8) reflects the decision of the Commission of European Communities in Re Continental Can Company Inc[100]. It should also be noted that the s 36 test is two tiered. One must have a dominant position in a market and one must use that position in an anti-competitive manner. Thus the "dominant

position" test is whether a person as a supplier or acquirer of goods or services either alone or with any interconnected body corporate is in a position to exercise a dominant influence over the production, acquisition, supply or price of goods or services in their market and does so.[101] The factors listed in s 3(8) (a) to (c) are to be considered in determining whether the test has been met. In News Ltd/Independent Newspapers Ltd[102] the Commission felt it could take other factors into account where they were relevant. It therefore set out an "extended and expanding list of...factors." These are set out below with an asterix beside those which are implicit in any of paras. (a) - (c) of s 3(8):

(i) The structure of the market which requires a consideration of:

* (a) the share of the market of the [allegedly dominant] merged new concern;
(b) the degree of market concentration;
(c) the size distribution of all concerns in the market;
(d) the extent to which the products in question are characterised by product differentiation and sales promotion, ie, whether there are reasonably close substitutes;
* (e) access to technical knowledge, materials and capital;
(f) the financial stability of the [allegedly dominant] merged concern in relation to other operators in the market;
(g) the nature of any formal, stable, and fundamental contracts, arrangements or understanding[s] between concerns in the market;
(h) the extent of corporate integration (eg, interlocking shareholdings and cross directorships) among concerns in the market;
(i) the extent of vertical integration.

(ii) * The extent of restraints imposed by the conduct of competitors or potential competitors or by others affected which requires a consideration of:

(a) the extent to which competition exists or has existed and is likely to continue;
* (b) the extent to which the concern is constrained by the conduct of competitors;
* (c) the capacity of the concern to determine prices in or to exclude entry to the market without being inhibited in that determination or action by suppliers and acquirers;
(d) the height of barriers to entry in the market and the ability of potential competitors to enter the market and to sustain a position in the market.

These factors extend the earlier market definitions mentioned above, particularly regarding delineation of markets in terms of barriers to

entry. It is submitted that although the focus here is upon dominance in a market, this is still a question of defining the level of market power held by one party. As market power is the 'antithesis of competition', market concepts should be consistent when discussing s27 or s36.

Two tests of "dominant position" arose from the News Ltd/INL case.[103] The first of these required "an absence of effective competition". This focussed on the statutory objective of promoting competition and held that dominance arose when a party could make "significant business decisions" without being constrained by other market participants. This independence was inferred to arise only when there was an absence of workable or effective competition.

The second test comes from the Australian case of TPC v Ansett[104]. There Justice Northrop had to consider the meaning of the words "control or dominate" (s50 Australian TPA). He concluded that "dominate" should be construed in its ordinary sense and used the Shorter Oxford dictionary definition: "having a commanding influence on". The case contains a careful analysis of some of the cases decided under European Economic Community trade practices law[105] but its definitions of market dominance are of less use as they tend to be merely reformulations of the statutory test incorporating synonyms. The Australian test refers to "control and dominate", and distinctions relating to this are irrelevant to the New Zealand situation as s36 is framed only in terms of market dominance. However, it is interesting that in that case a share of 43-46% of the market was not held to be dominance. It is to be noted that other factors were seen as central particularly the ease of entry and controls on Avis' pricing policy by competitors. In the USA a broadly similar result regarding market share was reached in the ALCOA decision.[106] In that case Judge Learned Hand stated that:

> "Ninety percent of output is enough to constitute a monopoly; it is doubtful if sixty to sixty four percent would be enough; and certainly thirty three percent is not."

The conclusion is not that market share alone provides dominance but that when a firm has a significant market share, dominance, whether intentional or not, will generally follow.

This is interesting as in the F&P case the market share over a number of products ranged between 55% and 85%.[107] Thus the Commission is drawing narrower boundaries. But market share should arguably not be the primary concern. Market power which focusses on the independence of a party to act without regard to other market participants is of more relevance. This view is supported by the factors to be considered in s 3(8) of the Act and the further factors added in the cases; in the writing in this area;[108] and is implicit in comments by the Commission in the Draft Determination on the F&P application[109].

SECTION 4 : EXCLUSIVE DEALING : EXAMINING THE RELEVANT SECTIONS OF THE COMMERCE ACT

For the purposes of this paper only s27 and s36 will be analysed in terms of exclusive dealing. The fundamental terms have already been discussed but further comments on the way these sections apply to exclusive dealing arrangements is necessary.

Section 27

This is a general 'catch-all' provision which prohibits contracts, arrangements or understandings which have the purpose of, or are likely to, substantially lessen competition in a market. Under s27 such arrangements are unenforceable. Most anti-competitive practices will be caught by this section, however in some areas specific provisions (such as those on price fixing) will also regulate these activities. As Yvonne von Roy points out in her text:

> Section 27 is well designed to catch horizontal anti-competitive arrangements, etc. It does not cover the range of vertical practices well, however, for it covers only contracts, arrangements and understandings, and not unilateral actions of one party alone. Most vertical practices will not affect competition sufficiently anyway, but some will, for example a refusal to supply...

However, exclusive dealing practices require a contract, arrangement or understanding of some sort. As such they may be caught under s27.

In the area of exclusive dealing (as stated) Australia has provided specific provisions to regulate this practice. New Zealand's omission of similar provisions has received some criticism which will be examined here. Pengilley makes two arguments regarding the s27 provisions. Both refer to the ineffectiveness of the section in dealing with this practice. The first has been briefly mentioned. That as Australia has a specific provision for exclusive dealing,as well as general provisions (upon which New Zealand's Part II is based) then by implication the latter are considered insufficient to control this practice. By analogy Pengilley argues[110] that the New Zealand provisions are therefore of no effect.

In the writer's opinion this argument is flawed. The Commerce Act is not a reproduction of the Australian Trade Practices Act. It is a response to a different market environment and open to interpretation

by the New Zealand courts. Although s47 of the Australian legislation does provide specific provisions for exclusive dealing these practices could be dealt with under the general provisions in s45. The basic premise of this paper is that if the aim of the Commerce Act is increased competition as a vehicle for greater consumer welfare then the New Zealand provisions are sufficient to deal with anti-competitive exclusive dealing situations.

The question is then: What does s47 of the Trade Practices Act provide (if anything) that is missing from the New Zealand provisions?

As is indicated in the later discussion on the Australian jurisdiction s47 is not easily interpreted. It is also apparent from s45 that the exclusive dealing practices covered by s47 would be caught, as s45 regulates all arrangements. The reasons for the specific treatment of exclusive dealing are unclear. One possible reason was the desire of the legislature, following the Swanson Committee Report[111], to clearly define what exclusive dealing practices would be lawful.

However several degrees of potential anti-competitive effect mean that the s47 provisions must deal with various exclusive dealing situations. As Heydon and Donald put it:

> "Some of them [the exclusive dealing arrangements which s47 regulates] may promote or retard competition, and so need only be prohibited in particular cases where they have detrimental effect. Others are considered to have no possible competitive benefits, but they may produce public benefits and so ought to be permitted if such public benefits can be proved." This is the case with third line forcing under s47(6).

With all due respect to Mr Pengilley (and others) it is submitted that though the intention of the Australian provisions may have been to clarify what exclusive dealing practices were unlawful they do not provide further protection against anti-competitive effects than the New Zealand provisions.

In all of the s47 categories of exclusive dealing a minimum requirement for a breach would appear to be substantially lessening competition. Although the conduct which brings about this result may be defined in greater specificity, the requirement for a breach is no

more than the general provisions of s27 provide. The focus of the New Zealand legislation is the promotion of competition. The prohibition under s27 concerns practices which substantially lessen competition. That these practices are not precisely defined should not impede finding that there has been a breach of the Act under either s27 or, where appropriate, s36.

Pengilley's first argument would seem to be further denied by the approach of the Commerce Commission in the F&P case. However, in that situation, there was a substantial market share and the conclusions seem largely based on the dominant position of F&P in the whiteware market.

The second argument raised by Pengilley is that because suppliers "impose" terms on dealers there is no mutuality of obligation. Agreement, even if only an informal "wink or nod"[112] is required for the purposes of finding a contract, arrangement or understanding within the meaning of s27.[113] According to Pengilley this problem is alleviated in the Australian legislation (s47(2)) by prohibiting the imposition of a "condition" (widely defined) on a supplied party if this results in anti-competitive effect(s). Thus the supplied party does not have to "agree" to the condition for a breach. This seems to refer to unilaterally dictated terms: "[t]he usual position would be that the supplied party simply had no choice in the matter."[114]

Again, with respect, this seems a distorted view of the New Zealand law. As Hill and Jones point out[115] under s27 of the Commerce Act, all that is required is a contract, arrangement or understanding, "containing a provision" that is anti-competitive. It does not require mutuality of all the provisions of the trading agreement.

These are the only major criticisms of s27, to date, that relate to exclusive dealing. It is likely that any future actions regarding this practice will result in further comments. To date the only exclusive dealing case where a breach of s27 was alleged was Bond & Bond Ltd v Fisher & Paykel Ltd[116]. In that case Barker J found that in the circumstances the application for an interim injunction could not be based on s27 because of s111(1) which provided that s27 should

have no application until 1 March 1987.

The writer's view is that s27 is the most appropriate method for regulating exclusive dealing. Although s27 is usually concerned with horizontal competition, that is, agreements between two competitors in the same functional market, the provision can accommodate vertical practices. With consistent judicial interpretation this broad section together with s36 can catch those EDAs which are anti-competitive. This avoids further difficult drafting and provides the scope for adjudicating bodies to deal with practices which may not fit within specific definitions. A wide provision such as s27 is useful in a commercial context where the development of new "arrangements" to circumvent existing legislation may be quite rapid. This is particularly so in the Commerce Act where the focus is on promoting **substantive** competition and not merely prohibiting a certain form of enterprise.

Section 36

This provision regulates monopolistic conduct. It focusses upon preventing enterprises misusing dominant market positions and is one of three approaches used to deal with increases in market power. Part III of the Act examines monopolistic structures focussing upon mergers and takeovers where market power is increased. Part IV deals with price control and particularly regulates monopoly pricing.

Section 36(1) provides that:

> "No person who has a dominant position in a market shall use that position for the purpose of-
> (a) Restricting the entry of any person into that or any other market; or
> (b) Preventing or deterring any person from engaging in competitive conduct in that or in any other market; or
> (c) Eliminating any person from that or any other market."

EDAs may result in any one of these circumstances, though the degree to which EDAs alone may eliminate a person from the market is limited. However they may form a strong barrier to entry and they clearly prevent or deter certain types of competitive conduct. Thus if a firm is held to be in a dominant position in a market and engages in EDAs for any of the purposes listed above then the danger of an action

under this section is high.

Thus s36 has three major elements:

(i) market dominance (discussed previously);

(ii) The use of that dominant position; and

(iii) One of the three listed purposes. This "purpose" need not be the only one, however it must be a "substantial" purpose of the conduct in question.[117] For the present discussion "purpose" only refers to deterring or restricting competitors.

It is not proposed to examine the general points raised by the Act under s36. These are discussed in detail elsewhere.[118] However two points are of specific relevance to exclusive dealing. The first effects all alleged breaches of s36 but may have particular relevance in the exclusive dealing area. It concerns the wording of the section. In contrast to the rest of the Act, in s36 the language refers to power affecting "any person". Further, breaches of s36 may result in the award of damages to an individual trader for any loss suffered. Thus the section may be perceived as focussing upon individual rights. As Land states in his discussion[119] this is inappropriate. The Act aims to promote competition. The elimination or restriction of competitors by a firm may reflect inefficient resource use by those competitors[120]. Their demise in itself may not be inconsistent with the objective of greater consumer welfare; indeed efficiency may be improved by such a departure. The focus is therefore on the **purpose** of any such action by dominant firms. This purpose may manifest as:

(i) Predatory Pricing - particularly pricing below marginal cost[121]

(ii) Refusals to supply: e.g. As was the case in the <u>Bond & Bond Ltd</u> v <u>Fisher & Paykel Ltd</u> case[122],

(iii) Denial of Access to Essential facilities;

(iv) Enforcement of intellectual property or contractual rights; and

(v) Exclusive dealing and related practices.

All of these practices, and others[123] which are employed **may** give results, which are illegal under s36. Thus if a firm is dominant the substantial purpose of such action should clearly be **other** than one of the three prohibited purposes: e.g. - Refusal to supply because

retailer is a proven credit-risk. However, competition often demands that practices which give prohibited results be used. Successful competition on an individual basis involves the furtherance of one person or organisation's aims, often at the expense of others. Thus the threshold level of "dominant position in a market" is vital.

Therefore the second major point is that in adjudicating disputes it is important that the bodies concerned do adhere fairly closely to the objective of the Act. Because of the nature of the language in s36 and the problems assessing market dominance it is likely that difficulties will arise. The first New Zealand decisions[124], like many of the Australian cases, seem to focus on individual justice rather than a competition objective. As Land states:

> It is far from certain, however, that the courts in New Zealand will take an approach which gives sufficient weight to the economic objectives of the Act. The Australian courts, with respect, have failed to do so in most of the cases on section 46 of the Trade Practices Act 1974 (Aust.), the provision on which our section 36 was based. Two of the first three New Zealand decisions on section 36 are also not encouraging.

The writer is in agreement with the general point made, that the policy objective of the Commerce Act may not have been given sufficient weight. However, it is submitted that the New Zealand cases to date have not had sufficient opportunity to develop in this area. So for example in Bond & Bond Ltd v Fisher & Paykel Ltd[125] Barker J commented that it is:

> "desirable for the Court; when feeling its way in determining the proper approach to be taken to litigation under the statute, to confine itself as much as possible to the issues before it, leaving general principles to be distilled from a number of judgments."

Therefore, a clear judicial approach to the policy objectives has not developed yet, however there have been some encouraging comments. Barker J in the later case of ARA v Mutual Rental Cars (Auckland Airport) Ltd[126] in discussing the nature of competition stated that:

> The test of competition is not concerned with the economic fate of individual competitors but with the level of rivalrous behaviour in the market. The relevant service or functional market is the provision of rental cars to the public. The geographic market is national.

The Commerce Commission particularly seems to be viewing

monopolisation and oligopoly as economic phenomena and abandoning judgment of such conduct on more moral grounds. For exclusive dealing and franchising the degree to which this development continues will determine the continued existence of these practices in their present form.

Future Interpretation in Light of Present Uncertainty

As stated it is the author's view that the existing New Zealand provisions are appropriate to regulate anti-competitive exclusive dealing practices. This area has not received much interpretation to date. The decided cases have, with respect, tended to give less weight to the competitive objectives of the Act in response to situations of perceived unfairness to individual traders. This is not the role of the Act and would seem to cause problems for company officials in determining any liability under the Act. Up until recently the Commerce Commission has been unsure of the application of the Act to exclusive dealing[127] and even the F&P Draft Determination does not provide a guide to the approach of the Commission to exclusive dealing cases except in fairly extreme cases of market dominance.

An examination of other practices similar to exclusive dealing which have been examined under the Act may provide a useful guide to future interpretations under the relevant legislation. Particularly useful in this context are those examining franchising arrangements. As stated, these, like exclusive dealing, may impact upon vertical competition. In Auckland Motors v Todd Motors[128], one of the issues was whether franchising agreement contravened s27 of the Act. However, the test formulated by Justice Craig does not assist us much more than the Draft Determination. It merely states that if either party in the franchising arrangement has significant market power the risks of being caught under s27 or s36 will be greater. On the previous analysis in this paper this risk will largely depend on the court's definition of the market. This is itself uncertain until there are a greater number of decisions and a more obvious and consistent line in the reasoning.

Until the final determination on the F&P case and probably, of more

use, a decision on a more 'balanced' case (regarding pro-and anti-competitive effects) involving exclusive dealing the present uncertainty of the law in this area will remain. This uncertainty itself may be a factor behind agitation for a separate section on exclusive dealing as is the case overseas (notably in Australia). However it is submitted that such specific provisions will not alleviate the problems of uncertainty for New Zealand organisations regarding their exclusive dealing and franchising practices.

SECTION 5 : OTHER JURISDICTIONS

Introduction

A comprehensive focus on competition in the New Zealand law is relatively recent. The USA has nearly a century of antitrust legislation; the United Kingdom and the European Economic Community over 40 years; and Australia more than a decade. It is therefore useful in the continuing development of our own legislation to look to these overseas authorities.

A broad trend can be seen in the legislative development of all the countries mentioned. From viewing exclusive dealing as per se illegal and focussing only on the monopolistic structure of arrangements, now most legislations apply some form of the "Rule of Reason"[129]. This latter approach requires a balancing process and takes greater account of economic analysis. In some jurisdictions this development has progressed a step further to viewing the practice of exclusive dealing as per se legal.

Only two jurisdictions will be analysed here: Australia,focussing upon the Trade Practices Act 1974 - this is relevant because of CER and as it formed the model for our own legislation; and the United States, because Australian legislation has tended to take a more American style antitrust approach since 1974[130] and the United States also has the most extensive history of competition law.

I. AUSTRALIA : THE TRADE PRACTICES ACT 1974

Much of the relevant Australian law has been alluded to, such is the degree of harmonisation in this area. But it is important to note that harmonisation does not require replication of other legislation. It should be the case that local conditions temper the provisions enacted.[131] Thus even should one reach a decision that specific exclusive dealing and/or franchising provisions are necessary it may not be sensible simply to import the equivalent overseas legislation. This may be particularly so in the case of s47 of the Trade Practices Act 1974.

Exclusive dealing under the Australian Act is governed by s47[132]. However this section has been described by Justice Stephen as "replete

with double negatives and proliferating alternatives (which defy) accurate synopsis."[133] Indeed in their extensive text on restrictive trade practices[134] Ransom and Pengilley suggest that "[t]he first task in studying exclusive dealing is to decipher what s47 actually says. This is not easy[135]." However although in the writer's opinion the language is unclear and often ambiguous, it is possible to outline reasonably clearly the manner in which s47 regulates exclusive dealing[136]. Section s47(1) prohibits the practice: "subject to this section, a corporation shall not in trade or commerce, engage in the practice of exclusive dealing...". The section details four different kinds of conduct which it defines as exclusive dealing:

- Restrictions imposed by one person in the chain of distribution on another person lower down (e.g. by the manufacturer to the retailer). This includes solus agreements and requirements contracts: see s 47(2) and (3). [Solus agreements are also referred to as "tied outlets". They provide that the customer is expressly prevented from dealing in products which compete with the supplier's product. Requirements contracts provide that customers agree to buy some or all of their requirements of a particular product from the supplier and therefore effectively excluded from other suppliers. This contract therefore indirectly achieves the same as a solus agreement.]
- Restrictions imposed in the opposite direction by a person from a chain of distribution higher up: See s. 47 (4) and (5).
- Restrictions on 'third line forcing'. Under this practice a supplier will only supply goods or services on the condition that the customer agrees to acquire certain other goods and services not related to the supplier: See s. 47 (6) and (7).
- Restrictions included in the last category are similar to those above but imposed or enforced in regard to leases and licences of land and buildings: see s47 (8) and (9).

With the exception of third line forcing, exclusive dealing conduct will not be in breach of the Act unless it has the likely effect of substantially lessening competition in the given market: see s 47(10). Regarding third line forcing, it is illegal irrespective of the effect on competition. All four kinds of exclusive dealing can be authorised if public benefits can be shown. As mentioned in the introduction to

this paper, the focus will be on the first category of exclusive dealing arrangements.

The basic argument made in this paper is that provisions which specifically define exclusive dealing practices are not necessary for effective regulation of such practices. This point has already been discussed in relation to the form of the New Zealand provisions. The present section will examine the Australian case law relating to s47 of the Trade Practices Act to discern whether these specific provisions have resulted in effective regulation and/or certainty regarding the outcome of the exclusive dealing decisions.

The structure of s47 of the Trade Practices Act results in two general requirements for a breach:

(i) that practices come within the specific categories proscribed under s47; and

(ii) under s47(10) that, as a minimum, exclusive dealing has the **purpose**, or has or is likely to have, the **effect**, of substantially lessening competition. The exception is third-line forcing (defined in subss47(6), (7) and paras 47(8)(c), 47(9)(d)) which contravenes s47 whether or not it is anti-competitive.

As exclusive dealing practices must be created by some form on "contract, arrangement or understanding", in the terms that these words are defined in the Commerce Act. Therefore s27 of that Act would regulate all exclusive dealing practices caught by s47 of the Australian Trade Practices Act. Further s27 would provide the same minimum standard as the specific Australian exclusive dealing provision. Therefore it is not proposed to examine all the categories of exclusive dealing proscribed under s47. Analysis will be in two stages:

(A) Exclusive dealing practices which avoid the specific provisions of s47 that may be caught under the Commerce Act ss27 or 36 if they were anti-competitive; and

(B) Other problems or ambiguities which may be evident in the Australian case law on s47.

(A) Section 47 : Avoiding the exclusive dealing categories

The avoidance of s47 itself poses no threat to trade practices regulation. Other general provisions exist in the Trade Practices Act especially the s45 "catch-all" provisions. However some examples are provided to highlight the needless complexity which results. If anti-competitive exclusive dealing practice(s) can avoid the specific s47 provisions, particularly after significant amendment[137] and judicial consideration, then the provisions would seem to be largely redundant. This is even more pertinent when the effectiveness of the Australian provisions in the area of exclusive dealing is being considered against a New Zealand Act which focusses on promoting competition to achieve increased consumer welfare. It is submitted that this focus is difficult to maintain without being further obscured by unnecessarily complex and to some degree redundant provisions.

Avoiding s47 : Specific Examples of Avoidance

1. **Subs 47(2)** refers to exclusive dealing arising where a corporation supplies or offers to supply goods or services, or gives or allows (or offers to do so) a discount, allowance, rebate or credit, on the condition that the person supplied **will** not (or will not to a limited extent) acquire goods or services from a competitor of the supplier.

An issue arises as to the timing of transactions required by this subsection. In SWB Family Credit Union v Parramatta Tourist Services[138] a majority of the full court agreed with the judge at first instance and held that in subs 47(6) the word "will" imparted a temporal requirement. Therefore the phrase "will acquire" required that the first supply preceded the acquisition of the other goods or services.

If this interpretation applies generally to s47, and there seems no reason why it should not,[139] then subs 47(2) will involve a similar temporal requirement and thus provide a way of avoiding s47. For instance discounts[140] which relate to goods supplied on the condition that over a prior order the customer has exclusively purchased from the supplier would fall outside s47(2) according to the SWB Family Credit Union case. In practice this may not arise for several

reasons. Firstly it is a complex manner in which to circumvent the provisions and in any event likely to be caught under s47(3) if the discount was refused to a customer who had not met the exclusive dealing condition. Secondly, even if s47 was avoided ss45, 46 or 49 might apply. However this situation gives an indication of the additional avenues which may be considered to avoid specific provisions. Such complex legal distinctions which may be utilised also compound the problem of certainty under the law.

2. **Minimum quantity conditions** - conditions which require a proportion of total acquisitions from a supplier seem to fall within s47(2)(d). This paragraph refers to limitations on the acquisitions of goods and services from a competitor.[141] The position is not clear regarding two other conditions. For convenience the labels used by Taperell will be adopted here.[142] These are "minimum quantity conditions" and "tying conditions". The report of the Swanson Committee recommended that minimum quantity conditions should be covered by s47 in certain circumstances, namely where the supplier knows her customer's needs and frames the conditions of sale on the basis that supply will only take place in units of that 'needed' amount. This situation, where there is no economic rationale for such a condition, merely an attempt to "tie in" the customer was to be regulated under s47[143]. However, on the language adopted in s47(2)(d), where no proportion of a customer's acquisitions is stipulated, problems may arise in arguing that the nature of the condition[144] is to require the customer to buy exclusively or in part only from one supplier. If there is no required proportion then changes in the customer's needs would seem to undermine the 'exclusive' nature of such a condition.

As Taperell points out "[t]o treat a minimum quantity condition as exclusive dealing is to confuse its purpose or effect with the terms of the conditions itself[145]." The writer would agree that this is a sensible distinction. To include minimum quantity provisions of **all** sorts within s47 seems to deny the economic reality of many transactions. However, the distinction which arises rests on the purpose of the supplier in requiring such a minimum quantity. If this purpose is to 'tie' the customer to the supplier then it will be caught under

s47(2)(d). This agreement between supplier and purchaser will then have to be analysed to determine whether it has the "purpose or has or is likely to have the effect, of substantially lessening competition". (This will be examined in more detail below). Again this would seem to be an unnecessarily convoluted method of excluding anti-competitive practices. Further, a finding that the purpose of a minimum quantity condition is to tie the purchaser may influence decisions on whether the purpose or likely effect of such a practice is to substantially lessen competition. The latter issue involves examining at the effects on a **market situation** (per s47(13)(b) & (c)) while the prior analysis of purpose will generally focus on **individual** persons or organisations and the arrangements between them. In the author's view this specific legislation for exclusive dealing may bring about unnecessary confusion. The area of competition law is one which already poses problems for the judiciary particularly where traditional ideas of justice for the individual must arguably be ignored unless consistent with the common good.[146] This general difficulty which, with respect, seems to have arisen in some Australian cases[147] will be examined below together with other more general points relating to s47.

Section 47 : General Points

This section will not cover all of the case law in this area. A number of Australian cases have been discussed previously which have assisted the New Zealand adjudicating bodies. In the main these have been on concepts of more general application to competition law, for instance the QCMA case. It is now proposed to examine exclusive dealing decisions. The aim, as in the immediately preceding discussion, is to determine whether the specific s47 provisions of the Trade Practices Act have resulted in consistent decisions and thus some certainty for those whose actions the law may regulate.

The Trade Practices Act and the application of the Act in leading cases by the Trade Practices Commission ("TPC")[148] has been strongly criticised by academics[149]. In two major cases Toohey's Ltd, Tooth & Co Ltd[150] ("Tooheys") and Application of Shell Company of Australia Ltd[151] (the "Shell" case) the Commission decided that practices were anti-competitive under s47.

In the Shell case[152], the Trade Practices Commission refused clearance of an agreement by petrol sellers to sell only their suppliers' petrol and other products. The TPC held, without detailed reasoning, that this restricted competition between the suppliers and between the resellers. However it is possible to glean much of the reasoning for this decision from the authorisation proceedings[153]. The Commission looked at "competition between the companies" rather than the broad test of competition in the entire market which is required by s47.[154]

The TPC seems, with respect, to have made other statements inconsistent with the Trade Practices Act and particularly s47[155]. For instance the Commission relied heavily on the fact that requirements contracts were widespread throughout the industry (these were of the "tying" variety discussed previously). The reliance of the TPC on this fact resulted in what Donald and Heydon have referred to as the "industry wide aggregation fallacy.[156]"

As Donald & Heydon state this aggregation approach repeats the errors of the Standard Oil Co v US[157] (discussed later) and also arises in the Tooheys[158] decision. If a practice(s) are common throughout an industry, such as requirements contracts, and one firm is judged on the basis of the anti-competitive effects of all those contracts on the market, this analysis is unfair and unjust.

Donald and Heydon[159] go further than this and feel that it is unfair if government attacks are made on "those whose new requirements contracts begin to affect competition substantially." By this they refer to attacks to stop undesirable future trends. The writer's view is that irrespective of the likely trends that may be caused the focus is upon the degree to which competition is reduced. Therefore even the innovator should be caught if the new practice substantially lessens competition. However, the writer agrees with Donald and Heydon's basic point. The extent to which all competitors use a practise(s) is irrelevant to an analysis of the anti-competitive effects of a single company (or group) on the market. The extent to which practices are generally used is relevant to determining conditions in the market but should apply no further than this. Even if

the situation is, as in the Shell[160] case, that virtually all resellers are tied to one supplier the adjudicating body must look at the practice(s) of the individual company in question and the effect this has on the market as a whole. The economic effects of such a situation may in fact be pro-competitive (as will be discussed in more detail in Section 6 of this paper). Thus by analysing the effect of exclusive dealing on individual competitors rather than the market as a whole, the Commission negated any of the potential pro-competitive effects. As Horman put it:[161] "[T]his [approach of the TPC] always leads to the conclusion that the arrangement is anti-competitive as exclusive dealing by its very nature prevents competition between competitors in dealing with individual tied producers."

However, as Horman and others[162] point out, exclusive dealing may result in a greater level of market competition. In this context the development in the US case law and in economic analysis is particularly useful add will be examined in later sections.

A final point regarding the Shell case[163] is what occurred after the denial of clearance and later of authorisation. The TPC opposed any restrictions on lubricants, or on dealer controlled sales sites, but permitted petrol companies to stipulate for up to 100 percent of requirements on sites they used for Agency Depots[164] and 50 percent of requirements to be taken on retail sales they controlled.[165] The petrol companies could also stipulate that their pumps could only be used for their products[166] and that if their equipment was used for a competitor's product a fee could be charged. However the TPC stated that the fee could not be so large as to deter from using competitors products. The fee should only reflect the cost of capital invested in the equipment[167]. Thus, although the initial decision was against such practices and on s47 many of the practices listed above would seem to be caught, the TPC gave limited permission for such practices to continue.

The second case examined in this section is Toohey's Ltd, Tooth & Co Ltd[168]. In this case the test for competition in the market was dubiously defined very widely.[169] This definition included a number of discrete products "lumped together", namely beer, other alcoholic

products and soft drinks. Although a great number of anti-competitive factors arose here, arguably the Commission's decision contained a number of errors. Notable among these was the so-called "industry aggregation fallacy"[170] by which the behaviour of individual competitors is lumped together, rather than looking at the effect of exclusive arrangements relative to the market as a whole. Again the TPC created a test that meant the practice of exclusive dealing had to be anti-competitive.

Although there have been clearer Australian judgments which have been more consistent with their general trade practices law, such as the oft quoted QCMA case, in the writer's opinion anomalies have occurred in the area of exclusive dealing and franchising. For instance, the view of single brand markets which arose in Top Performance Motors v Ira Berk[171]. This decision has been followed in two later cases[172] and provides authority for the view that a single brand may constitute a "market". Thus a product franchise over that brand may result in a monopoly or something approaching this.

These decisions have been criticised in Australia[173] and New Zealand[174] and the Trade Practices Act (Aust.) 1974 amended to prevent such future decisions by including a test of substitutability in the statute. Although the cases have received much criticism, as Ian Eagles points out in his discussion[175] the single brand market is not impossible but "the fact must be demonstrated.[176]"

In these cases a question arises as to why the judges should focus so closely on individual brands. It is submitted that this problem comes about in part because of the traditional focus of adjudicating bodies remedying harm done to individual parties. It is not the contention of this paper that the Courts should cease their endeavours to provide a remedy for individuals, merely that the overall focus must be upon competition in the market. Cases such as Top Performance[177] and Tavernstock[178] although presenting market definitions which would "seem to be risible"[179] (they held respectively that there could be a local Gold Coast market **solely** for datsun automobiles; and a market for **one** brand of whiskey) do highlight the difficulties involved in focussing upon overall competitive effects rather than on the specific

harm done to individuals.

Arguably part of the difficulty for the Commission and the Courts in these cases is applying s47. Although each case must largely rest on its facts, the disparity of the Australian tests for the effect of exclusive dealing on competition is cause for concern. A clearer view of an appropriate test may be gained from the US development. (see later discussion)

Comparative Comments : the Pro-New Zealand View

It is submitted that the problem of focus is compounded by the complex exclusive dealing section of the Trade Practices Act (Aust) 1974 which even the judiciary find difficult to comprehend[180]. Such provisions do **not** seem to add greater certainty. Further, where existing provisions can adequately regulate the practice of exclusive dealing, as it is argued the provisions of the 1986 Commerce Act can, there is no reason to clarify the approach of the adjudicating bodies unless legislative policy objectives are not followed. In Australia, arguably, policy objectives may be obscured by the greater specificity of the exclusive dealing provisions and the focus upon the actions of individual persons. By contrast, the New Zealand provisions regulating exclusive dealing are relatively clear and simple. Although the elements of these provisions (particularly ss27 & 36) require interpretation and analysis against case facts, the Act has a single clear objective. It is submitted that the New Zealand approach in the Commerce Act is more appropriate than that of the Australian Trade Practices Act 1974 and may result in greater certainty and consistency in the law. Land has described two of the first three New Zealand cases on s36[181], as "not encouraging". However, as stated, the writer would disagree slightly. Land's comment, though valid, would seem to require a caveat. All the cases to date have involved only a very limited analysis of the broader issues of competition law. As Justice Barker noted in the ARA v Mutual Rental Cars[182] case the adjudicating bodies are still carefully feeling their way in the application of a relatively new Act. Some encouraging comments have come from the Courts[183] but as yet broad principles relating to the regulation of exclusive dealing practices may have to wait for further cases.

The F&P Draft Determination, discussed later, provides further encouraging remarks and in the writer's opinion provides an appropriate focus for future cases. However, as stated it is fairly clearly a case where authorisation will be denied. More useful and detailed principles can be expected from a more balanced and therefore more difficult decision on exclusive dealing practices alone or within the franchising context.

The next sub-section examines US legal developments in the area of exclusive dealing. Although the USA does not provide a comparable market to New Zealand it is a useful source of case material dealing with the economic analysis of restrictive trade practices. This is particularly important for exclusive dealing decisions where the extent of any competitive effects or public benefits depends to a large extent on the economic consequences of such practices.

II. THE UNITED STATES : DEVELOPMENTS IN THE AREA OF EXCLUSIVE DEALING

In recent years the US courts' treatment of exclusive dealing has shifted dramatically: from a position that exclusive dealing was primarily a device to lessen competition to a position that exclusive dealing can and often does promote competition. Encouraged by advances in the understanding of the economic role of exclusive dealing and of distribution practices in general, US courts are now inquiring into the business reasons for exclusive dealing. The courts are increasingly finding that exclusive dealing and other "vertical"[184] nonprice restraints offer many pro-competitive benefits while presenting little likelihood of lessening competition. This development is important in the area of exclusive dealing as the extent to which it may be seen to "substantially lessen competition" depends on economic analysis. Changing views have also assisted the evaluation of what constitutes dominance in a market[185].

The US has almost a century of experience in adjudicating antitrust cases concerning exclusive dealing. These cases involve a wide variety of industries and economic circumstances. The pro- and anti-competitive consequences of exclusive dealing have been subject to extensive evaluation by US economists and lawyers. Hence, the evolution of US thought on exclusive dealing can provide a useful background for analysing the manner in which New Zealand's legislation should develop. However the differences between the two economies mean that concepts and analysis from the US jurisdiction, although useful, must be tempered by a consideration of the New Zealand situation.

A. **Major US Decisions**

The Clayton Antitrust Act passed by Congress in 1914, made exclusive dealing illegal where its effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce." As with the Sherman Antitrust Act of 1890 and the US common law tradition, the wording of the Act was vague and its interpretation was left up to the courts.

In the first major exclusive dealing case decided under the Clayton Act, the leading dress pattern manufacturer in the US, Standard

Fashion, was found to be illegally imposing exclusive dealing restrictions on retailers[186]. Exclusive dealing had in fact been used by most pattern makers for many years. However, the Court reasoned that in rural communities only a single brand would be available, creating a monopoly in patterns in thousands of small communities. In reality, such an event was unlikely, since all pattern makers had extensive mail order operations.[187]

The next important Supreme Court decision involving exclusive dealing was Standard Oil Co v US[188]. Here exclusive dealing between petrol refiners and retail petrol stations was held to lessen competition by restricting entry of new suppliers. In their written opinion the Court recognised the possible benefit of exclusive dealing, observing that: "Requirement contracts...may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public...From the seller's point of view, requirement contracts may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and – of particular advantage to newcomers to the field to whom it is important to know what capital expenditures are justified – offer the possibility of a predictable market." But these recognised benefits carried little weight in the final decision. Ultimately, the Court simply noted the share of the market which the practice allegedly barred competitors from ('foreclosure'), found it substantial, and invalidated the contracts between the refiners and station operators. It apparently mattered little to the Court that the exclusive dealing contracts for retail gasoline distribution were of short duration (only about one year), so that retail stations could easily switch to rival suppliers; nor did they consider that it is generally uneconomical for stations to carry more than one brand of petrol.[189]

Like Standard Fashion and Standard Stations, most of the major US antitrust decisions on exclusive dealing are quite old. The US Supreme Court has not ruled on an exclusive dealing case since the 1970s. Relatively recent cases include a 1961 case concerning a long-term exclusive dealing contract between a coal supplier and an electric power generating utility where the Court found exclusive dealing to be legal.[190] Again the Court mentioned the efficiency

benefits of exclusive dealing, but the decision turned upon the small amount of market foreclosure (less than 1 percent of the coal market) potentially involved. In a 1966 decision, the Court ruled that Brown Shoe Company, which sold under exclusive franchise agreements with about one-third of its retail outlets, had engaged in a practice which foreclosed rival shoe manufacturers.[191] Brown's franchise dealers accounted for about one percent of the nation's shoe dealers. Under the Brown franchise program, Brown supplied franchisees with architectural plans, inventory and accounting systems, low cost group insurance, and technical services from Brown's field representatives. The Court, however, engaged in no economic analysis of the relationship between Brown's willingness to make these investments and its use of exclusive dealing.

Since the 1960s the lower Courts continued to hear cases on exclusive dealing, and showed an increasing awareness of the possible competitive benefits the practice might generate. The lower Courts have made large strides in their understanding of the competitive effects of exclusive dealing by their use and acceptance of economic analysis.[192] In addition, retail franchising has become extremely widespread in the US and generally the exclusive dealing involved in the arrangement has not been legally challenged. In effect, exclusive dealing in retail distribution is now widely condoned in the US[193]. Thus the increased development of economic analysis has significantly changed the anti-competitive perceptions of exclusive dealing. This effects the extent to which such practices should be regulated and the consequent need for specific provisions.

B. The Sylvania Case

The more "economic" approach to vertical distribution practices was adopted by the US Supreme court in 1977 with <u>Satellite Television & Associated Resources Inc</u> v <u>Continental Cablevision of Virginia Inc</u> (the "<u>Sylvania</u>" case)[194]. Sylvania's practice of granting geographic areas of sales responsibility to its retail television dealers was upheld by the Court. This decision overturned a <u>per se</u> rule against territorial and customer restrictions for dealers (under certain conditions) as decided by the Court a decade earlier in a case involving bicycles.[195] In <u>Sylvania</u>, the Court concluded that nonprice

vertical distribution practices, including, among others, exclusive dealing, exclusive territories, and refusal to deal, are not per se illegal and should be decided by a rule of reason. Under a rule of reason approach, the business reasons for a practice are fully investigated and weighed against any possible anti-competitive harm.

The Court concluded that: "Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."[196] Some of the efficiencies noted by the Court included: "To induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles and major household appliances. The availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his products".

The Court adopted an analytical framework for examining vertical restraints in which the loss in intrabrand competition (competition between distributors of a single supplier's goods) is weighed against the gain in interbrand competition (competition among manufacturers of the same generic product, such as refrigerators). The Court recognised that some vertical restraints, such as exclusive territories, restrict intrabrand competition, but do so in order to stimulate interbrand competition. The gains from increased interbrand competition in most cases outweigh any losses from reduced intrabrand competition.[197]

Since Sylvania, the US Department of Justice and Federal Trade Commission have brought fewer and fewer cases involving nonprice distribution practices. Exclusive dealing cases have dropped off sharply. From 1980 to 1984, the US antitrust agencies brought only four exclusive dealing cases. In contrast, from 1970 to 1974, they brought twenty-one exclusive dealing cases.[198]

C. Vertical Restraint Guidelines

Further relaxation of the law on exclusive dealing is reflected in the U.S. Justice Department's Guidelines on Vertical Restraints.[199] These

Guidelines, issued in 1985, explain the enforcement policy of the Justice Department. The Guidelines concentrate on two distribution practices: exclusive dealing arrangements and territorial and customer restrictions. The Guidelines conclude that, "...vertical restraints that only affect intrabrand competition generally represent little anti-competitive threat and involve some form of economic integration between levels of production or distribution that tend to increase efficiency".[200] And, more generally that, "Vertical restraints rarely have a significant anti-competitive effect."[201] The value of this guideline has been recognised by the New Zealand courts in the News Ltd case[202] and in the Magnum/DB decision[203]. In the area of exclusive dealing these guidelines have also been referred to by the Commission in the F&P case.

The Guidelines recognise that exclusive dealing can create benefits including the facilitation of new entry and the protection of the investment of a manufacturer and its dealers from "free riding" by rival manufacturers. Free riding refers to the use of the investment of one manufacturer, such as advertising that draws customers into a store, by another manufacturer. (see also Section 6)

The primary anti-competitive concern about exclusive dealing expressed in the Guidelines is that it may, under certain circumstances, exclude rivals by increasing their cost of obtaining distribution. A new producer may suffer a cost disadvantage if he cannot obtain a dealer network at a cost comparable to that expended by existing manufacturers. The Guidelines caution, however, that this cost standard must be applied carefully, since an existing manufacturer who established an efficient distribution system in the past should not be penalised for its superior skills or denied a return on its past investments. In addition, if exclusive dealing is not used by all or a large share of the manufacturers in the market, entrants can utilise the remaining available retail outlets. Moreover, if the term of an exclusive dealing contract is short, say one year or less, and dealers who switch suppliers are not subject to a manufacturer-imposed penalty, then new suppliers are unlikely to be excluded from the market.[204]

D. The Revolution in US Antitrust Law

This shift to a more accepting position on exclusive dealing is just part of a major transformation in the application of antitrust law in the US. Experts on antitrust law, including judges and economists formed a strong consensus[205] in the late 1970s that much antitrust law has been misapplied in the past, to the detriment of consumers. This consensus was based on advances in economic theory, economic knowledge gained from empirical testing, and from analyses of past antitrust cases. These analyses indicated that all too often in the past, antitrust laws had the unintended effect of lessening competition by barring efficient business practices. For example, past anti-merger policy was found to be too restrictive, prohibiting many pro-competitive mergers. Cases against firms with large market shares, so called dominant firm monopolies, were in retrospect seen to have been in error, serving to penalise large firms for their superiority in innovation, management, distribution, product quality, and efficiency of production. Further, as noted above, past treatment of nonprice vertical restraints were recognised as much too restrictive, ignoring the many pro-consumer efficiencies stemming from these distribution agreements. Lacking sufficient knowledge of the business purposes of vertical restraints, such as exclusive dealing, the courts imputed anti-competitive motives without adequately considering the efficiency gains which actually lead to their adoption[206].

Modern economic analysis has changed these perceptions. Much has been learned about transaction costs and efficiency gains from contractual arrangements, especially vertical contractual arrangements. Antitrust law now recognises that large firm size is not, in itself, anti-competitive and that market structure frequently results from fundamental economic factors, such as the existence of large economies of scale and differences in efficiency across firms. A better understanding of the concept of barriers to entry has evolved in the US with the recognition that many historical notions of barriers to entry were, in reality, mistaken. What appeared to be a barrier was often simply the result of the superior efficiency of incumbent firms. Further, vertical restraints have been recognised as pro-competitive and efficient marketing arrangements that generally have few anti-competitive effects. In particular it has been stated by some[207] that

in the case of a manufacturer and retailer/distributor, exclusive dealing is unlikely to have anti-competitive consequences when **any** of the following conditions hold:

(1) Exclusive dealing contracts are of short duration (that is, less than one year).

(2) The conduct of firm(s) using exclusive dealing is limited by other manufacturers/distributors that already have access to retail outlets.

(3) The barriers (including economies of scale) associated with the establishment of new retail outlets, or expansion of output using non-exclusive dealing outlets are low.

When one or more of these conditions hold, no significant market power can arise from the use of exclusive dealing, and no benefits to the competitive process result from the prohibition of exclusive dealing. Some theorists[208] believe the fundamental concern of competition law should be horizontal market power. That is, changes in the extent to which individual organisations can act independently of other market participants because of a practice(s) within a certain functional market. This has important implications for New Zealand (and Australian) legislation. Although this view has not been expressly approved in New Zealand, the acceptance by the Commission that vertical nonprice practices are generally **not** anti-competitive implies a degree of approval of this approach.

These views will be more closely examined in the following section. However, as stated, overseas conclusions need to be tempered by new Zealand's unique commercial environment.

SECTION 6 : AN ECONOMIC PERSPECTIVE

Restrictive practices are broadly of two sorts: those which result from agreements between independent businesses; and those resulting from single enterprises which have acquired significant market power (unilateral actions). In the latter category one would place monopoly, monopsony[209], some vertical integrations and power resulting purely from size[210].

Exclusive dealing fits into the first category. It is an agreement, for present purposes, by which a manufacturer places conditions on her dealings with a retailer/distributor. But it may have effects similar to that of vertical integration[211]. Restrictive agreements themselves may be divided into two general classes which have been described as "exploitative" and "regulatory".[212] Exploitative agreements as the term suggests seek to attain collectively higher rewards by affecting prices and therefore profits. Regulatory restrictions may have some of the same effects, but the aim of the participants is often ostensibly not to impair competition. Participants do not seek higher prices or the removal of all independent competition, merely the prevention or regulation of certain activities which are deemed as undesirable. Exclusive dealing may fit into both categories. Its purpose may in rare cases be to create barriers to entry, though as will be discussed, this is seldom effective. Alternatively, it may simply regulate territorial marketing areas for franchisees so there is no overlap. In both instances, the activity has anti-competitive elements. Today more of the pro-competitive benefits are being recognised.

A. EXCLUSIVE DEALING : THE TRADITIONAL VIEW

The traditional model of the ideal competitive market is that of 'perfect competition'. This is a useful model in understanding economic forces. But because of its simplifying assumptions, perfect competition in itself does not provide a good general guide to the reality of the market place. Unfortunately this view of competition with many buyers and sellers, none of whom have a controlling influence, has permeated thinking in this area. It has been accepted by John Collinge[213] that competition as a goal in itself is not desir-

able. Such a goal may not provide efficient resource allocation and more importantly the social benefits which may flow from 'appropriate' competition control. Thus a situation of oligopoly may not produce harmful effects for society. Profit maximisation even if it is in reality the goal of industries in such a market, may not result in a significant decrease in the level of output or an increase in price.[214] With the economies of scale that result from increased size prices may actually be reduced.

Perfect competition is seen as the ideal because it results in 'perfect' efficiency. Production occurs at the precise level where the market demand and supply for goods and the marginal costs of the units involved at this level are equal. From a legislative point of view, the social costs and benefits are equal; and perhaps as important, no single producer or purchaser has market power. But as stated the model is flawed, particularly as it assumes away a number of factors covered in reality. With regard to exclusive dealing and franchising, these may include:

(1) Information, transaction and gathering costs - for example, about market preferences and production techniques.

(2) Implementation costs - include: the costs of drawing up, monitoring and enforcing contracts which specify the terms and conditions for sales, purchases or payments for services including those which relate specifically to organising economic activities within firms.

(3) Enforcement costs - for instance, the costs of defining and enforcing property rights[215] including intangible assets such as image and reputation or those which provide other forms of information to consumers.

(4) Government Intervention costs - these would include pre-emptive measures taken regarding potential intervention and particularly those costs involved in compliance with and administration of competition regulation.

Thus it is not surprising that the traditional explanations of exclusive dealing have received some criticism.[216]

B. <u>EXCLUSIVE DEALING TRADITIONAL EXPLANATIONS</u>

Two explanations of exclusive dealing are: firstly, that it is a

device to obtain increased dealer promotional effort;[217] and secondly that exclusive dealing is used to create entry barriers for competitors.[218]

Marvel discounts both of these arguments[219] largely on 'efficiency grounds'. However it should be noted that his perspective reflects the USA market reality which arguably may not be transferred to the New Zealand environment in some cases. He puts forward strong efficiency reasons why exclusive dealing is used. It is "a device used to create a property right to information concerning potential customers for a manufacturers produce...[and] to ensure that dealers do not act opportunistically so as to avoid paying the manufacturer for valuable ancillary services in a tie-in to the product sold."[220]

Exclusive dealing is thus seen as a way to protect manufacturers investments in advertising and brand-enhancement activities. Manufacturers try to charge for the extra custom dealers receive by incorporating the charge for the promotional effort into the wholesale prices of their goods. However, without exclusive dealing or tie arrangements, dealers can take advantage of this investment. While receiving more customers (through the manufacturers image or advertising) dealers may also divert customers to "no-frills" type products on which the profit margins are greater ("free-riding"). This argument implies that the degree of free-riding depends on the role of the dealer in the purchase division. For this reason, the 'protection' of exclusive dealing is more likely to be used where products are technically complex or require substantial after-sales backup and unlikely to be used by producers of simple goods (for example, breakfast cereals).

In considering the American material one must bear in mind the differences between the two countries. Most notable is the different levels of market share which, in the USA, are seen to give rise to significant market power. In the US the threshold level for examination under the Vertical Restraint Guidelines[221] is only a 10% total market share. In New Zealand, because of the smaller economy and the necessity for less suppliers a larger individual market share is required for an organisation to be held to "substantially lessen

competition" or have a "dominant position in a market". As the Commerce Commission noted in the F&P Draft Determination[222] "the background of industry experience in the United States market, is that market concentration is generally a great deal less than that found in the smaller New Zealand market."

However, the arguments and rationale of economists such as Marvel, have found favour with the New Zealand Courts. In the early Commerce Commission determination in the Newspaper Publishers Association case[223] which decided authorisation for non-rebating provisions in advertising agency agreements with the NPA, the Commission adopted an economic analysis similar to the American approach. In the case of Fletcher Metals Ltd v Commerce Commission[224] the High Court, although not examining exclusive dealing, accepted the US Department of Justice approach to vertical mergers. The analysis in these cases reflects the changing view towards vertical practices such as exclusive dealing.

Whatever the arguments on the appropriate rationale for exclusive dealing it seems clear from the US case law (discussed previously) that it may have pro-competitive effects. Further the anti-competitive elements can be reduced where certain factors are present.[225] Three recent cases in the United States have found exclusive dealing to be pro-competitive on efficiency grounds.[226] In one of them,[227] which involved industrial machinery, the court identified several 'benefits' of exclusive dealing:

(1) a dealer does not have divided loyalties and commits his sales efforts totally to one brand,
(2) exclusive dealing prevents free-riding by dealers on the manufacturer's promotional efforts by preventing dealers from switching customers to brands with higher margins, defeating the manufacturer's ability to recover promotional costs, and
(3) exclusive dealing leads dealers to promote the manufacturer's brand name more vigorously than under non-exclusive dealing, resulting in a lower quality adjusted price (where quality includes information and other services rendered by dealers).

In the writer's view and on current economic analysis, arguably these 'benefits' may not always arise from exclusive dealing practices. It

is accepted[228] that exclusive dealing does provide benefits by protecting manufacturer's promotional costs. This in turn may ensure the retailer receives a higher level of support services and promotion from the manufacturer. However, a question is raised as to whether these benefits to the retailer are sufficient to offset the potential loss in custom from stocking only one brand. This must be answered by individual retailers. Particularly in the New Zealand context the need to stock a major supplier may reduce the ability of retailers to choose freely. It is at this stage that the Commerce Act may intervene. Thus in some situations the second 'benefit' may seem to only accrue to the manufacturer. However, especially in the context of the Commerce Act the effects on competition as a whole are central. If all retailers are "tied" interbrand competition and economies may arise which provide consumers with lower prices and better service. As the previous discussion has shown, the extent to which these practices effect workable or effective competition must be decided as a matter of fact and commercial common sense. Therefore, a consumer welfare benefit may on balance result.

It is arguable whether the two other 'benefits' should be described as such. The first benefit may arise from an EDA but the degree to which it is advantageous to the retailer depends upon the services and promotion received in return for the limitation on brands. Thus in some situations a dealer may have little choice whether to accept an EDA. In such cases the retailer is forced to devote sales efforts to one brand.

The third benefit may often result from exclusive dealing, however as was mentioned in the <u>F&P</u> Draft Determination[229] vigorous promotion and particularly quality services (such as information and sales service) are often claimed to be generated by retailers themselves, therefore the extent to which lower quality adjusted prices are a benefit of exclusive dealing may be doubtful in some cases. Thus, although these benefits may have occurred in <u>Roland Machinery</u> v <u>Dresser Industries</u>[230] mentioned above, any benefits must be proved as a matter of fact and common sense <u>in each case</u>.

This intrabrand/interbrand competitive effect trade-off has been shown

in other cases, such as the Joyce Beverages case.[231] This involved a bottler with an exclusive contract to bottle one cola, but with the wish to add a second cola. The court held that exclusive dealing increased competition by focussing the efforts of soft drink bottler-distributors on a single brand. Quoting an earlier soft drink case the court stated: "A bottler with a dual franchise might be hesitant to strongly promote one cola product over the other, with competitive detriment to both syrup manufacturers."[232] By remaining separate the two cola drinks compete directly. If marketed by one company, they would rarely compete **directly** on price, advertising, self space (i.e. neither would receive particular promotional effort from the retailer/distributor). Although it is submitted that this may be **generally** the case, the qualifications mentioned above must be borne in mind and the facts proved in each situation.

These cases exemplify the U.S. courts' decision to incorporate economic analysis into exclusive dealing cases. In most cases potential entrants are not foreclosed by exclusive dealing. Further the practice is only anti-competitive within a product brand and may actually stimulate interbrand competition. However, the analysis here would not be complete without examining the recent development in economic analysis. This examines economic activity in terms of the contractual arrangements which are used to facilitate those activities. Under this analysis distinctions between the market and the individual company disappear. As Klein, Crawford and Alchian put it:[233]

> "Many long-term contractual relationships (such as franchising) blur the line between the market and the firm. It may be more useful to merely examine the economic rationale for different types of particular contractual relationships in particular situations, and consider the firm as a particular kind or set of interrelated contracts. Firms are therefore by definition, formed and revised in markets and the conventional sharp distinction between markets and firms may have little general analytical importance. The pertinent economic question we are faced with is 'What kinds of contracts are used for what kinds of activities, and why?'"

Bearing in mind the comments made earlier regarding the requirement for a degree of 'mutuality' under s27 of the New Zealand provisions the approach suggested above is very useful. It focusses on the choice between alternative contractual relationships and the compara-

tive costs of those alternatives. The essence of exclusive dealing is a reduction in choice. This approach necessitates an examination of costs and benefits of different alternatives. It is this which will pinpoint the effect on competition and more importantly whether society as a whole is a winner or loser under the chosen alternative.

This approach has lead to greater understanding of those practices which have traditionally been outside the ambit of the perfect competition model. These practices include vertical integration and other vertical activities such as franchising and exclusive dealing. As was noted in the previous discussion the U.S. approach to these practices has been accepted in some of the recent New Zealand cases[234]. Although there were no decided cases on exclusive dealing at the time, this paper was compiled, assistance can be gleaned from the F&P case[235] and other cases which deal with vertical practices. There are important similarities in the considerations which lead to the use of these practices and, as stated below, the way they should be viewed in the competition law context.

C. PRO-COMPETITIVE EFFECTS : VERTICAL INTEGRATION AND OTHER VERTICAL PRACTICES

In addition to Marvel's efficiency reasons for exclusive dealing which result in manufacturer promotional and image-enhancement investments there are a number of other pro-competitive effects which may result from these practices.

(a) A further efficiency reason for exclusive dealing is to protect manufacturers' investments in the development of distributor services by way of training and advice given to dealers. This argument is expressed by John Chard as follows:[236]

> "The manufacturer could supply information about management systems, staff training, selling techniques, and after-sales servicing. To the extent that the manufacturer's investment in providing such information can generate customers by increasing the efficiency of a distribution outlet independently of whether the manufacturers's product is sold by the outlet, free-riding possibilities exist unless exclusive purchasing (or a similar restriction, such as a tie-in provision) is employed."

Because exclusive dealing prevents substitution of other sup-

pliers' products for the product of the manufacturer supplying the distributor services, it effectively precludes any free-riding on those services.

(b) Chard also argues that exclusive dealing may be used by manufacturers to protect their reputation for quality in situations where consumers find it difficult to know whether to assign the blame for quality faults to manufacturers or dealers. As an example, Chard refers to a report by The United Kingdom Monopolies Commission on liquified petroleum gas (LPG) where it was found that exclusive purchasing probably had a beneficial effect on safety because it enabled suppliers to exercise more effective control over the storage and handling of LPG by their distributors. Exclusive dealing allowed suppliers to protect their reputations for safety, an important asset in the case of a dangerous good such as LPG.

(c) Exclusive dealing may provide protection for investments similar to that afforded by vertical integration. Vertical integration may cover two or more separate stages of production and frequently occurs when there are significant investments in assets with low salvage value[237] relative to cost. Vertical integration avoids problems which can arise in supplier-customer relationships. One party will be in a position to act opportunistically and barter for the difference between the market and salvage value of the assets concerned. By internalising[238] the supplier-customer relationship, vertical integration avoids the costs of opportunistic behaviour as well as the costs of contractual arrangements (where these are possible) designed to prevent such actions. Exclusive dealing fits into the latter category. It provides a contractual safeguard where investment is contemplated in assets with low salvage value.[239]

(d) Generally, reducing information costs and risk, - exclusive dealing may do this in the specific context mentioned in (c) above. However, generally where exclusive dealing is used, particularly under franchising arrangements, it provides a certainty of knowledge and therefore of risk. Customers are likely to have more knowledge of the products because of promotional efforts and likewise in many situations with the dealers. It is submitted that all these effects may arise from exclusive

dealing. However EDAs may not be the only causes of such pro-competitive effects. For instance, the last factor (d) may arguably arise from equally high level of dealer initiated development may occur bringing about the similar costs savings. Similarly the other practices may result on balance in anti-competitive effects. For instance, vertical integration or exclusive dealing may result in market dominance if one of the functional levels involves a "bottleneck facility". This situation was referred to by Barker J in ARA v Mutual Rental Cars Ltd & Anor[240] as resulting in a dominant position in a market. As the Vertical Restraint Guidelines[241] state, although it may not occur often, EDAs may present significant barriers to competition which lessen competition. Thus again the author would suggest that although recognition of these benefits is useful it still falls upon the adjudicating bodies to decide whether the facts are consistent which such benefits arising.

D. EXCLUSIVE DEALING : REDUCING THE ANTI-COMPETITIVE EFFECTS

Based particularly on the U.S. case law and economic analysis of exclusive dealing, it would seem that unless the practice provides the firms using it with a significant degree of market power it does not harm competition and may generate valuable economies. The major potential anti-competitive harm from exclusive dealing derives from the possibility that its use will raise barriers confronting competitors[242]. In the case of a manufacturer-retailer exclusive dealing arrangement, exclusive dealing may make it more difficult for competing manufacturers to gain access to retail outlets[243]. Where exclusive dealing in conjunction with existing entry barriers results in a substantial barrier at the retail level and the manufacturer using exclusive dealing is not subject to a significant degree of discipline from competitors that already have access to retailers, exclusive dealing may result in increased market power. This may lessen competition in itself or lead to a dominant position in the market for the organisation concerned.

The "Guidelines for Vertical Restraints"[244] emphasise that the focus in antitrust law should be on horizontal market power and that vertical restraints rarely damage competition. The main concern the

Guidelines express regarding exclusive dealing is that it may raise the cost of distribution to rivals. However, the guidelines suggest that exclusive dealing is unlikely to be used for anti-competitive purposes unless it significantly raises rivals' costs of gaining access to distribution facilities. In applying this test, account is taken of extra costs incurred by firms using exclusive dealing so as to avoid penalising them for investments in improved product quality and distribution service. The vertical restraint guidelines note that exclusive dealing will not facilitate anti-competitive exclusion unless entry into the "foreclosed" market is difficult.[245] If within a reasonably short time frame a small or new firm is able to contract with the distribution outlets needed to operate at an efficient scale at the same effective cost as existing firms, the guidelines expressly state that there will be no exclusionary effect[246].

Further, the entry barrier posed by exclusive dealing is directly related to the duration of the agreement. Exclusive dealing agreements with a shorter duration than one year which impose no penalty on dealers that switch suppliers are considered to be innocuous by the U.S. Department of Justice.[247]

To summarise, the view expressed in the recent U.S. case law[248] and the Vertical Restraint Guidelines regarding exclusive dealing is that the potential for competition to be damaged by the use of exclusive dealing flows from the possibility that exclusive dealing will raise the entry barriers confronting entrants to such an extent that it provides incumbent firms with market power by protecting them from potential competition. In the case of a manufacturing firm with exclusive dealing contracts with its distributors/retailers the exclusive dealing is unlikely to have anti-competitive consequences when any of the following conditions hold:

(a) the exclusive dealing contracts are of short duration (i.e. less than one year) and/or there are no penalties involved in termination;

(b) the barriers (including economies of scale) associated with the establishment of new retail outlets or expansion of output using non-exclusive dealing outlets are low; and

(c) the conduct of the firm(s) using exclusive dealing is constrained

by other manufacturers or distributors that already have access to retail outlets.

When one or more of these conditions hold, no significant market power will usually arise from the use of exclusive dealing and there is no benefit to the competitive process from prohibiting exclusive dealing. The US attitude to vertical integration has been accepted in New Zealand[249]. It is suggested by the writer that a similar approach be adopted for exclusive dealing. Unless significant market power results from such a practice the case law and economic analysis would suggest that on balance it has a pro-competitive effect particularly in the context of franchising arrangements.

It is submitted that although the USA does not provide a comparable market the analysis which has developed there should be used in New Zealand exclusive dealing cases. However, because of the unique commercial environment in New Zealand, the results of such analysis may, as the Commerce Commission has noted[250], be different. This is consistent with the need to judge each case on its facts and according to commercial common sense for New Zealand markets.

SECTION 7 : AN ANALYSIS OF THE DRAFT DETERMINATION ON THE APPLICATION BY FISHER & PAYKEL LTD (the F&P Case)

Introduction : Background Facts

This section of the paper will briefly analyse the legal and economic analysis of the Commerce Commission's draft determination. The case concerns an authorisation sought by F&P ("the company") for its exclusive dealing practices. This practice is covered in all F&P Dealer Agreements under clause 5.[251] This clause thus requires that dealers only stock and sell F&P brands. In return dealers receive promotional and service support. The EDA may be terminated by either party on 90 days written notice. Further F&P can terminate the franchise immediately on written notice to a dealer if that dealer no longer wishes to adhere to the terms of the contract, or if agreements or modification cannot be reached or managerial control of that dealer's business changes materially.

F&P (the applicant) sought authorisation under s58(1)(a) & (b) of the Commerce Act for the whole of clause 5. However, arguments were only made on clause 5(a).

The Commission discussed the history and fields of activity of F&P.[252] The company is listed with a significant asset base ($294.6m as at 31.3.87). It has been in existence since 1934 and is at present the only New Zealand manufacturer of whiteware goods, producing electric ranges, washing machines, clothes dryers, dishwashers, refrigerators and freezers. It also imports and distributes a range of smaller whiteware products (e.g. food processors) together with various electronic equipment (e.g. VHS video recorders).

The company sells its products under the "Frigidaire" & "Kelvinator" brand names and also produces "Shacklock" products for distribution by the Whiteware Corporation Ltd. The strong position F&P has reflects to some degree many years of import protection (this is now largely removed) and the fact that F&P has in the past been the only New Zealand manufacturer to offer a complete range of whitegoods.

The Commission briefly commented on the Australian whiteware industry. Notably the evidence indicated that there were no EDAs. It is submitted that this situation is largely due to the fact that there are two major manufacturers of refrigerators and of washing machines. As will be discussed in more detail in the market analysis of this case (see later section) the presence of two manufacturers of relatively equal size increases the need for dealers to carry both products and also increases dealers ability to bargain on the terms of any arrangement with manufacturers.

Market Definition

This was defined by the Commission following the structure adopted in the Nathans/McKenzie[253] merger case:

Products - The manufacture and/or importation of certain household whitegoods/whiteware products, i.e. refrigerators, freezers, washing machines, clothes dryers, and dishwashers;

Function Markets - The manufacture and/or importation and distribution (wholesaling), and the retailing of the whitegoods referred to above;

Geographic Markets - The manufacture or importation and wholesaling of whitegoods in a national market, and the retailing of whitegoods in regional and/or local markets.

The Commission carried out a market analysis. Points of note:

(i) Licensing requirements for imports of whitegoods have largely been removed and tariffs have been reduced or in the case of Australia, removed since 1 July 1987.

(ii) Other Major Brand Competitors - "Prestcold"[254] & "Simpson" - are imported and distributed in New Zealand by Ceramco through its subsidiary Appliance Marketing Ltd (AML). AML also imports limited volumes of other brands (e.g. "Samsung" & "Zanussi" refrigeration products). "Hoover" products (washing machines and clothes driers) are distributed by the New Zealand branch of Hoover (Aust.) Pty Ltd. Previously they were imported by F&P. The Commission noted[255] that F&P had, at the time Hoover established its own New Zealand office, put Hoover on notice that it would introduce a new model to compete "head-on" with Hoover. This has since occurred.

(iii)Other wholesalers selling whitegoods on the New Zealand market

which compete with F&P products include L D Nathan Ltd & Robinson Industries Ltd.

(iv) Substitutability of Product - Generally whitegoods are substitutable, however the New Zealand building standards in following space modules in house construction designed to F&P standard specifications may be a limiting factor especially for washing machines and refrigerators.

(v) Size of market - A detailed breakdown of the market is provided in the F&P draft determination[256]. Several facts are of particular note:

(a) Overall market size - Total number of units distributed on the local market for the year ended June 1987 were between 275,000 and 300,000 in 1987. Imports were around 25% of this total.

(b) F&P Brand Products ("Kelvinator" & "Frigidaire") accounted for 60% of the total market share for whitegoods[257]. Total F&P production, imports and contract manufacturing (particularly for the Whiteware Corp) accounted for 80% of the total market.

(c) Retail market data[258] - The concentration of F&P stores tends to increase inversely to the population size of a centre. Particularly in centres where the population is lower, the whitegoods dealers tend to be smaller and as such unable to market a great number of manufacturers Products particularly if a full range of goods is not offered due to economics of scale (i.e. advantages that accrue to an organisation with increases in size e.g. Increased spread of overheads and other fixed costs.) Further, the smaller centres seem to perceive goods as of lower quality and more difficult to service. Thus F&P stores tend to dominate the smaller population centres.

F&P also seem to have franchised the better quality outlets (i.e. those which have better store reputation and sales turnover). In total F&P had (at the time of application) approximately 450 of the 866 whiteware retail outlets[259]. However, because of factors mentioned above, although F&P accounts for only 50% of the whitegoods stores, its share of

the market (local production and imports) was estimated nationally for the year ended June 1987 at approx. 70%.

(d) Retail price comparisons : Australia and New Zealand- Distributor mark-ups in New Zealand are about 40% (from wholesale to recommended retail price) whereas in Australia the markups are much lower, averaging around 25%, representing a 20% margin. As the Commission stated[260]:

> These margins are said to reflect a relatively more open market situation operating in Australia...there are no regulatory controls on imports of whiteware and imports are a significant share of the domestic market, there are two major manufacturing competitors...and there are no EDAs operating in the whiteware market.

Thus retail prices are lower on the Australian market and for equivalent models the price differences range from almost $400 for expensive items to $150 for less expensive goods. According to information received by the Commission[261] "economies of scale are not likely to be a significant factor in explaining the differences in retail prices" between the two countries[262]. In both countries after-sales service charges for whitegoods are reflected in consumer prices. However in New Zealand many of these costs are borne by the retailer and reflected in the mark-up. In Australia these costs are borne by the manufacturer who takes on responsibility for providing such services.

Other Actions

Prior to this application, L D Nathan on behalf of Bond & Bond Ltd brought proceedings in the High Court under the Commerce Act 1986 against F&P. Damages were sought for the losses incurred by F&P's refusal to supply it with whitegoods to some of its stores. The application for interim inunction was refused by Barker J[263] who said the case should proceed to a full hearing in the High Court. In February 1987 F&P sought authorisation of its EDAs. Shortly afterwards, a judicial conference was held before Barker J where it is reported he commented that "there would be little point in proceeding to the High Court to hear matters already before the Commerce Commission provided the Commission will deal with them expeditiously."

F&P Application

F&P claims, with support from expert submissions, that no **net** anti-competitive effects result from F&Ps EDAs. The economic experts viewed the increase in the level of import competition over the last three years, the existence of a large number of retail outlets outside the F&P dealer network, the short duration of the EDAs and public benefits associated with the practice as factors outweighing any anticompetitive effects resulting from the practice.

In short, almost all the factors examined in this paper which produce pro-competitive or reduce the anticompetitive effects of exclusive dealing were claimed to be relevant in the F&P case. The author's opinions are consistent with those of the Commission and a number of other interested parties,[264] namely that facts do not support such claims. The analysis of the Commerce Commission leading to such a conclusion is examined below.

Draft Determination : Substantive Points

F&P's application was sought under s58(1)(a) & (b) which provides for authorisation of persons for contracts, arrangements or understandings to which section 27 of the Commerce Act applies. Submissions opposing the application contained allegations which fall within ss36 and 37. Although market dominance and resale price maintenance may be associated with franchising or exclusive dealing arrangements, the Commission emphasised that it cannot authorise practices falling under ss36 or 37. These are to be decided by the Courts. Therefore the analysis here focusses only upon s.27.

Purpose & Effect

An initial issue in evaluating an application under s58 is whether the practice in question has the "purpose" or "effect" (or "likely effect") of substantially lessening competition. The Commerce Commission held that the intention of clause 5(a) was clearly to prevent the use of F&P franchise stores for the sale of non F&P products as part of the company's market strategy. The Commission therefore considered the purpose of the clause to be the "lessening of

competition"[265].

In analysing whether there was a substantial effect upon competition the Commission followed the view of Deane J in the Tillmann Butcheries case[266] that substantial means:

> "...'real or of substance' in New Zealand [this] was intended to mean not insignificant, not ephemeral, not nominal or minimal."

The effect of clause 5(a) was seen as clearly to inhibit new entrants' ability to gain access to the whiteware market. Measures to gauge whether such an effect was "real or of substance" included:

(i) the high proportion of outlets which are F&P franchised

(ii) the majority market share held by F&P products

(iii) the importance which the company places on clause 5 as part of its marketing strategy[267]

On this basis the Commission concludes that clause 5(a) has the purpose and effect of "substantially lessening" competition in terms of s27 and according that it has jurisdiction.

F&P claimed in their application that clause 5(a) has pro-competitive effects. The Commission stated the effect on competition of this clause must be evaluated according to the test under s61(6) of the Act as to whether the substantial competitive effect is outweighed by a benefit to the public that will, or is likely to result.

Although the Commission carried out little explicit analysis in deciding they had jurisdiction it is submitted that the facts provided indicate clearly that the clause 5 exclusive dealing agreements did have the purpose or effect of substantially lessening competition. The Commission therefore turned to an analysis of the practice as provided under s61(6). This requires the extent of the actual or likely lessening in competition to be taken into account. Further s61(6) provides that:

> The Commission shall not make a determination granting an authorisation 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 an understanding; or
>
> (b) The giving effect to the provision of the contract, arrange-

ment or understanding...;

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 is deemed to result therefrom.

In defining "competition" the Commission referred to three cases, (all of which have been discussed above). There were:

(i) QCMA[268] - the quote from this case implies that a market is an area of "rivalrous competition". In itself this quote is of little use but combined with the factors mentioned in the case which define this area, guidelines are provided for assessing the market.

(ii) Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd[269] - the reference in this case focusses upon the need to analyse competition in the market and highlights the need to look at the effect of the practices of the individual person on the market as a whole.

(iii) Whakatu/Advanced Meats - highlighted from this case is the antithesis of competition and market power. The Commission defines market power in the following terms:[270]

> The degree of market power can be represented by the degree of independence of behaviour exercised by a person in a market - in other words, conduct that is pursued independently of the presence, actions or reactions of existing or potential competitors, suppliers or consumers. This suggests a lack of restraint on the behaviour of a person-restraint that would be assumed to be associated with condditions of affective competition. While it can be presumed that market power increases as market share rises, it is the cumulative impact of various factors that is important in determining market power.

Thus as implied in the judgment, an increase in the market power of one organisation will result in a decrease in competition. However the writer would submit that although this is generally true, it must be shown to be so in each case. If there is an increase in the market power of several organisations in the market the net result may actually be a net increase in the level of competition. Thus increases in market share do not necessarily result in increases in market power. However the two factors would usually be expected to follow. As the Commission notes[271] restrictive trade practices such as exclusive dealing can increase market power. They state that the

independence of an organisation can be a useful measure to the amount of lessening in competition which results from the practice. It is submitted that a proviso should be added to this view, that a clear connection must be made between the trade practice and the market independence. Organisations should not be punished for greater efficiency which provides them with a degree of market power. The focus must be upon the degree to which **the practice** in question substantially lessens competition, or further, the degree to which such a practice(s) results in market dominance.

The Commission embarks on a review of the economic effects of vertical restraints on competition. The review refers to economic writing and case law[272], particularly the Tampa Electric Co case[273] and the Sylvania case. It is submitted that the general verdict of the Commission is that such material provides a framework for analysis but no definitive solutions.[274] However note is taken of the Vertical Restraints Guidelines (1985)[275]. These acknowledge the pro-competitive effects of practices such as exclusive dealing but state that although generally not the case, these practices may exclude competitors from the market by increasing the costs of obtaining distribution channels. This is balanced by a statement emphasising the need not to penalise organisations for superior skill and it is recognised that new market entrants may suffer a cost disadvantage irrespective of such practices. However an overall caveat is made that the USA does not provide a comparable economy and different results will be appropriate in New Zealand, particularly in the area of market concentration levels. This fact is borne out by the fact that none of the US authorities cited concern companies with market shares approaching that held by F&P[276].

After noting the dynamic nature of the market, particularly the continuing reduction in import restrictions the Commission turned to an evaluation of the impact of EDAs on competition[277].

At para. 120 of its determination the Commission states that[278]:

> F&P through its EDA has in effect vertically integrated into the wholesaling market and thus through this integration deals directly with the dealers in its products. Accordingly amy existing or new entrant into the whitegoods supply market must

also enter the wholesaling market and deal directly with retail outlets for access to the retail market.

On its face this may not be strictly true. Access to the retail market would be possible through a wholesale distributor. However even if an organisation would take on this distribution role the 'access' gained is likely to be minimal. Further the options for a new entrant discussed by the Commission could be modified to permit a manufacturer-wholesaler relationship. Thus according to the Commission[279] the effect of the EDA on competition will depend on an analysis of:

(a) The extent to which competition in the retail market is foreclosed by the EDA;

(b) The extent to which the foreclosure (if any) in the retail market makes more restrictive the conditions of entry to the supply/wholesaling market;

(c) Any anti-competitive and pro-competitive effects of the EDAs.

Thus the Commission has adopted a framework which reflects (to a large degree) the American approach to vertical restraints[280]. Analysis will follow on each of the three factors listed above.

(a) <u>Retail Market Foreclosure</u>

F&P franchised stores amount to approximately 50% of the market and as the previous facts indicate, this concentration increases in the provincial centres. The Commission outlines three options for potential or existing competitors wishing to gain or increase access to the retail market and thus final consumers.

(i) Convince F&P franchised stores to forego their franchises in favour of a new brand (the "rival" brand).

Under the clause 5 of F&P Dealer Agreement this would be possible within 90 days. However significant problems could be encountered. The rival would have to convince dealers of likely sales volumes, the degree of risk involved and offer significant margins or support services. The author would agree with the Commission that this is not really a reasonable proposition. Experience in Australia such as that in the case of <u>Ford Motor Coy (Aust.) Ltd</u> v <u>Ford Sales Company</u>

of Australia[281] noted that although the dealer agreement was easily terminated, Ford's relatively high market share (22%) meant that it was unlikely that dealers could adequately replace the Ford franchise. This problem is accentuated in the F&P case where the market share for products ranges between 65 and 85 percent.[282]

(ii) Use Existing Non F&P franchise Stores as Outlets:

Assuming that such stores were willing to stock a new brand, which may not be the case particularly for small dealers, there are still problems. Although F&P provided evidence indicating a large number of available outlets the "quality" of such outlets is important. On this point the Commission referred to the case of Southern Cross Beverages Pty & Others[283] where the importance of factors such as location and turnover were seen as requirements when analysing the availability of outlets. On the facts presented F&P has many of the "quality" outlets. F&P claims that its own investments in support services have contributed to this fact. The Commission acknowledged this fact but made the point that many of the stores involved, particularly the larger departmental stores, have independently achieved significant quality status. Thus the number of such outlets is limited by F&P EDA practice.

(iii) Vertically integrate into a Chain(s) of Retail Outlets

As the Commission states[284]:

> This option would be costly in terms of establishing a reputation for the store and in capital outlay. F&P has itself chosen not to incur costs of this kind.

Further in New Zealand it would be difficult to find a chain which would provide nationwide coverage. The need to purchase several chains and rationalise would greatly increase the costs of integration.

A further factor mentioned in the draft determination was brand awareness. As the evidence presented highlighted, because of its long existence and prominence public awareness of F&P brands is high. Further there is suspicion (particularly provincial) of foreign products. In the Dunlop/Goodyear case[285] it was noted that high promotional costs are in themselves not a barrier.

However the Commission noted that the number of competitors and access to the retail market is linked to the level of promotional costs required. Thus the existence of EDAs in the relatively small sized New Zealand whiteware market presents an adverse effect on a rival's perception of establishing a franchised dealer network and thus successfully entering the market.

(b) Extent that Retail Market Foreclosure has made more Restrictive the Conditions of Entry to the Supply/Wholesale Market

Foreclosure in the retail market does effect the ease of entry into the supply/wholesale market. Although it is submitted that the Commission's statements on this are not particularly clear[206] several points are evident. F&P's control of half of the retail outlets reduces the scope for those in the wholesale market. This control is reflected in F&P's market power - their ability to act independently of other market participants - which would be a negative factor for rivals considering entry into the wholesale market. Several factors are relevant to the level of this market power:

(i) the historical protection of New Zealand whiteware manufacturers, which has permitted F&P to achieve such a strong position to be the only local whitegoods producer today;
(ii) the need for entrants to combat F&P's control (through EDAs) in the retail market - it is submitted that the options for new entrants (discussed above) are severely limited. In the case of a wholesale competitor there would be a need to establish a distribution system. Again, the costs of this would be high, even if limited to the Auckland area, because economies are limited as F&P's EDAs reduce the number of outlets which are available.

The costs of constructing a whitegoods manufacturing plant in New Zealand are seen as prohibitive due to the size of the market. Thus imports, though involving transport costs and delays, are the only likely avenue of supply.

As the Commission point out the above factors are not in themselves restrictive, but as the writer has indicated, the effect

of EDAs is to increase the costs of entry. Thus the exclusive dealing practices of F&P effect costs sufficiently so that the market is perceived as difficult to enter successfully.

F&P's Market Power

This is assessed by

(i) the competition F&P's products receive from imports (as the only local producer); and

(ii) the behaviour of F&P in the market place.

(i) Import Competition. F&P accounted for nearly all imports in 1985 and around 5% in 1985 thus import competition experienced by F&P up to June 1987 had increased by only 20%. Imports for year ended June 1987 represented around 25% of the market share. However evidence shows a decline in import levels for 1988 despite the removal of many import controls. Thus the total level of import competition is not of great significance although there are variations over different products.

(ii) Behaviour of F&P in Supply/Wholesale Market

From the evidence presented, it would seem that F&P has very significant market power. As the Commission stated[287]:

> Actions taken by Fisher & Paykel to deter the entry of competitors or generally to consolidate its market position can be used as a measure of the lack of competitive constraint imposed on Fisher & Paykel or market power possessed by Fisher & Paykel. These actions, when taken in association with the operation of EDAs have the effect of raising the costs of entry to the market.

The Commission detailed a variety of facts illustrating this market power. These included:

- Removal of Hoover products even though many dealers preferred to carry them.
- Significant delays which have been incurred by F&P in supplying dealers without losing these franchised outlets.
- Contract manufacturing for Whiteware Corporation. This increases problems of access for competitors.
- The enforcement of F&P EDA (as occurred in the Bond & Bond case[288]).

As the Commission stated[289] "many F&P franchised dealers, while

preferring to stock more than one brand of whiteware, elect not to do so for fear of losing their F&P franchise." The facts provided do illustrate the very significant level of market power which F&P wields. It is submitted that these facts, though pertinent, should not mask the overall focus. This must be whether the EDAs substantially lessen competition or alternatively (in the court setting) whether F&P has a dominant position which it has used for any of the prohibited purposes under s36 of the Commerce Act.

On the basis of the information before it the Commerce Commission concluded that the company has a significant amount of market power and that the EDAs "prevent or hinder the entry of new suppliers/wholesalers into the retail market and the expansion of existing non F&P brands share of that market, competition is to a significant degree less than it would otherwise be without the EDAs."[290] The Commission detailed the competitive (anti and pro) effects of the EDAs.

Anti-Competitive

(i) Reducing product choice - on average 50% of retailers are limited to stocking F&P goods only; this percentage is greater in provincial areas.

(ii) Reducing dealer choices - EDAs limit the ability of F&P dealers to bargain over price and supply terms. This limit on the ability to respond to market changes was seen as the greatest "vice" of EDAs in Broken Hill Pty & Anor v TPT[291]. To the extent that F&P cannot perform to the same standard as other overseas suppliers the public and dealer suffer a detriment from the EDAs.

(iii) Price competition is reduced - the intra-brand/inter-brand trade-off discussed above (and below) rarely occurs because F&P have such a strong (50%) control over retail outlets. Further F&P issues a Recommended Retail Price (RRP) list to dealers. Although this arguably does not contravene the provisions of the Commerce Act regulating pricing, under s3(5) of the Act the Commission may investigate the effect of price lists on competition in terms of s27. Under the EDA F&P dealers must provide for after-sales service out of their gross margin. This is a strong incentive to keep to the RRPs particularly as F&P in its letter stresses its preference that dealers adhere to such prices

to "ensure an adequate standard of after-sales service".[292]

(iv) Inter brand competition - As detailed by the facts this has been relatively low for many years. This is highlighted by the differences in retail prices for equivalent products in Australia and New Zealand.[293]

(v) Supply shortages - The Commission notes[294] that despite significant delays only one dealer has chosen to terminate their agreement (which itself reflects a lack of choice for dealers). However it is submitted that the Commission has not really provided a connection between the supply shortages and the EDAs. It is submitted with respect that such shortages arise because of the number of dealers that must be supplied. The number of dealers and their lack of effective choices in supply may be attributable to the EDAs, but in itself the EDAs do not result in supply shortages. The EDAs merely increase the market power of F&P and reduces the ability of dealers to switch to another supplier.

Pro-Competitive

F&P claimed significant savings and efficiencies arise from its EDA practice particularly in the marketing of products. However, the Commission was not satisfied that such benefits would **not** arise in the absence of the EDAs[295]. Particularly the Commission noted that some of the costs claimed by F&P have also been claimed by dealers in their own right as paid for out or profits: e.g. promotional costs[296]. Thus the Commission concluded in the draft determination that it was not satisfied that pro-competitive effects **would** results from the exclusive dealing practices. As the Commission stated[297]:

> On the evidence available to the Commission it is questionable whether such effects as claimed are directly attributable to the practice and thus diminish the net anti-competitive detriments identified above. The Commission thus concludes that the EDAs result in a lessening in competition to a high degree .

The Commission therefore examined the public benefits resulting or likely to result from the practice as required under s61 of the Act. These benefits must outweigh the lessening of competition which results from the practice.

Public Benefits

Previous Commission guidelines[298] were followed in evaluating these benefits. Two factors are relevant[299]:

(a) The benefits must be demonstrated as a matter of evidence and probability;
(b) That they must flow from the practice.

F&P claimed a number of benefits resulted from this practice. These relate to cost efficiencies in[300]:

(i) manufacturing whiteware;
(ii) meeting customer service requirements;
(iii) promotion of innovative product design;
(iv) export and manufacturing development; and
(v) employment creation.

However, the writer would agree with the Commission that on the evidence presented, these benefits are not clearly to be viewed as resulting from the EDAs. Indeed the benefits "appear to derive from the efficiency claims"[301] rather than the exclusive dealing practice. It is submitted that EDAs may assist in providing sufficient dealer numbers for economies and greater efficiency to result. However as the Commission states, such benefits are not attributable to the existence of the EDAs. Further, and of particular importance to the development of this area, the Commission emphasises that[302]:

> The [1986 Commerce] Act is predicated on the basis that the promotion of competition in a market is the best way to ensure the efficient allocation of resources among competing industrial ends.

The writer would agree that this is the appropriate focus. The comments generally in the F&P draft determination seem to reflect, to a large extent, this approach and it is submitted that this is an encouraging sign in the developing approach of the adjudicating bodies to the Commerce Act and more particularly, in the area of exclusive dealing.

Draft Determination : Conclusion of the Commerce Commission

On balance the Commission felt that the anti-competitive effects of the EDAs were not outweighed by any pro-competitive or public benefits. Therefore the tentative conclusion of the draft determination was that the exclusive dealing practices in question could not be authorised in terms of s61(6) of the Act. However, the Commission sought more information particularly on the public benefits likely to result. Therefore further submissions were called for on this point

to be received at a conference. This conference has occurred but at the time of compiling the paper final determination material was not available.

Conclusion

The material presented and the conclusions reached (above) only relate to the F&P Draft Determination. However, from the information presented in the draft and the additional material presented at the conference[303] it seems unlikely that the final view of the Commission will change from the tentative view expressed above. In the writer's opinion, a denial of authorisation seems the correct decision. The draft tended to state the facts and the framework (legal and economic) used in reaching conclusions without a great deal of analysis of the manner in which specific facts should be applied under the framework adopted. However, it is submitted that the facts present a fairly clear situation of an exclusive dealing practice which has "substantially lessened competition". Further, the facts evidence clear market dominance,as Land has noted in his recent article[304]. This decision is therefore one which should improve the potential for competition in the whitegoods market. More importantly, in the writer's opinion, it provides an appropriate focus for future exclusive dealing decisions to follow.

SECTION 8 : EXCLUSIVE DEALING : A MARKETING PERSPECTIVE

Exclusive dealing particularly where it is part of a franchising agreement may be central to a company's corporate and marketing strategy. The F&P Draft Determination[305] referred to "the statement by F&P in its submission that the EDAs are crucial to the company maintaining an economic size of production; clearly in the absence of the EDA F&P itself expects to lose market share."[128] This section of the paper focusses briefly on the marketing approach of companies using exclusive dealing in New Zealand and a marketing model which provides another way of analysing the effects of this practice on competition. This model will then be applied to the F&P facts and conclusions drawn.

A. EXCLUSIVE DEALER PROFILE

A profile of the types of organisations which use exclusive dealing is extremely difficult. However, several general factors emerge which suggest a greater likelihood of exclusive dealing:

(1) A high degree of product differentiation

(2) Complex Higher Order[306] Goods or Services - Both of these factors necessitate a substantial investment in promotion and advertising. In terms of efficiency this best occurs at the manufacturer level. This may also entail assistance to distributors in training, layout and design of systems, particularly where product **quality** is a major factor. As mentioned exclusive dealing is utilised in these cases to safeguard return on that investment.

(3) Dealer Role is significant - again, this links to the factors above. If dealers are in a position to free-ride on investments made, then exclusive dealing is the most efficient method of protection short of vertical integration.

(4) 'Image" Goods - this relates particularly to the franchising situation. Exclusive dealing is used to preserve the image of a franchise. For example, in the case of McDonalds, in addition to preventing free-riding, exclusive dealing maintains the standard-isation essential to the perpetuation of the public image. It requires franchisees to deal only with the franchisor allowing a general standard to be set across all operations.

When some or all of these factors are present there is a high likelihood that exclusive dealing will be utilised, often together with territorial restrictions and resale price maintenance. (The latter and their position under the Commerce Act 1986 will not be examined here). Exclusive dealing as a safeguard of investment and franchise image is thus a marketing tool. It provides a 'risk cushion' against losses which would otherwise be possible. In its absence other safeguards would need to be found. One possibility would be direct fees for manufacturer promotional efforts, however in practice this may be difficult to quantify and manage for individual dealers. Without some form of protection arguably the level of manufacturer investment and services would decline. So as with other restrictive devices, such as patents, it does have beneficial effects. The previous section looked at some economic analysis of competition. Here it is proposed to use a marketing model. Although there is some overlap with economic concepts, it provides another perspective for the analysis of the effects of exclusive dealing.

B. <u>MODEL : PORTERS FIVE FORCES OF COMPETITION</u>

This model is adapted from that used at the Harvard Business School[307] as a tool for the analysis of competition **in the market**. It provides another framework for analysing competition. Particularly this model provides an approach which focusses on the marketing factors relevant to competition. As F&P's submissions to the Commerce Commission in its application and elsewhere[308] suggest, EDAs may be a crucial element in a company's marketing strategy and thus its overall profitability. Thus the model provides a further framework for analysing competition and is designed to assist decision-making at three levels:

1. Corporate strategy – the choice of industries and markets in which an enterprise competes and the balance of the business portfolio. It includes decisions regarding acquisition (vertical integration), divestments and new ventures. Particularly for present purposes it gives a guide as to the competitiveness of a market and the viability of entry.
2. Business strategy – the specifics of how a firm competes within a single industry or market. This would include decisions on the use of practices such as exclusive dealing and franchising.

3. Functional Strategy - the deployment of resources at the functional level as implied by the business strategy.

The five forces seen as relevant are:

1. The threat of entry which includes barriers to entry and the likely reaction of incumbent firms;
2. The threat of substitutes;
3. The bargaining power of customers;
4. The bargaining power of suppliers; and
5. The intensity of rivalry between firms. This includes the difficulty of exit.

The factors relevant to F&P exclusive dealing practice will be examined below.

C. APPLYING THE MODEL TO THE F&P CASE

I. Threat of Entry

This depends on:-

(a) Barriers to Entry which include:

(i) Economies of scale - F&P though not large by international standards has the only local manufacturing plant for whitegoods. However the recommended retail prices (RRPs) for its products are significantly higher than Australian equivalents. Ranging from $43 - $387 more for F&P goods.[130]

(ii) Capital requirements - these would be significant to set up just a manufacturing plant. In analysing these costs, the 'sunk costs' relative to the possible returns must be compared. In the New Zealand whiteware market the sunk costs would be large. Therefore, in view of the small market such a plan is probably not viable.

(iii) Access to distribution channels - here is where the real impact of exclusive dealing comes. Approximately 50% of all the whiteware outlets are F&P franchised. Further, F&P has tended to franchise the better quality distributors. This would be a factor in considering competition or entry. As disucssed, an entrant would almost need to enter as vertically integrated in two functional markets: manufacturing and retailing. This could have a bearing on the necessary capital costs. As the Draft Determination pointed out,[131]

other options such as persuading F&P franchisees to forego their franchise or use existing non F&P franchise outlets also have problems.

(iv) Product differentiation - this is quite high. To some degree F&P's true market power is disguised through different brand names (e.g. Frigidaire, Kelvinator) but promotional activity has been such that much of the market clearly recognises F&P products. Further, there is some negative reaction to foreign products which assists in the positive differentiation of F&P products.

(v) Other factors - these include government policy (of prospective importance regarding exclusive dealing and cost advantages.

Note that it is arguable whether some of these are really barriers to entry. For instance, economies of scale and product differentiation in themselves are not barriers in economic terms. They may merely reflect an organisation's efficiency, innovation and promotional efforts. To what extent factors such as economies of scale and differentiation should be taken account of together with restrictive practices is unclear. Should a company be sanctioned merely because it is first in a market which is not sufficient to sustain two participants at present demand levels? As long as the criteria of maintenance of efficient resource allocation is not violated the answer would seem to be no. However, regarding access to distribution channels, exclusive dealing is a factor which can, and in this case arguably does form a major barrier. This may have concomitant implications for the capital investments required.

(b) Likely Reaction of Incumbent(s)

Here this is really only F&P. It has indicated through its actions that it will fight competition that encroaches on its market share. Examples include the dropping of Hoover products to introduce a model to compete in the market niche occupied by Hoover goods; and F&P's response to dealers who try to sell non-F&P products. (These activities in themselves show the large degree of market power wielded by F&P power which could be brought to bear on any serious rivals).

II. **Threat of Substitute Products**

As discussed in the F&P draft determination, although there is a large degree of differentiation between products and different features available in whitegoods, product brands may be fairly easily substituted. Thus the threat of substitutes may be a significant element of competition.[309] This threat will be more severe where:

(i) Substitutes are subject to trends improving their performance - although this is the case with the reduction in import restrictions, the reality is that whitegoods imports have declined in 1988. However, this is consistent with a general decline in New Zealand's import levels.

(ii) Substitutes are produced by organisations earning high profits or of very large size (particularly multi-nationals) - These organisations can enter the market and afford to suffer losses in the short term, however the evidence received by the Commission[310] is that F&P production capacity is approximately equivalent to that of the large Australian producers which reduces any economy of scale advantages. Further, the existence of EDAs which tie half of the market outlets make the potential for reaching a large proportion of the consumer market difficult. In such a small market as New Zealand this is a significant problem.

III. **Bargaining Power of Customers**

At present this does not have a significant effect on competition in the whitegoods market. However if customers' perceptions of foreign goods continue to change (as they have to some degree in the metropolitan areas) this may effect both the demand for F&P goods and the effective choice of dealers considering abandoning the F&P franchise.

IV. **Supplier Power**

As a supplier F&P is very powerful. Some of the factors relevant under the model for increasing supplier power are:

(i) The degree of connection of the supplier(s). If they are more concentrated than the industry they supply then their market power is greater. In the case of F&P it is the only local producer and one of the few manufacturers, until recently, to provide a full range of whitegoods.

(ii) The supplier's product is important to buyers business - their

point is central to F&P's market power. It has EDAs with 50% of the market and for many of these whitegoods are a dominant product.[311]

(iv) Products are differentiated - The draft determination highlighted this fact and its impact on the perceptions of new entrants[312].

V. **Intensity of Rivalry Between Firms**

Intense rivalry between firms is not, on the analysis of the Commerce Commission in the F&P Draft Determination, a strong feature of the New Zealand whitegoods market. However rivalry is likely to be more intense where:

(i) Numerous or equally balanced competitors are present - Neither factor applies. Competitors are, as yet, not numerous & F&P on the evidence presented is in a much stronger position to the extent that it is seen as having a dominant position in the market.

(ii) Slow industry growth and/or high fixed costs - Although both factors apply to the New Zealand whitegoods industry because F&P is the only local producer these factors would actually tend to enhance its strong position by deferring much competitive investment.

(iii) Lack of product differentiation and low switching costs - As mentioned in the draft determination significant differentiation occurs. However the products are homogeneous enough that switching can occur relatively easily bearing in mind the evidence on building standards[313].

(iv) High exit barriers - In the are of whitegoods these would particularly be the high costs involved in specialised assets. These cannot easily be recovered[314]. However because F&P is the only local producer this factor, rather than promoting competition is another factor which hinders it. Competitors perceive profits as difficult to attain considering F&P market power. Therefore significant investments of a specialised kind in a market which is unlikely to be very profitable, are not made.

Concluding Comments

Overall this model would seem to confirm the decision of the Commerce Commission in the F&P Draft Determination. In the F&P case the

evidence was such that a denial of the authorisation was in the author's opinion almost undeniable.[315] However in exclusive dealing practices where the results are more balanced in their competitive effects Porter's model may provide another useful tool for discerning the competitive effects of EDAs. This would particularly be the case in situations where, as in the F&P case, the EDAs were considered an integral part of the marketing strategy.

CONCLUSION

The Australian Trade Practice Commission stated that[316]:

> "Exclusive dealing is not illegal, only exclusive dealing that is substantially anti-competitive. There is a lot of exclusive dealing in Australia like other countries and Parliament recognised that much of it should be allowed to continue."

Such is also the case in New Zealand. The Commerce Act 1986 seeks to promote competition as a means of ensuring efficient resource allocation and ultimately greater consumer welfare.

The basic proposition contained in this paper is that the general provisions of the New Zealand Act are an appropriate means for regulating exclusive dealing. In reaching such a view the writer's conclusions on the Commerce Act have changed. New Zealand has "got it right". The situations in which exclusive dealing practices will be anti-competitive **will** generally fall under the sections discussed in the paper (particularly ss27 and 36). Therefore additional provisions to specifically deal with exclusive dealing practises seem somewhat redundant. Additional exclusive dealing provisions can be difficult to draft (as s47 of the Trade Practices Act 1974 perhaps evidences. More importantly the provisions add another legal test which may obscure the objective of the Commerce Act and may hinder the development of certainty in this area of the law. As discussed there are problems in applying the policy objectives of the relevant trade practices legislation. The degree to which the Australian cases have retained this policy focus has varied considerably[317]. By contrast the writer would submit that the New Zealand cases, although still at an early stage in applying the Commerce Act, have made a reasonably encouraging start in the promotion of competition. The comments in the Application by F&P[318] make it clear that a competitive focus is required under the New Zealand Act. However, the F&P case was the first New Zealand decision on exclusive dealing and was a fairly extreme example of this practice. Thus detailed principles cannot be expected without more case law development.[319]

Although franchising was not the topic of this paper[320] some of its competitive effects have been mentioned. Exclusive dealing may look worse viewed in isolation than in the usual franchising context.

Again greater clarity of the adjudicating bodies view of exclusive dealing will only arise with further cases.

In reaching a conclusion that the New Zealand approach was the most appropriate, several criticisms were refuted. Most important of these was that unilateral actions would avoid the "catch-all" provisions of s27 of the Commerce Act. As stated the writer's view is that by their nature exclusive dealing arrangements will involve some agreement which will fit within the wide definition of "contract, arrangement or understanding" under s27. Unilateral actions which relate to EDAs, such as the refusal to supply in the Bond & Bond case[321] will therefore be caught. However, if the legislature wished to clarify this point a definition could be added stating that:

> "provision" refers to any matter forming part of, or related to, the understanding, arrangement or understanding even if this provision has been imposed by one party.

The only other misgiving the writer had, although not relating to the main emphasis of the paper, concerned the protection of parties to EDAs who wished to challenge these arrangements. As the Act stands it appears that persons involved in EDAs who bring actions under the Act could themselves be potentially liable to pay damages or pecuniary penalties. Under ss80(1)(e) & 82(1)(e) persons who are directly or indirectly, knowingly concerned in or party to, the contravention of s47 may be liable[322] for damages or pecuniary damages.

However as Justice Barker pointed out in the Bond & Bond case[323] "under s80(2) the Court has to have regard to all relevant matters and one would consider it unlikely that the Court would impose a penalty on a party such as the plaintiff when it sought but failed to gain an interim injunction..." Thus in situations where one of the parties to an EDA has not been a willing party to such an arrangement or more particularly has suffered harm there is scope for that party to bring an action without being vulnerable itself to attack under s80. In the writer's view the fact that such protection depends on the court's analysis of the situation is appropriate. There is an assumption that EDAs do involve mutuality. Thus unless a person can present relevant matters to the court which would negate the appropriate penalty, that

person as a party to an arrangement must face the consequences of a decision that the practice has anti-competitive effects.

At present s82, unlike s80, does not detail the matters which the court must consider in determining an appropriate penalty. This could be remedied in two ways:

(i) through judicial interpretation - however this may prove difficult as a comparison of the sections would seem to indicate that this 'omission' was intended; or

(ii) by amendment - such an amendment would be fairly simple, merely involving the copying and adjusting of part or all of s80(2). Certainly such an amendment would be simpler (and in the author's view more effective) than the drafting of a specific section on exclusive dealing.

Even if neither of the above remedies are available it would appear from s82 that the court has a discretion in determining the "loss or damage **caused** by that person". This would permit the court to take account of the particular circumstances of the parties to an EDA.

The Australian QCMA case[324] and the New Zealand cases which followed it have stressed that competition is a means of allocating resources. The fact that firms with a significant degree of market power may be able to increase price and/or lower output below that which is optimal from society's viewpoint implies that anti-competitive behaviour (in a legal sense) involves actions and outcomes which hinder the achievement of an efficient allocation of resources.

It is the writer's view that in the area of exclusive dealing the objective of promoting competition is achieved by the existing provisions of the Commerce Act 1986 while still effectively regulating exclusive dealing practice.

POSTSCRIPT

As the paper details, competition law, particularly in the area of exclusive dealing involves a variety of disciplines, therefore it was suggested that some indication be made of the author's qualifications in any of the areas concerned.

Law: Finishing the requirements for an Honours degree in Law with this paper.

Marketing: Completing a Bachelors Degree in Commerce and Administration in June 1989 majoring in Business Administration. The focus of courses has been on marketing and management studies.

Economics: Acceptance to interview stage for Pembroke College Oxford in Philosophy, Politics and Economics (PPE). However New Zealand qualifications are not extensive with courses only to 200 level at Victoria University. The writer has an interest in the "Contractual Analysis" of economic problems which ties in nicely with the framework in the Law of Contracts. Studies in this area proved particularly useful in compiling this paper.

FOOTNOTES

1. Based on information supplied by Richard Fletcher of the Commerce Commission, exclusive dealing and franchise arrangements involve approximately 20% of registered New Zealand companies (private and public). However, their indirect effect is much wider.

2. Application by Fisher & Paykel Draft Determination of the Commerce Commission, 13 July 1988.

3. This was Clause 5 of Fisher and Paykel Ltds's ("F&P") standard form franchising agreement.

4. The final determination will follow the conference that was held on 30 August 1988. At the time of compiling this paper a final determination was not available.

5. In this paper "competition law", "antitrust" and "restrictive trade practices" will be used interchangeably; for practical purposes the terms are identical.

6. W Pengilley "New Zealand Commerce Legislation: the likely impact on commercial conduct in the light of Australian experience" (1986) NZLJ III at p. 117

7. s47 Trade Practices Act 1974; see also SECTION 5 : OTHER JURISDICTIONS in this paper.

8. Those with an extensive knowledge of the Commerce Act and its background may wish to merely skim this section.

9. For instance, the Monopoly Prevention Act 1908 and the Commercial Trusts Act 1910 - the latter being based on the Sherman Antitrust Act 1890 in the USA.

10. Restrictive Trade Practices Act 1956.

11. See Collinge, The Law Relating to Restrictive Trade Practices & Monopolies, Mergers and Takeovers in New Zealand (2nd ed.) Butterworths, Wellington, 1982.

12. See later discussion on this concept later in this paper.

13. Supra n.2.

14. Othe practices could be added under s23(1).

15. See Vautier K. "Competition Policy and Competition Law in New Zealand", in A Bollard and R A Buckle, Economic Liberalisation in New Zealand, Allen & Unwin, 1987, p.59.

16. Historically, this can also be seen as parallelling the move (particularly in recent times) from legislation consistent with that of the UK to that more in line with Australia.

17. This has itself caused problems in the administrative law area and practically. See, for example, L. Stevens, "The Commerce Act 1986: some theoretical and practical observations". (1986)NZLJ

197 at 202.

18. Supra n.6, s111(1)

19. Supra n.15, p.46

20. See also SECTION 6 : ECONOMIC PERSPECTIVE in this paper.

21. See John Collinge, "First Steps Under the Commerce Act 1986", at 13, an address given at a seminar at the Beehive on 26 March introducing the new Act; and Department of Trade and Industry "Competition Policy and the Government's Legislative Proposals in the Commerce Bill" (1985, Wellington).

22. See J Land, "Monopolisation: The practical implications of section 36 of the Commerce Act 1986" 1988 18 VUWLR pp.53-54

23. See later discussion in SECTION 6 : ECONOMIC PERSPECTIVE in this paper.

24. See for instance supra n.4 at p.112.

25. The exceptions are those which breach s36.

26. See also Yvonne Van Roy, Guidebook to New Zealand Competition Laws (1987) Commerce Clearing House, New Zealand, p.2 and following.

27. See Collinge, supra n.21 at p.18.

28. There are many examples from Australia's development. Notably competition legislation is labelled as "too blunt" or "insensitive" as was stated in a letter to the Australian Prime Minister in June 1980 from the Australian Council of professions.

29. See The Dominion, 10 October 1985.

30. Ibid

31. National Business Review, 21 October 1985.

32. Rob Cameron in NBR, 14 October 1985.

33. NBR, 18 July 1986.

34. Input suppliers are those organisations which supply all the components and/or raw materials required for the manufacture of the final product.

35. In this paper the practice adopted as to gender will be to arbitrarily mix the use of "he" and "she". This avoids the clumsy "he or she" conjunction and it is hoped is a more sensible way of provoking thought in this area.

36. See H. P. Marvel, "Exclusive Dealing" Journal of Law and Economics, 25, p.1

37. Richard v Golden Fleece Petroleum Ltd (1983) ATPR 40, 392 at 40,

38. However agency may exist in some situations depending on the terms of the franchise.

39. See also Martin Mendelson, "international Franchising", Paper for International Franchising Conference (1984).

40. Franchises which involve intellectual property rights may be protected under s45 of the Commerce Act. However, the subject is quite complex and tangential to the focus of this paper. Further, there is some suggestion that the present review of the Commerce Act will recommend the abolition of this intellectual property protection because of its abuse. Therefore, this paper will not deal with this area.

41. For instance The Four Square Co-operative Grocery chain was initially a group of independent grocery stores who chose to operate together under the same name and using similar systems and prices.

42. Harkins, "Tying and the Franchise" (1979) 47 Anti Trust L J 903 at 904.

43. Similarly, it is also conceivable that exclusive dealing arrangements may exist outside the context of a franchise.

44. See SECTION 6 : AN ECONOMIC PERSPECTIVE later in this paper.

45. Supra, n.5

46. For the precise wording of the sections see Appendix One where these sections and other relevant portions of the Act are reproduced.

47. Sections 27 and 28, unlike s36, are authorisable.

48. See for instance J F Northey Cheshire & Fifoot's Law of Contract, 6 ed Butterworths, Wellington, 1984.

49. [1961] NZLR 1121

50. See Re New Zealand Master Grocers Assoc. [1961]NZLR 177 and The New Zealand Council of Registered Hairdresser [1961]NZLR 161.

51. (1963-1964)LR 4 RP 116 at p. 154

52. The earlier test was propounded by Cross J - for a fuller analysis of both cases see particularly supra, n.11 at pp.152-154

53. G Q Taperell & R B Vermeesch Trade Practices and Consumer Protection (3rd ed.), 1983, Butterworths, Sydney, p.201, para 523 See also supra, n.5

54. Supra, n.50

55. Supra, n.51

56. Idem

57. Note that this is also relevant in authorisation decisions (ss58 and 61).

58. This was adopted from the US Clayton Act 1914 s7.

59. Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees Union (1979) ATPR 40-138.

60. From the Radio 2UE Sydney pty Ltd v Stereo FM Pty Ltd (1982) ATPR 46, 912 which is of virtually no use on this point.

61. B G Donald and J D Heydon, Trade Practices Law (1978) Vol 1, p. 91;

62. For a useful collection of the relevant Australian case law which is particularly useful for examining the fundamental terms, see Russell and Miller Annotated Trade Practices Act, 7 ed, Sydney, 1986; and the Dandy Power Equipment Case (1982) ATPR 40, 315 at pp 43, 887 - 43, 888.

63. Decision number 205 of the Commerce Commission, 22 July 1987.

64. Decision no. 84 of the Commerce Commission, 21 June 1984.

65. Queensland Co-operative Milling Assoc v Defiance Holdings Ltd (1976) ATPR 40-012 at p. 17, 246.

66. Ibid p.17,247

67. Idem

68. Supra, n.63

69. Ibid, p.17

70. Idem

71. The comparative merits of the Australian approach are central to this paper. These are discussed in SECTION 5 : OTHER JURISDICTIONS later in this paper; see also the collection of case material, supra n.62.

72. Commerce Act 1986 s3(5)

73. This gives legislative sanction to the Commerce Commission's decision in the Visionhire Holdings Case [1984]NZAR 288. In that case the Commission gave primacy to "effective competition" and choosing from the statutory objectives listed in s2A of the 1975 Act.

74. This will be briefly examined in SECTION 6.

75. See SECTION 6; see also Ransom & Pengilley infra n.134 where they reproduce Nienwehuysen "The Theory of Competition" (1976). This article comments that at least 18 writers have proposed criteria

for workable competition.

76. Supra, n.61, p.90

77. Similar comments were made in The Report of the Attorney Generals National Committee to Study Antitrust Laws, (1955), Ch 7.

78. Supra, n.61

79. Supra, n.75

80. Supra, n.21 at p.12

81. Idem

82. [1985]2 NZLR 338 at p. 348; (1985)1 NZBLC 102, 262 at p 102, 271. Also see Y. van Roy supra, n.26 pp. 57 - 59.

83. Supra, n.65

84. Visionhire Holdings Ltd v Sanyo Rentals Ltd [1984] 4 NZAR 292

85. Supra, n.65 at p.17,223

86. The term "contestable market" at this stage will be used to describe a market structure where particular entry costs are not too great to dissuade entrants. Thus the five factors outlined in QCMA will be relevant.

87. See cases referred to in supra, n.22

88. Supra, n.63

89. Supra, n.84

90. Ibid, p.19

91. Proposal by News Ltd (1986) 6 NZAR 47.

92. US v Dupont (1957) 353 US 586.

93. This definition comes from the Edmonds Food/Tucker case-decision 84, Commerce Commission, 21 June 1984, at pp 4 and 5.

94. Supra, n.65 at p.17,247

95. Supra, n.64

96. Re The Proposed Takeover by L D Nathan & Co Ltd of McKenzies (NZ) Ltd (1981) 2 NZAR 321, para. 120.

97. Supra, n.51

98. But see: Lion/Superliquorman (1985)5 NZAR 92; and Central Feed Mills Ltd/Sandy Lodge Ltd Decision No. 131, Commerce Commission, 12 June 1985.

99. [1985]BCL 1250

100. Re Continental Can Co. Inc [1972] CMLR D11, p. D27 and see also the case of Akzo Chemie (1986)14 Int Bus Lawyer, No 3 at 47.
For the purposes of sections 36, 66 and 67 of this Act, a dominant position in a market is one in which a person as a supplier or an acquirer of goods or services either alone or together with any interconnected body corporate is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-

(a) The share of the market, the technical knowledge, the access to materials or capital of that person or that person together with any interconnected body corporate:

(b) The extent to which that person is constrained by the conduct of competitors in that market:

(c) The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

101. Note that the full s36 test will be discussed in more detail under SECTION 4.

102. Supra, n.91

103. Idem

104. TPC v Ansett Transport Industries (Operations) Pty Ltd (1978) ATPR 40-071; 20 ALR 31

105. Idem at pp 17, 717 et seq : Reference is made to Re Continental Can Company Incorporated (1972) CMLR D11; United Brands Co v Commission of European Communities (1978); and Akzo Chemie (1986) 14 Int Bus Lawyer, No 3 at 47

106. US v Aluminium Co. of America 148 F 2d 416. See also SECTION 4 : OTHER JURISDICTIONS in this paper.

107. Supra, n.2

108. Supra, n.15

109. Supra, n.2

110. Supra, n.5

111. This report formed the basis for the section 47 provisions in the Trade Practices Act 1974.

112. Supra, n.53

113. See supra, n.5; c.f. B M Hill and M R Jones "New Rules on Competition" (1986) NZLJ 190 at 192.

114. Supra, n.5, p.117

115. Supra, n.113

116. 8 December 1986, H.C., Auckland, Barker J (CP 1435/86)

117. s2(5)(b) Commerce Act 1986

118. Supra, n.22; and J Land "Monopolisation : Section 36 of the Commerce Act 1986" LLM Research Paper, VUW, September 1986

119. Idem

120. See the comments of the US Court of Appeals in Ball Memorial Hospital Inc v Mutual Hospital Insurance Inc 784 F.2D 1325, 1338 (1986)

121. Marginal cost relates to the incremental increase in costs of producing one more unit of output. For a closer examination of the relevance of this concept, see SECTION 6.

122. (1986) 6 NZAR 278

123. E.g. Coercive price leadership; and tie arrangements; see Berkey Photo Inc v Eastman Kodak Co 603 F.2D 263 (1979) at 275-276

124. Supra, n.22 at p.53; see also supra, n.118

125. Supra, n.122 at p.

126. Unreported, Auckland Registry, CP 1373/86

127. Information supplied by Richard Fletcher in interview. Further, note that exclusive dealing is not covered by any of the pamphlet material provided by the Commerce Commission which also reflects the unclear status that this practice has at present under the Act.

128. Unreported CP 1502/86

129. This developed from Continental TV v GTE Sylvania, 433 US 36 (1977)

130. Up until the 1974 Trade Practices Act Australian legislation and decisions tended to follow the UK's "case by case" pragmatic assessment of trade practices.

131. This view was echoed in comments by Richard Fletcher of the Commerce Commission.

132. For a full discussion of s47 of The Trade Practices Act see: W Pengilley, "Exclusive Dealing Under the Trade Practices Act" [1975] 3 ABLR 174; or Infra n.134; or R V Miller, Annotated Australian Trade Practices Act (1985) 6 ed.

133. TPC v Tooth & Co (1980) ATPR 40-127, at p. 18, 366

134. A A Ransom & W J Pengilley, Restrictive Trade Practices : Judgments, Materials and Policy, Legal Books, Sydney, 1985.

135. Ibid at p. 749

136. Ibid at p.614 et seq. particularly for their "map" for defeating the maze of s47.

137. Much amendment followed the Swanson Committee Report.

138. (1986) TPC 242 at 261

139. On this point see supra, n.53, Ch.7 at p.343 et seq

140. Instances of exclusive dealing involving discounts or offers of discounts are provided by: Cool and Sons v O'Brien Glass (1981) 6 TPC 816; and Victorian Egg Marketing Board v Parkwood Eggs (1978) 4 TPC 124

141. See s47 Trade Practices Act (Aust) 1974.

142. Supra, n.53 at p.355

143. Swanson Committee Report, para 4.108

144. Note that "condition" is defined widely in s47(13)(a)

145. Supra, n.53 at p.356

146. In the Commerce Act 1986 this "common good" has been defined by the legislature as the promotion (of consumer welfare) through competition.

147. e.g: Top Performance Motors v Ira Berk (1975) 5 ALR 465; Tavernstock Pty Ltd v John Walker and Sons (1980) ATPR 40-184; Toohey's Ltd, Tooth & Co Ltd [1974-5] ATPR (Comm) 8, 708

148. Note that under the Trade Practices Act 1974 there are two bodies involved in trade practices regulation: the Trade Practices Tribunal and the Commission.

149. See particularly supra, n.53; see also Horman, I G "Competitive Impact of Exclusive Dealing in Australian Motor Spirits Markets" (1979) ABLR, pp.3-33; and Donald and Heydon, Trade Practices Law vols I and II and Supplement, 1982, The Law Book Company Ltd, Sydney

150. Supra, n.147

151. Shell Company of Australia [1974-5] ATPR (Comm) 8, 621

152. Ibid

153. [1975-6] ATPR (Com) 16, 701; see also Hormon, supra n.149

154. See paras. 47(13)(b) & (c)

155. For instance the TPC saw four barriers to entry as relevant, yet none of them relate to exclusive dealing practices. See for example supra n.149.

156. Idem

157. 337 US, 293 (1949)

158. Supra, n.147

159. Supra, n.149, Vol. I

160. Supra, n.151

161. I G Horman, "The Competitive Impact of Exclusive Dealing in Australian Motor Spirits Markets" ABLR 1979, p1, 33

162. See supra n.149 and supra n.62

163. Supra n.151

164. Shell Coy of Australia Ltd [1976-77] ATPR (Com) 15, 568

165. See idem and Total Australia Ltd ATPR (Com) 15, 680

166. Supra n.164

167. Ampol Petroleum Ltd [1976-77] ATPR (Com) 15, 644

168. Supra n.147

169. For a more detailed analysis, see supra n.149, Vol. I p.312

170. Idem

171. Supra n.145

172. See Top Performance Motors, supra n.147; and J Ah Toy Pty Ltd v Theiss Pty Ltd (1980) ATPR 40-155

173. See for instance Walker's comments in 50 ALJ 89

174. Smellie J in Trutone v Festival Records, Unreported, Auckland Registry 17 February 1988 (CL 31/87)

175. I Eagles, "Franchising and the Commerce Act 1986 (I) and (II)" (1986) NZLJ at p. 351 (I)

176. Idem

177. Supra n.147

178. Idem

179. Supra n.175

180. E.g. Stephens J in supra n.133

181. These cases included Bond & Bond supra n.122. This is the only New Zealand court case to expressly deal with exclusive dealing.

182. Supra n.126

183. E.g.: Barker J ibid at p.56

184. Vertical practices refer to those which have effect over more than one functional market. (c.f. horizontal practices discussed previously). Vertical practices may include exclusive dealing and/or franchising.

185. Supra n.75

186. Standard Fashion v Magrane - Houston Co., 258, US, 346 (1922)

187. Supra n.36 pp.1-6

188. Standard Oil Co v United States, 337, US, 293 (1949)

189. For more analysis of exclusive dealing factors which effect competitive see SECTION 6.

190. Tampa Electric Company v Nashville Coal Company, 365 US 320 (1961)

191. Federal Trade Commission v Brown Shoe Company, 384 US 316 (1966)

192. See, for example, Satellite Television and Associated Resources Inc v Continental Cablevision of Virginia Inc, 714, F.2d 351 (1983), where the Court engaged in a detailed economic analysis of the cable television market and concluded that the use of exclusive contracts increased competition between cable television suppliers.

193. Posner & Esterbrook, Antitrust Cases, Economic Notes and Other Materials, 2d ed., 1981, West Publishing Co; and Neale, The Antitrust Laws of the USA, 3d ed., 1981, Cambridge University Press

194. Supra n.129

195. United States v Arnold Schwin and Company, 388 US 365 (1967).

196. Supra n.95 at p. 55

197. When exclusive dealing is used without exclusive territories, inter-retailer or intrabrand competition is not lessened. It may appear, at first glance, that interbrand competition is reduced since competing products are not sold side-by-side in the same store. However, depending on the good or service, consumers commonly shop from store to store. In any event, closer examination of exclusive dealing, as discussed in Section 6 below, indicates that it also works to increase interbrand competition.

198. Joseph C Gallo, Joseph L Craycraft, and Stephen C Bush, "An Empirical Study of Federal Antitrust Enforcement for the Period

1963-1984," Review of Industrial Organisation, 2, 2 (1985), pp. 106-130.

199. United States Department of Justice, Vertical Restraint Guidelines, January 23, 1985.

200. Ibid at p. 7

201. Ibid at p. 30

202. Supra n.91

203. Commerce Commission Decision No. 182, 25 November, 1986

204. Supra n. 199 at p. 35-36.

205. E.g. supra n.193

206. For a general discussion of the cases and development of this period, see supra n.193; and also Areeda and Turner, Antitrust Law (1978), Little Brown & Co, vol. III

207. For example see J S McGee & C R Bassett, "Vertical Integration Revisited" (1976) Journal of Law and Economics, 17, pp. 17-38.

208. Idem

209. Monopsony refers to monopoly control by a single purchaser in the market.

210. For a general discussion of restrictions, though somewhat dated, see C D Edwards, Maintaining Competition : Requisites of A Government Policy, McGraw Hill, NY, 1949.

211. Vertical integration refers to the undertaking by a single firm of successive stages in the production process of a particular good: e.g. major oil companies are vertically integrated. They undertake the exploration, drilling, extraction, transport, refining, distribution and sales of petroleum products.

212. Supra n.210 at p. 19

213. Supra n.21

214. The degree to which oligopoly will produce the same 'market distortions' (relative to perfect competition) depends on the degree of joint profit maximisation.

215. Property Rights will be used here to refer to those rights to use and receive the income from resources and assets.

216. Note particularly that by H.P. Marvel supra n.36 at p.2 et seq

217. For example F M Schezer, Industrial Market Structure and Economic Performance, 1980.

218. See L E Preston, "Restrictive Distribution Arrangements :

Economic Analysis and Public Policy Standards", 30 L & Contemp. Prob 500 (1965)

219. Supra n.36 at pp. 3-4

220. Ibid

221. Supra n.199

222. Supra n.2 at p.27

223. Supra n.91

224. Unreported, Auckland, M600/85 at p.14. See particularly comments received from Robert Crandall, a US economist.

225. These will be discussed below in SECTION D : EXCLUSIVE DEALING : REDUCING THE ANTI-COMPETITIVE EFFECTS.

226. Belton Electronics Corporation 100 FTC 68 (1982) Roland Machinery v Dresser Industries 749 F 2nd 380 (1984) Sumeyer v Cola Company 515 F 2nd 835 (1975)

227. Roland Machinery v Dresser Industries 749 F 2nd 380 (1984)

228. By Marvel, supra n.36 and J S Chard, "Economic Effects of Exclusive Purchasing Agreements in the Distribution of Goods in Pellegrin, Luca and Srinigs", RK Marketing Channels Relationships and Performance, 1986, Lexington.

229. Supra n.2

230. Supra n.227

231. Joyce Beverages v Royal Crown Cola Company, 555 F.Supp. 271 (1983).

232. Sulmeyer v Cola Company, 515 F.2d 835, 840 n.2 (1975).

233. B Klein, R G Crawford, A A Armen, "Vertical Integration, Appropriate Rents,and the Competitive Contracting Process", (1978), Journal of Law and Economics, 21, p. 326

234. Supra n.91 and supra n.224

235. Supra n.2

236. Supra n.228

237. "Salvage values" refer to those costs which are not retrievable by an organisation on exiting an industry. Particularly this would include costs of selling assets and inventory. If the value of such assets is low (low salvage value) then the incentive to protect such an investment by a vertical integration (or EDAs) increases. This situation may also be described by the "sunk costs" involved. This refers to those costs invested which cannot be retrieved on exit and are therefore "sunk".

238. "Internalising" of costs in this context refers to the process by which an organisation converts external costs (such as those involved in delayed payments, loss of bargaining power and customer dissatisfaction) to costs internal to the organisation. This would usually occur through acquisition of another independent organisation.

239. See for example the General Motors and Fisher Body agreement referred to by Chard supra n.228 at p. 309. For a fuller list of specific pro-competitive factors see supra n.133 at pp. 750-752.

240. Supra n.126; and also see supra n.134 at p.985 re the Australian Bankcard case.

241. Supra n.199

242. Idem

243. See for example supra n.2 at p.7-16

244. Supra n.199

245. I.e. "Foreclosing inputs or distribution facilities would present no problem to a firm seeking to expand in or enter into the output market if it could easily enter into the foreclosed market itself or count on entry by other firms in response to the increased demand for input production or distribution facilities." Vertical Guidelines, 1985, p. 20

246. Vertical Guidelines, 1985, p. 35

247. I.e. "large suppliers' exclusive dealing arrangements that are limited to a one-year term and that do not penalise dealers that subsequently switch suppliers are unlikely to exclude new suppliers from the market" Vertical Guidelines, 1985, pp. 35-36. Note also the statement by Richard Posner: "If the contract is terminable on short notice...the exclusionary effect will normally be zero, since the distributor is free to take on anew supplier at any time." from R A Posner, Antitrust Law, An Economic Perspective, University of Chicago Press, Chicago, 1976, p. 201.

248. See that described in SECTION 5 of this paper; also see discussions supra n.206

249. Fletcher Metals v Commerce Commission (1986) 3 NZCLC 99, 680; 6 NZAR 33.

250. E.g. supra n.2 at p.27

251. Supra n.2 para. 5. See also Appendix III.

252. Ibid p.5-7

253. Supra n.96

254. Note that previously Prestcold products were subject to EDAs between McAlpine (purchased by Ceramco) and its dealers.

255. Supra n.2 p.9

256. Ibid p.10 et seq

257. Whitegoods in this section will refer to refrigerators, freezers, washing machines, clothes dryers and dishwashers. Estimates of total market share for all goods are on a weighted average basis. See also Appendix III of the Draft Determination supra n.2.

258. This material is provided in detail in the Draft Determination p.16, para 73 et seq and in Appendix VIII of that document.

259. This has since been extended with F&P acquiring further outlets through merger and takeover activity e.g. Irvin and Stern.

260. Supra n.2 p.18

261. Ibid

262. Fisher and Paykel's production volumes are as great as those of any of the plants of its major Australian competitors: Hoover/Phillips and Email/Simpson.

263. Supra n.122

264. Supra n.2, p.20

265. Ibid, p.22 para 103

266. Supra n.59. This view is also followed in <u>Whakatu/Advanced Meats</u>, Decision no.205, supra n.63

267. This inference is drawn from the letters cited in the <u>Bond & Bond</u> case by Barker J; and from the statement by F&P reported in the <u>NBR</u> 18 July 1986. (This statement, though hearsay, was also referred to by Barker J in the <u>Bond & Bond</u> case.)

268. Supra n.65

269. Supra n.62

270. Supra n.2, p.25, para 110

271. Supra n.2 para 111

272. Ibid p.25-26

273. Supra n.190

274. Supra n.2, p.25, para 113

275. Supra n.199

276. Supra n.2, p.27, para. 118

277. Note that some further evaluation of these factors will occur in the following section on a marketing analysis.

278. Supra n.2, p.27, para 120

279. Ibid, para 120

280. See particularly cases referred to at supra n.2, p.28, para 120.

281. (1977) ATPR 40-043

282. See Appendix VI of the Draft Determination.

283. (1981) ATPR 40-200

284. Supra n.2, para 131

285. Commerce Commission Decision No. 204 2 July 1987

286. Supra n.2., particularly para 135

287. Ibid, p.33, para 144

288. Supra n.122

289. Supra n.2, para 145

290. Ibid para 148. This conclusion was based in part on the definition of "substantial" in the Dandy Power case, supra n.62

291. (1981) ATPR 42-807

292. Supra n.2, p.37, para 152

293. See earlier discussion and Appendix VI of the Draft Determination.

294. Supra n.2, para 156

295. One benefit which may not arise is the protection of manufacturer promotional investments from "free-riding". However the extent to which this is a benefit depends on the facts of each situation. (See earlier discussion)

296. Supra n.2, para 158

297. Ibid p.39 para 159

298. E.g. Whakatu/Advanced Meats supra n.63

299. Supra n.2, p.40, para 161

300. Ibid para 162

301. Ibid, para 163

302. Ibid, p.40, para 163

303. Although the writer did not attend the conference, much of the information was made available through the Commerce Commission.

304. Supra n.22 at p.75

305. Supra n.2

306. Higher Order Goods - these are typically complex and high cost items which require more dealer/manufacturer assistance, both in terms of after-sales service and information at the time of purchase. The potential for free-riding is increased with higher order goods. Examples of such goods include larger whiteware items, stereo and TV equipment and cars.

307. This model is adapted from that outlined in M Porter, "How Competitive Forces Shape Strategy", Harvard Business Review, Mar-April 1979.

308. Supra n.2

309. And one which arguably F&P's EDAs seriously limit.

310. See discussion in previous section.

311. See supra n.2 Appendix III, Schedule 4 for an indication of the businesses of Fisher and Paykel dealers.

312. Supra n.2, p.27-39

313. Supra n.2, para. 45

314. I.e. High sunk costs which result in a low salvage value.

315. Supra n.22 at p.53-54

316. See supra n.134, Ch. 6,

317. Supra n.22

318. Supra n.2

319. See the comments of Barker J in supra n.126, p.56

320. For an excellent review of the pro- and anti-competitive effects of franchising and the likely implications of the Commerce Act 1986 see I Eagles, "Franchising and the Commerce Act(I)" (1986) NZLJ 349

321. Supra n.122

322. Note: The requirements provided in this section of the paper only constitute part of the sections concerned.

323. Supra n.122 at p.286

324. Supra n.65

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granted, or conferred in trade; and, without limiting the generality of the foregoing, also includes the rights, benefits, privileges, or facilities that are or are to be provided, granted, or conferred under any of the following classes of contract:

(a) A contract for, or in relation to,—

(i) The performance of work (including work of a professional nature), whether with or without the supply of goods; or

(ii) The provision of, or the use or enjoyment of facilities for, accommodation, amusement, the care of persons or animals or things, entertainment, instruction, parking, or recreation; or

(iii) The conferring of rights, benefits, or privileges for which remuneration is payable in the form of a royalty, tribute, levy, or similar exaction:

(b) A contract of insurance, including life assurance, and life reassurance:

(c) A contract between a bank and a customer of the bank:

(d) Any contract for or in relation to the lending of money or granting of credit, or the making of arrangements for the lending of money or granting of credit, or the buying or discounting of a credit instrument, or the acceptance of deposits;—

but does not include rights or benefits in the form of the supply of goods or the performance of work under a contract of service:

"Substantial", means real or of substance:

"Supply",—

(a) In relation to goods, includes supply (or resupply) by way of gift, sale, exchange, lease, hire, or hire purchase; and

(b) In relation to services, includes provide, grant, or confer;—

and "supply" as a noun, "supplied", and "supplier" have corresponding meanings:

"Trade" means any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or to the disposition or acquisition of any interest in land:

"Working day" means any day of the week other than—

(a) Saturday, Sunday, Good Friday, Easter Monday, Anzac Day, Labour Day, the Sovereign's birthday, and Waitangi Day; and

(b) A day in the period commencing with the 25th day of December in any year and ending with the 15th day of January in the following year.

(2) In this Act,—

(a) A reference to engaging in conduct shall be read as a reference to doing or refusing to do any act, including—

(i) The entering into, or the giving effect to a provision of, a contract or arrangement; or

(ii) The arriving at, or the giving effect to a provision of, an understanding; or

(iii) The requiring of the giving of, or the giving of, a covenant:

(b) A reference to conduct, when that expression is used as a noun otherwise than as mentioned in paragraph (a) of this subsection, shall be read as a reference to the doing of, or the refusing to do, any act, including—

(i) The entering into, or the giving effect to a provision of, a contract or arrangement; or

(ii) The arriving at, or the giving effect to a provision of, an understanding; or

(iii) The requiring of the giving of, or the giving of, a covenant:

(c) A reference to refusing to do an act includes a reference to—

(i) Refraining (otherwise than inadvertently) from doing that act; or

(ii) Making it known that that act will not be done:

(d) A reference to a person offering to do an act, or to do an act on a particular condition, includes a reference to the person making it known that the person will accept applications, offers, or proposals for the person to do that act or to do that act on that condition, as the case may be.

(3) Where any provision of this Act is expressed to render a provision of a contract or a covenant unenforceable if the provision of the contract or the covenant has or is likely to have a particular effect, that provision of this Act applies in relation to the provision of the contract or the covenant at any time when the provision of the contract or the covenant has or is likely to have that effect, notwithstanding that—

Cf. 1975, No. 113, ss. 2 (1), 67A (3); 1976, No. 67, ss. 22, 23 (3); 1979, No. 140, s. 2; 1983, No. 144, s. 26; Trade Practices Act 1974 (Aust.), ss. 4, 4C, 4F, 4H

3. Certain terms defined in relation to competition—(1) In this Act—

"Competition", means workable or effective competition:

"Market", means a market for goods or services within New Zealand that may be distinguished as a matter of fact and commercial common sense.

(2) In this Act, unless the context otherwise requires, references to the lessening of competition include references to the hindering or preventing of competition.

(3) For the purposes of this Act, the effect on competition in a market shall be determined by reference to all factors that affect competition in that market including competition from goods or services supplied or likely to be supplied by persons not resident or not carrying on business in New Zealand.

(4) In sections 27 and 28 of this Act, a reference to a market in relation to the purpose or effect in respect of competition of a provision of a contract, arrangement, or understanding, or of a covenant, or of conduct, shall be read as including a reference to—

(a) A market in which a person who is a party to the contract, arrangement, or understanding, or any interconnected body corporate, or, as the case may be, the person or any associated person (within the meaning of section 28 (7) of this Act) who requires the giving of, or gives the covenant, supplies or acquires or is likely to supply or acquire, or would, but for that provision, covenant, or conduct, supply or acquire or be likely to supply or acquire goods or services; and

(b) Any other market in which those goods or services may be supplied or acquired.

(5) For the purposes of section 27 of this Act, a provision of a contract, arrangement, or understanding shall be deemed to have or to be likely to have the effect of substantially lessening competition in a market if that provision and—

(a) The other provisions of that contract, arrangement, or understanding; or

(b) The provisions of any other contract, arrangement or understanding to which that person or any interconnected body corporate is a party—

taken together, have or are likely to have the effect of substantially lessening competition in that market.

(6) For the purposes of section 28 of this Act, a covenant shall be deemed to have or to be likely to have the effect of substantially lessening competition in a market if—

(a) That covenant; and

(b) Any other covenant to the benefit of which that person or an associated person (within the meaning of section 28 (7) of this Act) is entitled or would be entitled if the covenant were enforceable—

taken together, have or are likely to have the effect of substantially lessening competition in that market.

(7) For the purposes of sections 27 and 28 of this Act, the engaging in conduct shall be deemed to have or to be likely to have the effect of substantially lessening competition in a market if—

(a) The engaging in that conduct; and

(b) The engaging by that person in conduct of the same or a similar kind—

taken together, have or are likely to have the effect of substantially lessening competition in that market.

(8) For the purposes of sections 36, 66 and 67 of this Act, a dominant position in a market is one in which a person as a supplier or an acquirer of goods or services either alone or together with any interconnected body corporate is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to—

(a) The share of the market, the technical knowledge, the access to materials or capital of that person or that person together with any interconnected body corporate:

(b) The extent to which that person is constrained by the conduct of competitors or potential competitors in that market:

(c) The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

Cf. Trade Practices Act 1974 (Aust.), ss. 4, 4E, 4G, 45 (3), (4), 45B (4), 46

PART II

Restrictive Trade Practices

Practices Substantially Lessening Competition

27. Contracts, arrangements, or understandings substantially lessening competition prohibited—(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.

Cf. Trade Practices Act 1974 (Aust.), s. 45 (1), (2)

28. Covenants substantially lessening competition prohibited—(1) No person, either on his own or on behalf of an associated person, shall—

(a) Require the giving of a covenant; or

(b) Give a covenant—

that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(2) No person, either on his own or on behalf of an associated person, shall carry out or enforce the terms of a covenant 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 to a covenant whether given before or after the commencement of this Act.

(4) No covenant, whether given 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.

(5) No person shall—

(a) Threaten to engage in particular conduct if a person who, but for subsection (4) of this section, would be bound by a covenant, does not comply with the terms of the covenant; or

(b) In the case of a covenant to which section 28 of this Act applies, that the covenant is subject to the condition that it shall not have effect unless and until authorisation is granted to give effect to it and that application shall be made for that authorisation within 15 working days after the covenant is made.

(3) Nothing in this section—

(a) Prevents the giving effect to a provision of a contract or an exclusionary provision, as the case may be, from constituting a contravention of section 27 or section 29 of this Act, as the case may be:

(b) Prevents the giving effect to a covenant from constituting a contravention of section 28 of this Act.

Cf. Trade Practices Act 1974 (Aust.), ss. 45 (9), 45B (8)

Use of Dominant Position in a Market

36. Use of dominant position in a market—(1) No person who has a dominant position in a market shall use that position for the purpose of—

(a) Restricting the entry of any person into that or any other market; or

(b) Preventing or deterring any person from engaging in competitive conduct in that or in any other market; or

(c) Eliminating any person from that or any other market.

(2) For the purposes of this section, a person does not use a dominant position in a market for any of the purposes specified in paragraphs (a) to (c) of subsection (1) of this section 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 trade mark.

(3) Nothing in this section applies to any practice or conduct to which this Part of this Act applies which has been authorised pursuant to Part V of this Act.

Cf. Trade Practices Act (Aust.), s. 46

Resale Price Maintenance

37. Resale price maintenance by suppliers prohibited—(1) No person shall engage in the practice of resale price maintenance.

(2) For the purposes of this section a person engages in the practice of resale price maintenance if that person (in this section referred to as the supplier) does any of the acts referred to in subsection (3) of this section.

PART V

Authorisations and Clearances

Restrictive Trade Practices

58. Commission may grant authorisation for certain restrictive trade practices—(1) Subject to the provisions of this Part of this Act, the Commission may, upon application by or on behalf of any person, grant an authorisation for that person—

(a) To enter into a contract or arrangement, or arrive at an understanding, to which section 27 of this Act applies:

(b) To give effect to a provision of a contract or arrangement or understanding to which section 27 of this Act applies:

(c) To require the giving of, or to give, a covenant to which section 28 of this Act applies:

(d) To carry out or enforce a covenant to which section 28 of this Act applies:

(e) To enter into a contract or arrangement, or arrive at an understanding, to which section 29 of this Act applies:

(f) To give effect to an exclusionary provision of a contract or arrangement or understanding to which section 29 of this Act applies.

(2) While any such authorisation remains in force—

(a) In the case of an authorisation to enter into a contract or arrangement, or arrive at an understanding, to which section 27 or section 29 of this Act applies, nothing in those sections shall prevent any person from—

(i) Entering into, or in accordance with the authorisation, giving effect to or enforcing any provision of the contract; or

(ii) Entering into, or in accordance with the authorisation, giving effect to the arrangement; or

(iii) Arriving at, or in accordance with the authorisation, giving effect to the understanding:

(b) In the case of an authorisation to give effect to a provision of a contract, arrangement, or understanding to which section 27 or section 29 of this Act applies, nothing in those sections shall prevent any person from—

(i) In accordance with the authorisation, giving effect to or enforcing the contract; or

(ii) In accordance with the authorisation, giving effect to the arrangement or understanding:

(c) In the case of an authorisation for requiring the giving of, or to give, a covenant to which section 28 of this Act applies, nothing in that section shall prevent any person from—

(i) Requiring the giving of, or giving, the covenant; or

(ii) Carrying out or enforcing the terms of the authorisation:

(d) In the case of an authorisation to carry out or enforce the terms of a covenant to which section 28 of this Act applies, nothing in that section shall prevent any person from carrying out or enforcing the terms of the covenant in accordance with the authorisation.

(3) Every authorisation granted by the Commission to a person under any of the preceding provisions of this section to—

(a) Enter into a contract or arrangement or arrive at an understanding; or

(b) Give effect to a provision of a contract, arrangement, or understanding; or

(c) Require the giving of, or give, a covenant; or

(d) Carry out or enforce the terms of a covenant—

shall have effect as if it were also an authorisation in the same terms to every other person named or referred to in the application for the authorisation as a party to the contract, arrangement, or understanding, or as a person who is or would be bound by, or entitled to the benefit of, the covenant, as the case may be.

(4) An authorisation to a person under subsection (1) of this section may be expressed to apply to or in relation to another person who,—

(a) In the case of an authorisation to enter into a contract or arrangement or arrive at an understanding, becomes a party to the proposed contract or arrangement at a time after it is entered into or becomes a party to the proposed understanding at a time after it is arrived at:

(b) In the case of an authorisation to give effect to a provision of a contract, arrangement, or understanding, becomes a party to the contract, arrangement, or understanding at a time after the authorisation is granted:

(c) In the case of an authorisation to require the giving of, or to give, a covenant, becomes bound by, or entitled to the benefit of, the covenant at a time after the covenant is given:

(d) In the case of an authorisation to carry out or enforce the terms of a covenant, becomes bound by, or entitled to the benefit of, the covenant at a time after the authorisation is granted.

(5) Where an application is made to the Commission under section 60 of this Act for an authorisation in relation to a particular contract and is expressed to be made also in relation

Restrictive Trade Practices

80. Pecuniary penalties—(1) If the Court is satisfied on the application of the Commission that a person—
(a) Has contravened any of the provisions of Part II of this Act; or
(b) Has attempted to contravene such a provision; or
(c) Has aided, abetted, counselled, or procured any other person to contravene such a provision; or
(d) Has induced, or attempted to induce, any other person, whether by threats or promises or otherwise, to contravene such a provision; or
(e) Has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by any other person of such a provision; or
(f) Has conspired with any other person to contravene such a provision,—

the Court may order the person to pay to the Crown such pecuniary penalty as the Court determines to be appropriate, not exceeding $100,000 in the case of a person not being a body corporate, or $300,000 in the case of a body corporate, in respect of each act or omission.

(2) In determining an appropriate penalty under this section, the Court shall have regard to all relevant matters, including—
(a) The nature and extent of the act or omission:
(b) The nature and extent of any loss or damage suffered by any person as a result of the act or omission:
(c) The circumstances in which the act or omission took place:
(d) Whether or not the person has previously been found by the Court in proceedings under this Part of this Act to have engaged in any similar conduct.

(3) The standard of proof in proceedings under this section shall be the standard of proof applying in civil proceedings.

(4) In any proceedings under this section, the Commission, upon the order of the Court, may obtain discovery and administer interrogatories.

(5) Proceedings under this section may be commenced within 3 years after the matter giving rise to the contravention arose.

(6) Where conduct by any person constitutes a contravention of 2 or more provisions of Part II of this Act, proceedings may be instituted under this Act against that person in relation to the contravention of any one or more of the provisions; but no person shall be liable to more than one pecuniary penalty under this section in respect of the same conduct.

Cf. Trade Practices Act 1974 (Aust.), ss. 76, 77

81. Injunctions may be granted by Court for contravention of Part II—The Court may, on the application of the Commission or any other person, grant an injunction restraining a person from engaging in conduct that constitutes or would constitute any of the following—
(a) A contravention of any of the provisions of Part II of this Act:
(b) Any attempt to contravene such a provision:
(c) Aiding, abetting, counselling, or procuring any other person to contravene such a provision:
(d) Inducing, or attempting to induce, any other person, whether by threats, promises or otherwise, to contravene such a provision:
(e) Being in any way directly or indirectly, knowingly concerned in, or party to, the contravention by any other person of such a provision:
(f) Conspiring with any other person to contravene such a provision.

Cf. Trade Practices Act 1974 (Aust.), s. 80 (1), (2)

82. Actions for damages for contravention of Part II—(1) Every person is liable in damages for any loss or damage caused by that person engaging in conduct that constitutes any of the following—
(a) A contravention of any of the provisions of Part II of this Act:
(b) Aiding, abetting, counselling, or procuring the contravention of such a provision:
(c) Inducing by threats, promises, or otherwise the contravention of such a provision:
(d) Being in any way directly or indirectly, knowingly concerned in, or party to, the contravention of such a provision:
(e) Conspiring with any other person in the contravention of such a provision.

(2) An action under subsection (1) of this section may be commenced at any time within 3 years from the time when the cause of action arose.

Cf. Trade Practices Act 1974 (Aust.), s. 82

Mergers and Takeovers

83. Contravention of section 50 an offence—(1) Every person who contravenes section 50 of this Act commits an offence and is liable on conviction on indictment—

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