



Alan Stuart

Exclusive Dealing – What Is Its Real Purpose?

Can a business refuse to supply goods and services to a willing buyer? **Alan Stuart**, a partner with the Warkworth Lawlink firm of Webster Malcolm & Kilpatrick, warns against arrangements that might be construed as anti-competitive or price-fixing.

INTRODUCTION

Most of us do not expect to be able to buy a Big Mac from the local fish and chip shop, Shell products from a Mobil service station, an X-box from a licensee of Sony or to Hire A Hubby by phoning Action Plumbing. So it is somewhat surprising that one of the questions most often asked of competition lawyers is whether a business (often a distributor) can refuse to supply its goods or services to someone who wants to buy them.

These two issues may seem unconnected, but if it was illegal to refuse to supply goods or services to those who were willing to buy them, it follows that the local fish and chip shop owner could insist on buying the ingredients to make and sell Big Macs, and indeed, could insist on buying and reselling Shell products, X-boxes or on obtaining a Hire A Hubby franchise. The customer may always be right, but doesn't – yet? – have a right to buy goods or services from those who are unwilling to supply them. A business climate where a purchaser of goods or services has a legal right to be supplied would be unworkable. How would it accommodate – for example – a seller that is not able to supply the goods or services sought? And what part would price have to play in the market if the purchaser could demand what it required?

In New Zealand the legality of exclusive dealing came before the High Court for decision soon after the passing of the Commerce Act in 1986. The issue was raised by Fisher & Paykel, which sought from the Commerce Commission a determination that the exclusive dealership clauses in its agreements with retailer dealer outlets did not breach the Act. This clause prohibited the retailers from *stocking or selling*

any other make or brandname of [whiteware] product. It was Fisher & Paykel's clear intention not to supply its whitegoods to dealers who did not agree to this prohibition. Fisher & Paykel at that time had by far the largest share of the New Zealand whitegoods market, and competing manufacturers were keen to sell their products alongside those of Fisher & Paykel. They could not do so if Fisher & Paykel was entitled to maintain its exclusive dealing arrangements with retailers selling its products. The Commerce Commission's conclusion that *exclusive dealing is not as such unlawful* was accepted both in the High Court¹ and the Court of Appeal; it is not whether an arrangement constitutes exclusive dealing that makes it unlawful, but (in terms of section 27 of the Commerce Act 1986) whether the purpose or effect of the arrangement is *substantially to reduce competition in a market.* As the High Court pointed out, exclusive dealing clauses can even have positive pro competitive effects, and the court quoted an Australian decision (based on very similar wording to our Commerce Act):

It would, I think, be an unusual and exceptional case in which it could be shown that competition in a generally competitive market was or was likely to be substantially lessened by a refusal to supply one of a number of competitive retailers in the market with a product otherwise freely available and competitively marketed. Further, where there is a market which is generally competitive, it plainly does not follow that conduct which affects the balance of competition by advantaging or disadvantaging a particular dealer or dealers or a particular product or products necessarily lessens the competition in the market².

WHEN IS AN EXCLUSIVE DEALING ARRANGEMENT ILLEGAL?

But if exclusive dealing is not *per se* illegal, that does not mean that it is always safe for a supplier of goods or services to attempt to control the marketing of its products. It can depend on what methods are used, on the market power the supplier has, and on what the supplier's true objective is in refusing to supply its products to a potential customer. The public is thoroughly accustomed to brand owners asserting control over the marketing of their products by means of franchise agreements, licensing arrangements, or by selling directly to the public. How and from where goods are sold, the get-up of the retail premises, the level of staff training and the quality of after sales service are all unobjectionable methods of maintaining brand awareness and goodwill. Of course these elements of the total marketing package will in turn have some influence on the price at which goods and services can be profitably sold.

However there are two issues that require caution:

- the effect of section 27 of the Act is if these arrangements have the purpose or effect of substantially reducing competition in a market they are prohibited;
- the effect of section 30 of the Act is any supplier discussing with retailers the resale price of its goods will need to be extremely careful.

Whether the first of these is a genuine issue depends mainly on the market power of the supplier. As the Fisher & Paykel case demonstrates, the mere use by a supplier of exclusive dealing arrangements with its retailers is not likely in itself to result in a breach of the Act unless the supplier has extraordinary market

power and the barriers to enter the market are high.

The second aspect of concern is not so easily dismissed. The Commerce Act absolutely prohibits any attempt to control the price at which goods and services are offered for sale; whether this is done by price fixing arrangements between competitors (section 30), or by resale price maintenance across vertical levels of a market (section 37). The maximum penalty that may be imposed for these activities is \$500,000 against an individual and \$10m against a company. The highest penalty that has so far been imposed in New Zealand for resale price maintenance is \$250,000 plus costs against Toyota New Zealand Ltd in 1997 for enforcing price control through its dealers on fleet sales. But the maximum penalty for companies has doubled since that case.

REFUSAL TO SUPPLY

Returning then to the theme of refusing to supply: as we have seen, it is not illegal by itself, but the activities prohibited by section 37(3) of the Act as resale price maintenance include:

The supplier making it known to another person that the supplier will not supply goods to the other person unless the other person agrees not to sell those goods at a price less than a price specified by the supplier:

Thus if an exclusive dealing arrangement (which can be a formal written contract, or simply an unrecorded understanding), and the associated refusal to supply others that do not have that arrangement, is part of a scheme for controlling the price of goods or services, it is certainly likely to attract the attention of the Commerce Commission, and if it infringes the Act, a substantial monetary penalty. In the Fisher & Paykel case there was no suggestion that the purpose of the exclusive dealing clause was to control the price at which the retailer sold the goods. But contrast this with a recent case in Australia³ where a manufacturer had to pay a penalty of \$3.4m and a further penalty of \$200,000 was awarded against the former managing director because the company's agreement with retailers of its expensive skin care products included a requirement that retailers would not sell at less than specified prices, and would not engage in discounting practices.

If you have any concerns about whether any arrangements that you have with suppliers or retailer customers are in breach of the Commerce Act you should contact your Lawlink lawyer to discuss them.

-
- 1 *Fisher & Paykel v Commerce Commission* [1990] 2 NZLR 731
 - 2 *Outboard Marine Australia Pty Ltd v Hecar Investments (No 6) Pty Ltd* [1982] 4 ATPR 43,980 per Fitzgerald J at 43,990
 - 3 *Australian Competition and Consumer Commission v Julique International Pty Ltd* [2007] FCA 79

© Webster Malcolm & Kilpatrick

email

a.stuart@wmklaw.co.nz
[Website www.wmklaw.co.nz](http://www.wmklaw.co.nz)