

RESALE PRICE MAINTENANCE: ECONOMIC AND POLICY ANALYSIS

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I INTRODUCTION

Resale price maintenance (RPM) is one of the most controversial areas in the regulation of trade practices and, if overseas experience is any guide, one that is likely to generate numerous prosecutions and private actions for damages under the Commerce Act 1986.¹ It can, in very general terms, be defined as a practice whereby a supplier of a certain commodity prescribes a minimum, maximum² or fixed price which resellers have to observe on resale. In the last twenty years, most O.E.C.D. countries have either banned the practice outright, or have prohibited it unless the parties supporting the

¹ The RPM provisions are contained in ss. 37-42 of the Commerce Act 1986. For commentary on these provisions, see B. Hill & M. Jones, *Competitive Trading in New Zealand* 81-94 (1986); Y. van Roy, *Guidebook to New Zealand Competition Laws* ch.8 (1987). An excellent practical commentary on the equivalent Australian RPM provisions is Pengilly, "Recent Trends in Resale Price Maintenance and Dealership Problems" in *Recent Legal Developments in Trade Practices* (N.S.W. College of Law, 1985).

² Maximum RPM involving the fixing of a price ceiling falls outside the scope of the RPM provisions of the Commerce Act, although these and other provisions of the Act (particularly ss. 27 and 36) may apply to the practice if it is being used for an anti-competitive purpose or effect, e.g., as a cloak for minimum RPM. For a recent case where distribution contracts involving maximum RPM were held not to contravene the Commerce Act 1986, see *Tru Tone Ltd. v. Festival Records Retail Market Ltd.* (1988) 2 N.Z.B.L.C. para. 99-113 (H.C.), (1988) 2 N.Z.B.L.C. para. 99-135 (C.A.). While the judgments in *Tru Tone* recognize the pro-competitive benefits of maximum RPM they do not examine the practice in the context of economic theory.

Unlike RPM involving minimum or fixed prices, vertical maximum RPM is normally efficiency-enhancing as it is designed to eliminate the problem of successive monopoly. Successive monopoly arises not only in the classic bilateral monopoly situation. It could also arise where a manufacturer of a trademarked, patented or copyrighted product enjoys a degree of market power (falling short of dominance in the legal sense) and sells through a number of retail outlets who, because of locational advantages or concerted action, also possess market power. Retailers are thus able to set prices at a higher level than that desired by the manufacturer, whose product suffers a consequent reduction in sales volume. In this way, retailers exploit the manufacturer's "monopoly" for their own gain. The imposition of a price ceiling by the manufacturer will result in lower retail prices as well as increased total profits for the manufacturer. Such a result is both efficiency-enhancing and beneficial to consumers. From an economic perspective, the distribution contracts in *Tru Tone* can be usefully analyzed in the context of a "monopolist" supplier selling goods to a monopolistically competitive retail sector. See generally R. Blair & D. Kaserman, *Antitrust Economics* 342-49 (1985); F. Warren-Boulton, *Vertical Control of Markets* 62 (1978); Bittlingmayer, "A Model of Vertical Restrictions and Equilibrium in Retailing" 56 J. Bus. 477 (1983); Dixit, "Vertical Integration in a Monopolistically Competitive Industry" 1 Int'l J. Indus. Organization 63 (1983); Mathewson & Winter, "Vertical Integration by Contractual Restraint in Spatial Markets" 56 J. Bus. 497 (1983).

practice can demonstrate that in their particular case it is in the public interest.³ New Zealand has varied its legal regulation of RPM over the years.⁴ With the enactment of the Commerce Act 1986, New Zealand has joined Australia, Canada, Sweden, West Germany and the United States in making RPM illegal per se.

Economic analysis provides both competitive (efficiency-enhancing) and anti-competitive (collusion-enhancing) theories to explain RPM.⁵ I shall deal first with the efficiency explanation theories for RPM.

II EFFICIENCY EXPLANATIONS FOR RPM

1. *The Special Services Theory*

The efficiency explanation for RPM that has gained the most recognition hypothesizes that manufacturers impose price restraints upon their resellers to insure the provision of special services. Professor Lester G. Telser advanced this "special services" theory in his 1960 article "Why Should Manufacturers Want Fair Trade?"⁶ Telser persuasively argued that, in certain circumstances, it could be in the manufacturer's best interests to limit price competition among its dealers. Comanor and Kirkwood summarize Telser's answer to the question he posed in the title of his article:⁷

At first glance, . . . an [RPM] strategy seems counterproductive. Since the manufacturer's sales volume depends on the price charged to consumers, its output and profits would appear greatest when maximum competition among dealers assures the lowest possible distribution margin. Telser explained that the firm could benefit when vertical price fixing was necessary to stimulate dealer services. By "services" Telser meant not only delivery, credit, and repair, but also selling, advertising and promotion. Services include any dealer activities that may increase demand for the product. Having dealers supply these services benefits the manufacturer whenever the resulting stimulative effect on demand exceeds the depressing effect of the higher price charged to consumers.

In addition to showing how demand could be stimulated by higher prices, Telser explained why price floors were needed. He pointed out that resellers who provide special services to consumers, and who incur the costs associated with the provision of such services could be taken advantage of by other resellers who provide no services, incur fewer costs, and are therefore able to offer the product for sale at a lower cost. Consumers, after utilizing the pre-sales services of the higher priced resellers, will be induced to buy from

³ For a survey of RPM legislation in O.E.C.D. member countries, see O.E.C.D. report, *Comparative Summary of Legislation on Restrictive Business Practices* 135-44 (1978).

⁴ For a discussion of RPM under the Commerce Act 1975, see J. Collinge, *Restrictive Trade Practices and Monopolies, Mergers & Take-Overs in New Zealand* 198-208 (2nd ed. 1986).

⁵ For a comprehensive summary of theories of RPM, see T. Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence*, F.T.C. Bureau of Economics Staff Report, (1983). An excellent collection of articles on the economics of RPM is contained in the symposium "Resale Price Maintenance: Theory and Policy in Turmoil" 3 *Contemp. Pol'y Issues* 1-55 (Spring 1985). I have drawn extensively on both these works in the writing of this article. Earlier work on the economics of RPM includes E. Grether, *Price Control Under Fair Trade Legislation* (1939); B. Yamey, *The Economics of Resale Price Maintenance* (1954); Bowman, "Prerequisites and Effects of Resale Price Maintenance" 22 *U. Chi. L. Rev.* 825 (1955); S.Gammelgaard, *Resale Price Maintenance* (1958).

⁶ Telser, "Why Should Manufacturers Want Fair Trade" 3 *J. L. & Econ.* 86 (1960). For a formalized treatment of the special services theory, see Mathewson & Winter, "The Incentives for Resale Price Maintenance Under Imperfect Competition" 21 *Econ. Inquiry* 337 (1983).

⁷ Comanor & Kirkwood, "Resale Price Maintenance and Antitrust Policy" 3 *Contemp. Pol'y Issues* 9, 10-11 (Spring 1985).

lower priced sellers who take a “free ride” on the services offered by their higher priced competitors. These free riding activities discourage the sellers who are being taken advantage of from continuing to provide services, thus harming the manufacturer and consumers. To deal with this problem, the manufacturer can establish minimum retail prices so that “retailers are forced to compete by providing special services with the product and not by reducing the retail price”⁸.

Despite its seminal contribution to our understanding of why manufacturers engage in vertical RPM, Telser’s article had little immediate impact on either policymaking or academic commentary on RPM.⁹ The situation changed, however, in the mid-1970’s when scholars began to take a renewed interest in possible efficiency reasons for RPM.¹⁰ While commentators have debated the frequency, significance and generality of the “free rider problem” as explored by Telser,¹¹ few have questioned the theoretical validity of Telser’s hypothesis and its importance in some cases.

2. *The Welfare Effects of the Special Services Theory*

Scholars of the Chicago School of antitrust analysis, building on Telser’s work, have postulated that vertical restraints, including RPM, are generally welfare-enhancing¹² because they usually increase output. Judge Posner has reasoned:¹³

⁸ Telser, *supra* note 6, at 92. Although Telser’s article is commonly cited in regard to the special services theory of RPM, Telser also discusses in his article the cartel theory as an alternative explanation of manufacturers’ support of RPM. The cartel explanations of RPM are discussed *infra*.

⁹ In an important collection of studies of RPM in selected countries published in 1966, Professor B.S. Yamey mentions Telser’s article only once in his introductory chapter on the main economic issues of RPM, and then only as a footnote in support of the view that collective policies of RPM have often been part and parcel of agreements among manufacturers. See B. Yamey (ed.), *Resale Price Maintenance* 10n.6 (1966).

¹⁰ The renewed interest in RPM during the mid-1970’s had been foreshadowed by the publication in 1966 of an article by Professor (now Judge) Robert Bork who argued that RPM increases distribution efficiency and this promotes efficient resource allocation. See Bork, “The Rule of Reason and the Per Se Concept: Price Fixing and Market Division” (pt.2) 75 *Yale L.J.* 373 (1966). For a response by two leading United Kingdom economists and a counter-response by Bork, see Gould & Yamey, “Professor Bork on Vertical Price Fixing” 76 *Yale L.J.* 722 (1967); Bork, “A Reply to Professors Gould and Yamey” 76 *Yale L.J.* 731 (1967). The exchange continued with a rejoinder by Gould & Yamey and a counter-rejoinder by Bork. See Gould & Yamey, “Professor Bork on Vertical Price Fixing: A Rejoinder” 77 *Yale L.J.* 934 (1968); Bork, “Resale Price Maintenance and Consumer Welfare” 77 *Yale L.J.* 948 (1968).

The most influential article on RPM published in the mid-1970’s was probably that by Professor (now Judge) Richard Posner. See Posner, “Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger, and Potential Competition Decisions” 75 *Colum. L. Rev.* 282 (1975). The views of Professors Bork and Posner reached a wider audience with the publication in book form of their critiques on antitrust law and policy. See R. Posner, *Antitrust Law: An Economic Perspective* (1976); R. Bork, *The Antitrust Paradox* (1978).

¹¹ See generally Hay, “The Free Rider Rationale and Vertical Restraints Analysis Reconsidered” 56 *Antitrust L.J.* 27 (1987). Much of the debate stems from Telser’s narrow definition of the type of activity which he considered vulnerable to free riding, i.e. special pre-sale services which are both product-specific and readily exploitable by others. Because of the limitation of Telser’s theory to explain a variety of the applications of RPM, commentators have formulated more generalized free rider theories. These are discussed *infra*.

¹² Economists commonly define a practice as welfare-enhancing if it increases total surplus, defined as the sum of the manufacturer’s profits plus expected consumer surplus. The term “consumer welfare” is more ambiguous. Chicago School commentators commonly use consumer welfare as a synonym for economic efficiency. More conventional usage, however,

If [the firm's] output expanded, the [vertical] restriction must have made the firm's product more attractive to consumers on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition. The increase must exceed any net reduction in intrabrand competition considered in both its price and service.

Judge Bork has advanced a similar view.¹⁴ These two prominent Chicago School scholars conclude that the present per se rule outlawing RPM should be revoked in favour of a presumptively lawful approach.¹⁵

Bork and Posner's view that purely vertical RPM can increase output and expand dealer services has been influential, although the usefulness of the output test as a workable legal standard has been called into question.¹⁶ However, their conclusion that RPM is generally welfare-enhancing is more controversial as it is based on the premise that greater output is normally associated with improved consumer welfare. The validity of this assumption has been challenged by Professor Michael Spence who, in an important article in 1975,¹⁷ showed that, under certain conditions, actions which increase output and profits can *reduce* consumer welfare. Applying Spence's work to the vertical restraints context, economists have recently demonstrated that even though RPM may increase output, the practice can result in a reduction in consumer welfare.

Professor William S. Comanor¹⁸ has shown that, even if Telser is correct in his assertion that extra services and promotion are the manufacturer's motive for adopting RPM, social welfare need not be improved by allowing manufacturers to engage in the practice. The crucial point in Comanor's analysis is that a profit-seeking firm pays attention only to the preferences of marginal consumers (those who lack knowledge about the product) in deciding whether

maintains a distinction between these terms, equating consumer welfare with that part of the total surplus that accrues to consumers. Using this definition, something that increases economic efficiency will *normally* also lead to an increase in consumer welfare, but this need not *always* be the case. See Brodley, "The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress" 62 N.Y.U. L. Rev. 1020, 1032-41 (1987); D. Greer, "Efficiency and/or/versus/equals Competition?" (N.Z. Institute of Economic Research working paper, 1988).

¹³ Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality" 48 U. Chi. L. Rev. 6, 21 (1981).

¹⁴ R. Bork, *The Antitrust Paradox* 288-91 (1978).

¹⁵ For more recent expositions of this view, see Baxter, "The Viability of Vertical Restraints Doctrine" 75 Calif. L. Rev. 933 (1987); Easterbrook, "Vertical Arrangements and the Rule of reason" 53 Antitrust L.J. 135 (1984), and "The Limits of Antitrust" 63 Texas L. Rev. 1 (1984).

¹⁶ Carstensen & Dahlson, for example, consider that the output test favoured by Bork and Posner is flawed. First, it assumes that the causes of output changes can be easily identified. Second, even if this is possible, the relevant output would still be ambiguous. Expanded sales of one brand may be due to an efficiency-enhancing ancillary restraint or may arise from the operation of a "naked restraint" allowing cartel profits to be used to induce dealers to switch customers' brand preferences. The pertinent question to ask is *how* a restraint causes a change and not merely whether it causes a change. Carstensen and Dahlson reject the output test in favour of a functional analysis of vertical restraints. See Carstensen & Dahlson, "Vertical Restraints in Beer Distribution: A Study of the Business Justification for and Legal Analysis of Restricting Competition" 1986 Wis. L. Rev. 1, 27-29 (1986).

¹⁷ Spence, "Monopoly, Quality, and Regulation" 6 Bell J. Econ. 417 (1975).

¹⁸ See Comanor, "Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy" 98 Harv. L. Rev. 983 (1985); Comanor & Kirkwood, *supra* note 7; Comanor, "Vertical Arrangements and Antitrust Analysis" 62 N.Y.U. L. Rev. 1153 (1987). See also Scherer, "The Economics of Vertical Restraints," 52 Antitrust L.J. 687 (1983) (employing a similar analysis leading to the same conclusions).

to increase the level of services and promotion for its product. If marginal consumers value the extra services more than their cost — and increase their purchases of the product as a result — the manufacturer will find it profitable to impose vertical restraints such as RPM. The RPM-generated additional services or promotion, however, may have value only to customers at the margin and have little or no value for infra-marginal customers, i.e. well-informed consumers who value the product highly and do not cease purchasing it when its price rises. Comanor and Kirkwood explain how despite increased output, RPM could still harm consumers as a whole.¹⁹

Although marginal consumers would gain from the extra services, infra-marginal consumers might be hurt. If the latter prefer to purchase the manufacturer's product at a lower price (without additional services), RPM would reduce their welfare. Moreover, the welfare losses to these consumers may outweigh the gains to marginal consumers. When this possibility is recognized, the link between the interests of producers and consumers — presumed by many to hold in a purely vertical context — is effectively broken.

As regards the implications of the above analysis for antitrust policy, Comanor and Kirkwood believe that it would be difficult for a plaintiff to prove that RPM harmed infra-marginal consumers more than it benefited marginal consumers as no market tests exist to measure RPM's impact on either group of consumers. While conceding that evidence about the prevalence of the anti-competitive instances of RPM is not yet available, Comanor and Kirkwood believe that such instances may be quite frequent if one makes the plausible assumption that substantial quantities of products are bought by knowledgeable infra-marginal consumers who place little value on information services provided by dealers.²⁰ Until more extensive evidence is available, Comanor and Kirkwood believe that policymakers should be cautious about proposals to weaken the current per se rule against RPM. An exception could, however, be made in the case of new entrants. This is because few prospective purchasers of a new entrant's product are likely to be knowledgeable; most purchasers are likely to be ignorant and in need of advice. Consequently purely vertical RPM is more likely to increase efficiency in the case of a new entrant than it would in the case of an established firm.

3. *Quality Signalling Theories*

For the purposes of their analysis, Comanor and Kirkwood assume that special services or promotion are generated by vertical RPM. A number of opponents of RPM, however, have pointed out that RPM often has been used in contexts in which special services are not provided. Dean Robert Pitofsky has ably argued this point.²¹

[T]hink for a moment about the product areas in which resale price maintenance has appeared — boxed candy, pet foods, jeans, vitamins, hair shampoo, knit shirts, men's underwear. What

¹⁹ Comanor & Kirkwood, *supra* note 7, at 13.

²⁰ For an interesting examination of non-dealer sources of information, see Levimore, "Rescuing Some Antitrust Law: An Essay on Vertical Restrictions and Consumer Information" 67 *Iowa L. Rev.* 981 (1982).

²¹ Pitofsky, "Why 'Dr Miles' Was Right" 8 *Reg.* 27, 29 (1984). For a different view as to the services a department store provides in selling jeans, see G. Mathewson & R. Winter, *Competition Policy and Vertical Exchange* 41-45 (1985), discussing two Canadian RPM cases involving jean manufacturers, viz. *R. v. H.D. Lee of Canada* (1980) 57 C.P.R. (2nd) 186 and *R. v. Levi Strauss of Canada Inc.* (1970) 45 C.P.R. 25.

are the services we are talking about in these cases? Take jeans. What services does Saks Fifth Avenue provide that K-Mart does not? In both stores, the jeans are laid on the table, customers take them to a dressing room, try them on, and buy them. Is it really plausible that Jordache is fixing the resale price at \$32 and denying the product to K-mart in order to induce Saks to promote services on jeans? I think not.

The limitation of Telser's theory to explain the adoption of vertical RPM in situations where products require little, if any, pre-sales services, has led some economists to formulate generalized free rider theories that emphasize the importance of establishing and maintaining product reputation and/or sales outlets.²² These theories assume that, if certain products are to be established and promoted effectively, retailers with a high quality image must carry the product. By using the services of such retailers, the manufacturer conveys a quality signal to customers assumed to be unable to judge a product's quality prior to purchase. It should be noted that the retailer's premises and its general methods of doing business convey the quality signal, rather than the price of the product per se. To the extent that cultivating a high-quality image requires resources, retailers with images of higher quality require higher mark-ups over the manufacturer's price relative to retailers with lower quality images. The manufacturer may rely on RPM under these circumstances because having products available in the type of retail outlets which present consumers with a correct signal of the product's quality and relative value may be an efficient way of stimulating demand for the products.²³ Without RPM, a free rider problem might emerge in that consumers, observing that high-quality stores carry certain products, might purchase those products in discount stores. This could result in the high-quality stores refusing to stock the manufacturer's products with a consequent reduction in consumer demand and/or a debasement in their quality.

The quality certification theory may well explain the respondent's RPM conduct in *TPC v. Lois (Australia) Pty. Ltd.*²⁴ The respondent (Lois) was a new entrant in the apparel market and carried on business as a wholesale supplier of high quality jeans and jackets. The RPM proceedings arose from Lois' refusal to supply two businesses carried on in partnership in Western Australia engaged in retailing jeans and casual clothing. Lois made it clear to one of the partners (O) that it did not want its merchandise to be discounted except at the end of the season. Lois also notified O that the full range of its products for the forthcoming season would only be shown to the partnerships if O was prepared to enter into a verbal gentlemen's agreement that the partnerships would mark up the goods by ninety percent of the wholesale price. O declined to give such an undertaking and subsequently instructed his lawyers to write to Lois informing them of this fact and requesting the return of moneys held by Lois to the credit of the partnerships. Lois returned

²² Two prominent studies are Marvel & McCafferty, "Resale Price Maintenance and Quality Certification" 15 Rand J. Econ. 346 (1984) and Goldberg, "The Free Rider Problem, Imperfect Pricing, and the Economics of Retailing Services" 79 Nw. U.L. Rev. 736 (1984).

²³ For U.S. and Australian case studies where the quality signal may have been the explanation for RPM, see Goldberg, "Enforcing Resale Price Maintenance: The F.T.C. Investigation of Lenox" 18 Am. Bus. L.J. 225 (1980); Goldberg, "Resale Price Maintenance and the FTC: The Magnavox Investigation" 23 Wm. & Mary L. Rev. 439 (1982); Lindgren & Entekin, "Resale Price Maintenance in the Light of Selective Distribution" 1 Aust. Bus. L. Rev. 130 (1973). The Goldberg Lenox study and that by Lindgren & Entekin make for an interesting comparison as both involve suppliers of high quality household china.

²⁴ (1986) A.T.P.R. para. 40-645.

the money due but in their reply made no attempt to deny the RPM conduct which O's lawyers in their letter to Lois had alleged. Lois' conduct was in clear contravention of the RPM legislation and it is not surprising that they admitted liability when the Trade Practices Commission brought an action seeking the imposition of a pecuniary penalty.

The report of the case deals only with the issue of the penalty to be imposed. However, the following remarks of Forster J. shed some light on the motivation for Lois' conduct:²⁵

This was a deliberate course of conduct engaged in by senior management of the respondent and was undertaken pursuant to a deliberate policy to prevent discounting beyond a maximum of 10% of a markup of 100% in order to preserve what the respondent perceived to be its image in the market of a supplier of high quality goods. There was an effective threat to refuse supply and the retailer was not supplied. There were very clear breaches of sec.48 of the Trade Practices Act.

...
The respondent has been guilty of no prior contraventions and although it is established that there was a deliberate policy with respect to the partnerships there is no evidence that any other retailer was similarly treated. The respondent is a relatively small supplier of jeans and jackets in the market as a whole. The respondent was not operating on a retail basis so that there was no direct pecuniary advantage to be gained by the contraventions. The advantage, if any, was a rather more intangible one of preserving its image in the market which no doubt it hoped would lead to some future financial benefit.

From his remarks, it appears that his Honour was sceptical of the financial benefit that could accrue to Lois from engaging in RPM. Yet the case would seem to neatly fit the quality and style certification theory discussed above. To successfully compete in the high fashion quality jean and jacket market, a small, relatively unknown wholesaler like Lois would need to distribute its garments through stores with established reputations as sellers of high fashion quality merchandise. Consumers would perceive the decision of such stores to carry Lois' products as an independent signal of the style and quality of the products. Marvel and McCafferty have explained how their retailer certification theory applies to fashion apparel:²⁶

The certification provided by retailers need not be limited to quality. For example, apparel deemed to be in style can command a premium over that considered merely utilitarian. In good part, apparel retailers act as the consumer's agent, expending resources on sophisticated buyers and other devices to sense fashion trends in the making. These resource expenditures are valuable only to the extent that consumers value the style information that is produced. A manufacturing firm will prefer to have its merchandise marketed at leading stores to benefit from this style certification, simply because style certification will shift out the demand schedule for its apparel items. If, however, the product is branded, and if consumers rely on the brand label as an indication of standardization, the consumer will be indifferent to the store from which his apparel item is obtained. Hence, the exclusive store will be unable to charge a premium price to cover the services of the buyers who certified the clothing as exclusive in the first place. The solution to the problem is either to refuse to sell to discounters or to guarantee the style-certifying retailer a margin sufficient to cover its costs through resale price maintenance.

Lois, faced with the problem of the discounting practices of the two partnerships, no doubt reasoned that it was better to lose the custom of these two stores rather than risk alienating its style-certifying retailers. Action by the Trade Practices Commission could have jeopardized the company's demand-

²⁵ Ibid. at pp. 47,226-47,227.

²⁶ Marvel & McCafferty, *supra* note 22, at 348.

enhancing marketing strategy and may have seriously undermined its financial viability.

Professor Victor Goldberg's shelf space rental and retailer endorsement explanations of RPM also deserve mention. Goldberg's theories emphasize the provision of services by retailers to manufacturers rather than the provision of retailing services to customers. Goldberg notes in connection with his shelf space rental argument²⁷

that the retailer is renting more than "unimproved location." But it is important to recognize that much of the expenditure that increases the value of the shelf space does so for a wide range of products, not simply those of a particular manufacturer. The types of products specified by Pitofsky would be of this sort. The manufacturer of underwear or knit shirts wants to have his goods displayed to a large number of potential customers in an attractive atmosphere, and is willing to pay a higher rental fee for shelf space to a retailer who can provide this.

Goldberg argues that retailer services, whether in the form of desirable shelf space or endorsement of products, constitute valuable assets akin to property rights. Because it is in the mutual interest of both manufacturer and retailer that the value of these assets be protected from free riding activity, RPM and other types of vertical restrictions may be imposed.

Although the quality certification theories add considerably to our understanding of RPM, the welfare effects of such theories are still ambiguous at this stage. The theories, however, lend weight to the case for a new entrant exception to the per se ban on RPM. Benjamin Sharp,²⁸ in discussing the new entrant argument, invokes the concept of product life cycles in support of an exception for a limited period. "When a manufacturer first introduces a product, its consumer acceptance and reputation are poor; whereas the consumer acceptance and reputation of certain prestigious retailers may be very good."²⁹ However, "[o]nce a manufacturer's product acquires brand recognition and consumer acceptance — often through national advertising — the argument that RPM is needed to maintain a reputation is weak"³⁰.

It would also seem possible for a manufacturer to achieve a high-quality image for his product through vertical controls less restrictive than those inherent in RPM, e.g., a policy of selective distribution. The presence of both selective distribution and RPM may in some cases suggest that the manufacturer's adoption of RPM stems more from the demands of prestigious retailers wishing to be protected from intrabrand price competition than from any real desire on the part of the manufacturer to impose RPM.³¹

4. *The Outlets Hypothesis*

Another efficiency explanation for vertical RPM is the outlets hypothesis.³² This theory postulates that, under certain circumstances, manufacturers may have incentives to impose RPM when the total demand for their product is positively related to the density of retail distribution. Patricia Reagan explains

²⁷ Goldberg, *supra* note 22, at 741.

²⁸ Sharp, "Comments on Marvel: How Fair is Fair Trade?" 3 *Contemp. Pol'y Issues* 37 (Spring 1985).

²⁹ *Ibid.* at 40.

³⁰ *Ibid.* at 41.

³¹ For a fuller discussion of this point, see Goldberg, *supra* note 22, at 741-44.

³² For a discussion of the outlets hypothesis, see T. Overstreet, *supra* note 5, at 45-49.

how RPM in such circumstances can benefit manufacturers:³³

The theory is founded on the Hotelling principle that the full cost to consumers is the sum of the listed product price plus transportation costs constituted by the consumer's indirect cost of obtaining the product. Minimum resale prices establish distributors' profit margins and thereby establish the number of dealers that stock the product. If the increased availability sufficiently reduces consumers' transportation costs, the total amount sold increases and the manufacturer increases its profits.

Unlike the free rider theories discussed above, the outlets hypothesis does not explain RPM in terms of encouraging dealers to compete through the provision of services. Rather, an astute manufacturer will impose RPM when on balance the gains from obtaining additional outlets through RPM-induced subsidization of relatively high cost retailers more than offset any demand-reducing effects of higher prices associated with the protected resale margins. According to the theory, the increase in demand in response to additional outlets might allow the manufacturer to realize cost savings associated with economies of scale. This may lead to final consumer prices being lower under RPM than under competitive conditions. Even in instances where the manufacturer possesses significant market power and the effect of RPM is to raise final consumer prices, the net effect of the RPM will be to increase the quantity sold.³⁴

The fact that outlets motivated RPM may lead to increased sales of a producer's goods must be balanced against the decline in sales of substitutable but unprotected goods, which retailers will now be less likely to promote and may even refuse to carry. Competing producers may be forced to respond with restraints of their own, "creating the impression that distribution restraints are essential to successful marketing in that branch of the retail trade"³⁵. Even though traditional retailers are likely to benefit from this type of RPM, low-cost retailers will be prevented from capturing the gains that would be available to them in the absence of fixed prices and passing their lower distributions costs on to consumers. Unlike the special services or quality certification explanations of RPM, no additional services are generated by the imposition of RPM under the outlets hypothesis. In this respect, the outlets hypothesis is more akin to "a retailer cartel sponsored by a producer as a marketing device to serve its strategic interests"³⁶.

The outlets hypothesis was examined formally, in the context of an analytical model, in an article by Professors J.R. Gould and L.E. Preston published in England in 1965.³⁷ The publication date is significant because a year earlier the Resale Prices Act 1964 had been enacted in the United Kingdom. That Act prohibited vertical RPM but made provision for any supplier, or supplier's trade association, to apply to the Restrictive Practices Court for an exemption order for any class of goods. In *Re Chocolate and Sugar Confectionery*,³⁸

³³ Reagan, "Resale Price Maintenance: A Re-examination of the Outlets Hypothesis" 9 Res. L. & Econ. 1,3 (1986).

³⁴ T. Overstreet, *supra* note 5, at 48.

³⁵ Carstensen, "Legal and Economic Analysis of Distribution Restraints: A Search for Reality or Myth-making" in *Issues after a Century of Federal Competition Policy* 80, 90n.24 (R. Wills, J. Caswell & J. Cuthbertson eds. 1987).

³⁶ *Ibid.* at 91.

³⁷ Gould & Preston, "Resale Price Maintenance and Retail Outlets" 32 *Economica* 302 (1965). For a more recent study of the outlets hypothesis, see Reagan, *supra* note 33.

³⁸ (1967) L.R. 6 R.P. 338.

the first of only three cases to be argued before the Court, the chocolate and sugar confectionery industry invoked the outlets hypothesis. While the Court accepted the industry argument that, without RPM, supermarkets would cut the prices of the fastest moving lines, thereby undercutting traditional distributors with the result that as many as ten percent of retail outlets could be forced out, the Court believed that the number remaining would be adequate to meet demand. The Court also denied that higher prices would result, preferring the view that price competition would have the reverse effect. The economic logic of the Court's decision is hard to refute. In the absence of special public interest circumstances,³⁹ it seems unlikely that the outlets hypothesis would find favour with a competition authority.

III COLLUSION EXPLANATIONS FOR RPM

1. *Retailer Cartels*⁴⁰

The most popular, and historically the most important, explanatory hypothesis for RPM relates to the existence of retailer collusion.⁴¹ Traditional retailers, wanting to protect themselves against discounters and wanting to find a way to prevent destabilizing cheating from within their own group, combine to coerce manufacturers into the establishment of an RPM programme.⁴² The retailers use the manufacturer as a central body to enforce compliance with cartel prices. It is assumed that the retailers have sufficient market (monopsony) power to impose their will upon the manufacturer.

The result of such action is identical to that achieved by a horizontal price fixing agreement except that a vertical form masks the scheme. Using RPM in this form may be even more effective than if the retailers relied solely on agreements among themselves. Reliance on horizontal agreements allows new retailers to enter and undercut the cartel members. Because of the advantage of using vertical price fixing, it has been "theorized . . . that the motivation for resale price fixing often — perhaps usually or even almost always — comes from retailers"⁴³. Such a theory, however, has come under increasing attack by scholars who take a benign view of RPM.

One such scholar is Stanley Ornstein who has advanced a number of reasons why the likelihood of retail RPM cartels is remote.⁴⁴ It is instructive to examine Ornstein's arguments and to relate them to the New Zealand scene.

First, Ornstein believes that retail cartels, with or without RPM, are unlikely to occur because of the large number of rivals. In his view, agreement on price would be difficult without some means of organizing and the ability to discipline, such as through state licensing. While this argument has some general validity, it is considerably weakened in the New Zealand context where powerful trade associations have long been a feature of the commercial environment. In 1954 the Minister of Industries and Commerce said that trade associations operated virtual licensing systems in "a surprising number of cases"

³⁹ Such circumstances explain the Restrictive Practices Court upholding of RPM in *Net Book Agreement* (1962) L.R. 3 R.P. 198 and *Re Medicaments Reference* (No.2) (1970) L.R. 7 R.P. 267.

⁴⁰ For the sake of convenience, the term "retailer" will be used but the cartel theory under discussion is applicable to wholesalers as well.

⁴¹ T. Overstreet, *supra* note 5, at 13.

⁴² *Ibid.*

⁴³ L. Sullivan, *Handbook of the Law of Antitrust* 383 (1977).

⁴⁴ Ornstein, "Resale Price Maintenance and Cartels" 54 *Antitrust Bull.* 401 (1985).

and that many trade groups, “along with manufacturers either singly or in groups, operate a system of price control even more far-reaching than that operated by the government”⁴⁵. It is true that the more competitive climate of the last decade and strengthened trade practices legislation has made it more difficult for trade associations to impose and enforce restrictive trading practices on unwilling firms. Nevertheless, decisions of the Commerce Commission given under the Commerce Act 1975 provide examples of trade associations being able to command a high level of adherence to trade practices even where the industry membership is large in number.⁴⁶

The second reason that Ornstein advances for the improbability of retail RPM cartels is that the number of potential entrants is large. Ornstein believes that new entrants would be attracted as soon as prices rose above competitive levels. This argument assumes that retail cartels in non-licensed market sectors lack effective mechanisms to keep new entrants out. In New Zealand supplier and retail trade groups have used collective exclusive dealing agreements and other types of exclusionary practices to keep discounters from entering an industry. It should also be noted that import licensing and official price control may have had a depressing effect on the number of potential entrants in certain sectors of the retail trade. Ornstein’s statement that “only in product lines where entry is legally restricted, such as in state-licensed off-premise liquor stores, are retailer cartels a possibility”⁴⁷ is surely an exaggeration, even for United States conditions.⁴⁸ New Zealand experience does, however, suggest that retail RPM cartels are more likely to occur in market sectors which are licensed than those which are not.

Third, Ornstein suggests that, because retailer cartels reduce manufacturer sales there is “a strong incentive for manufacturers to destroy the cartel by forward integration into retailing, inducing others to enter, bringing a private antitrust suit, or by reporting the cartel to the government antitrust agencies”⁴⁹. Forward integration into retailing is often not a practical alternative for manufacturers, and, assuming the existence of barriers to entry, neither is inducing others to enter. In the New Zealand context, at least before the enactment of the Commerce Act 1986, manufacturers had little in the way of effective legal redress against a retailers’ cartel. The fact that the cartel coerces the manufacturer into imposing RPM implies that the retailers must have the necessary monopsony power to affect a significant portion of the manufacturer’s total sales. Particularly in the case of a licensed industry, the cartel may be successful in inducing RPM on all brands in a product class. If this is the case, a single manufacturer may have little option but to accede to the demands of the cartel.

The final reason Ornstein advances in support of his hypothesis is that⁵⁰

⁴⁵ Quoted in C. Westrate, *Portrait of a Modern Mixed Economy, New Zealand* 257 (1959).

⁴⁶ See, e.g., *Hotel Association of New Zealand*. Decision No.28 of the Commerce Commission, June 28, 1978, rev’d on appeal to the Administrative Division of the High Court (unreported decision of the Administrative Division of the High Court, Wellington, March 4, 1980, A 237/81 Davison C.J., and Addendum of April 2, 1981).

⁴⁷ Ornstein, *supra* note 28, at 412.

⁴⁸ For a discussion of RPM cartel behaviour in the United States, see, e.g., J. Palamountain, *The Politics of Distribution* (1948); Pitofsky, “In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing” 71 *Geo. L.J.* 1486 (1983); Parker, “The Baking Industry” 2 *Antitrust L. & Econ. Rev.* 111 (1969).

⁴⁹ Ornstein, *supra* note 44, at 413.

⁵⁰ *Ibid.*

[n]on-price competition will tend to dissipate the rents accruing from price-fixing, defeating the purpose of an RPM cartel. Accordingly, agreement to control non-price competition must generally be reached for a successful cartel, a difficult and costly process given the variety of non-price forms of competition possible.

While Ornstein's point about non-price competition dissipating cartel rents is logical it does not follow that this will be a sufficient deterrent to the formation of RPM cartels. Empirical evidence shows that such cartels may be long-lived even though profit levels may be low.⁵¹ To prevent new entry or non-members increasing their sales, RPM cartels may, through the devices of restrictive practices and/or legislation, be successful in securing some form of territorial protection for their members.⁵²

Ornstein concludes that the following requirements are needed for a successful retail RPM cartel: legal restrictions on entry, legal RPM, and legal control of non-price competition. While these conditions are conducive to RPM cartels, their absence does not rule out the possibility of a cartelistic function for RPM, even though the conduct may not involve a formal cartel coercing manufacturers into implementing RPM.⁵³

The outlawing of all forms of price-fixing under the Commerce Act 1986 makes it dangerous for retailer groups to enter into an agreement to impose price restraints or to exact such restraints from manufacturers. However, retailer-induced RPM can effectively occur in a number of ways that do not involve an agreement in the legal sense of that term.⁵⁴ Pressure from a single prestigious dealer may cause a manufacturer to initiate RPM,⁵⁵ even though,

⁵¹ For United Kingdom experience, see Hunter, "The Monopolies Commission and Price Fixing" 66 *Econ. J.* 587 (1956).

⁵² For a New Zealand example of a trade association of wholesalers exerting pressure on suppliers to impose locational and RPM requirements on distributors, see *Phillips and Pike*, decision No. 53 of the Commerce Commission, July 6, 1981.

For an extensive empirical analysis of proposed United States legislation to legitimize vertical restraints in the beer industry, which questions the alleged efficiency of the restraints and concludes that cartelistic and discriminatory functions probably better explain such restraints, see Carstensen and Dahlson, *supra* note 16.

⁵³ Several commentators have recognized this possibility. See, e.g., Bowman, *supra* note 5; Carstensen & Dahlson, *supra* note 16; Caves, "Vertical Restraints in Manufacturer-Distributor Relations: Incidence and Economic Effects" in *Antitrust and Regulation* 29, 42 (R. Grieson ed. 1986); Jones, Book Review, 99 *Harv. L. Rev.* 1986, 1994 (1986) (reviewing P. Areeda, *7 Antitrust Law: An Analysis of Antitrust Principles* (1986)); Sharp, *supra* note 28; L. Sullivan, *supra* note 43.

⁵⁴ Contemporary U.S. case law is replete with examples of retailer induced RPM falling short of an agreement on specific prices. See, e.g., *Burlington Coat Factory Warehouse Corp. v. Esprit de Corp.*, 769 F.2d 919 (2d Cir. 1985); *McCabe's Furniture, Inc. v. La-Z-Boy Chair Co.*, 798 F.2d 323 (8th Cir. 1986); *Gillette Tire Jobbers of Louisiana, Inc. v. Appliance Industries, Inc.*, 596 F. Supp. 1277 (E.D. La. 1984); *Garment District Inc. v. Belk Stores Services, Inc.*, 799 F.2d 965 (4th Cir. 1986); *Culberson, Inc. v. Interstate Electric Co.*, 821 F.2d 1092 (5th Cir. 1987); *Business Electronics Corp. v. Sharp Electronics Corp.*, 108 S. Ct. 1515, 99 L. Ed. 2d 808 (1988).

⁵⁵ This type of situation was alleged in *Direct Holdings Ltd. v. Feltex Furnishings of N.Z. Ltd.* (1986) 1 N.Z.B.L.C. para. 102,614, the first case to be decided under the RPM provisions of the Commerce Act 1986. *Direct Holdings Ltd.* (the plaintiff) was a furniture retailer offering goods at a substantial discount. One of its suppliers, *Feltex Furnishings Ltd.* (the supplier) changed the terms of trade as between the two companies, requiring that payment be made on a cash basis and adding a surcharge to its normal wholesale price. Previously it had supplied the retailer on credit and granted a discount from the wholesale price. The plaintiff alleged that the change in terms of trade had been introduced as a result of threats by a competitor to remove its custom from the supplier. The competitor denied the allegation. Interim injunctions were granted against both the supplier and the competitor to restore

in the absence of such pressure, the firm would prefer to distribute its products without a price restraint. The manufacturer may also succumb to pressures exerted independently by several independent dealers. Again, there is no agreement or cartel in legal terms. Even if there are no dealer complaints, the manufacturer may be fearful that the existence of price competition might cause some incumbent full-price retailers to refrain from handling its products. It is not enough for those who support a relaxation of the per se treatment of RPM simply to invoke formal cartel theory in dismissing the harmful effects of retailer-initiated RPM;⁵⁶ such conduct is commonplace⁵⁷ and, as yet, no theory adequately explains how countervailing efficiency considerations, if any, outweigh the anti-competitive effects of retailer-induced RPM.

2. *Manufacturer Cartels*

Manufacturers may impose RPM programmes to facilitate collusion.⁵⁸ If members of a manufacturers' cartel merely set uniform selling rates to buyers at the next level of distribution, there is always the temptation on the part of one or more cartel members (usually the more efficient) to offer secret discounts to resellers. Assuming that the price reductions pass through to consumers, this could affect market sales and shares of the cartel members. To prevent cheating of this sort, manufacturers can fix resale prices. Any deviation from the fixed resale prices would alert the cartel members to the possibility that one or more of their members was price shading or that the agreed resale prices were not being effectively enforced. Thus, it would be easy to detect possible cheating.

To avoid detection, it would be possible for a manufacturer to shade selling prices but to insist that his retailers maintain resale prices. It would be rational for a manufacturer to engage in such behaviour if it resulted in retailers increasing their purchases of the manufacturer's brand at the expense of other members' brands. However, the more retailers that the manufacturer has to negotiate with, the more likely that his discounting activities would become known to the trade generally. To prevent such discounting, the cartel may

supply on the same terms as other retailers, and to prevent action being taken in relation to the plaintiff's other suppliers.

⁵⁶ Yet this is precisely what the United States Supreme Court did in *Business Electronics Corp. v. Sharp Electronic Corp.*, 108 S. Ct. 1515, 99 L. Ed. 2d 808 (1988). The majority opinion written by Justice Scalia relied extensively on formal cartel theory in ruling that an agreement between a manufacturer and a dealer to terminate a competing dealer discounting from the manufacturer's suggested prices was not per se illegal because there was no explicit agreement between the parties to maintain resale prices at a particular level. It would have been more principled for the majority to have overruled *Dr Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the long-standing precedent establishing the per se illegality of RPM. The conduct of the parties in *Sharp* would arguably be illegal under the RPM, and possibly other, provisions of the Commerce Act 1986; this would clearly be the case if the manufacturer's suggested prices were construed as specified prices. See *Mikasa (N.S.W.) Pty. Ltd. v. Festival Stores* (1972) 127 C.L.R. 617; *Ron Hodgson (Holdings) Pty. Ltd. v. Westco Motors (Distributors) Pty. Ltd.* (1980) A.T.P.R. para. 40-143. For a comment on *Sharp* highlighting the mischief of dealer-initiated RPM, see "The Supreme Court, 1987 Term — Leading Cases" 102 Harv. L. Rev. 1297 (1988).

⁵⁷ On the basis of his own experience working in the Bureau of Competition at the Federal Trade Commission, Sharp estimates that at least 80 percent of RPM is dealer-initiated. Sharp, *supra* note 28, at 39.

⁵⁸ For a discussion of this topic, see T. Overstreet, *supra* note 5, at 19-24; Telser, *supra* note 3, at 96-105; Marvel & McCafferty, "The Welfare Effects of Resale Price Maintenance" 28 J. L. & Econ. 363, 365-69 (1985).

insist on a policy of exclusive dealing between individual manufacturers and their retailers. Under these conditions, a manufacturer would have little incentive to cut prices, unless higher retail margins, made possible by the secret price cuts, led retailers to push more aggressively the manufacturer's product, thus generating higher sales.

While economists have long recognized the manufacturer cartel theory of RPM, some recent commentators suggest that the use of RPM as a cartel facilitating device is both irrational and infrequent.⁵⁹ Judge Bork believes that RPM is not necessary to detect secret price cuts because such cuts will quickly be brought to the attention of other manufacturers by buyers hoping to gain matching or superior price concessions. Further, Bork believes that manufacturers imposing RPM for cartel purposes incur costs by not allowing efficient retailers to capture the gains that would be available to them in the absence of fixed prices. Ornstein endorses both these points and suggests that in the absence of other vertical restraints and complex agreements on both manufacturer and dealer sales, RPM is likely to be ineffective in reducing cheating. In Ornstein's view, the presence of RPM without elaborate restraints on non-price competition suggests that RPM exists to protect special services and not cartel prices. The suggestion that RPM by itself is neither necessary nor sufficient for an effective manufacturers' cartel leads Ornstein to the conclusion that the use of RPM to effect a manufacturers' cartel is only likely to occur infrequently. This conclusion is similar to Bork's. Bork believes that when RPM is used for this purpose it should be easy to detect.

One might conclude from Bork's and Ornstein's comments that collusive RPM by manufacturers is so unlikely as to be of no real policy concern. However, the New Zealand experience under the Trade Practices Act 1958 shows that the practice is not unknown in New Zealand. Two of the investigations referred to the Trade Practices Commission under the 1958 Act provide useful case studies to test the various hypotheses advanced by Bork and Ornstein.

(a) Phonographic Industry

The first of these investigations involved the phonographic record industry. The twelve manufacturers and importers of phonograph records, organized as the New Zealand Federation of the Phonographic Industry, agreed in 1957 upon uniform minimum prices at wholesale and retail and upon maximum mark-ups for retailers to apply to wholesale prices. Supplementary rules subsequently authorized lower retail prices on records that had been deleted from manufacturers' catalogues, forbade repayment of freight in mail order sales, and prohibited sale to record clubs. Loss of cut-out privileges and concerted withholding of supplies were the sanctions if retailers failed to comply. When the Examiner of Trade Practices challenged the scheme, the Federation applied to the Supreme Court for a declaratory judgment that the copyright laws expressly authorized the agreement and hence it was immune from inquiry by the Trade Practices Commission. In October, 1959, Mr Justice Haslam, while accepting that the method of computation of royalties laid down in section 25 (3) of the Copyright Act 1908 presupposed a pre-estimate of the ordinary retail selling price, rejected the contention that the provisions of the copyright legislation implied approval of group collaboration to ensure uniform

⁵⁹ See, e.g., Bork, *supra* note 10; Ornstein, *supra* note 44.

wholesale and retail prices.⁶⁰ Thereupon the Federation terminated the agreement. In December, 1959, it consented to an order by the Commission directing it not to renew the agreement or enter into any other of substantially the same kind.⁶¹

Phonographic Industry had all the hallmarks of a classic manufacturers' cartel utilizing RPM as a facilitating device. The cartel consisted of all the manufacturers of gramophone records in the industry, many of which were subsidiaries of the major overseas record companies. Because of import controls and copyright arrangements, there were substantial barriers to entry both at the manufacturing and master-distributor levels. The extensive controls over price and terms of sale at both the wholesale and retail levels were obviously designed to stabilize the market and act as a disincentive for any member to offer secret discounts. To guard against new forms of distribution undermining the status quo, sales to record clubs were prohibited and prepayment of freight in mail order sales was forbidden. As the arrangement was so visible, however, it was an obvious target of attack by the competition authority (the Examiner's Office) established by the then recently enacted Trade Practices Act 1958, thus lending support to Bork's contention that collusive RPM cartels are likely to be of short duration given effective enforcement of the antitrust laws.

To conclude, however, as Bork does, that easy detection of RPM cartels make them of little concern overlooks the fact that in a highly concentrated industry protected by substantial barriers to entry (typical of much of New Zealand industry) the termination of a formal agreement will often result in a tacit understanding on the part of industry members to pursue the same practices as prevailed under the formal arrangement. This may have happened in the New Zealand phonographic industry. Uniform prices continued to be the norm long after the agreements were terminated. Individual manufacturers openly engaged in RPM and retailers who discounted were threatened with industry supply cut-offs. Some limited price competition has occurred in more recent years. A partial explanation for the limited competition may be the strengthening of the law against RPM in 1975 and also the more competitive retailing conditions that emerged during the late 1970's. The structure of the New Zealand record industry and the basic conditions under which it operates, however, militates against widespread price competition. The determined discounter, however, will find it much easier to engage in price competition under the regime of the Commerce Act 1986 than under the largely ineffectual previous trade practices legislation.

(b) Hormone Weedkillers

The product involved in *Phonographic Industry* required very little in the way of special services; hence, control of non-price competition was not a problem for members of the Federation — no reference to non-price competition featured in the formal agreements.

Where special services, e.g., pre-sales promotion, are demand-enhancing, manufacturers who enter into a RPM cartel face the problem of members secretly inducing retailers to increase non-price or indirect competition beyond the level favoured by the cartel. Obviously, such cheating is more difficult

⁶⁰ See *His Master's Voice (N.Z.) Ltd. v. Simmons* [1960] N.Z.L.R. 25. Haslam J. found in favour of the Trade Practices Commission.

⁶¹ See N.Z. Gazette, Dec. 11, 1959, No. 77 at 1908.

to detect than price-cutting, and thus may pose a threat to the stability of the industry. Ornstein has suggested, in line with formal cartel theory, that RPM cartels which involve products requiring special services should be far less common than those not involving such services. He hypothesizes that when such cartels do occur, in the absence of elaborate restraints on non-price competition, manufacturers utilize RPM to protect special services and not cartel profits. Implicit in this argument is that cartel members perceive that industry-wide RPM is a more effective means of protecting special services than leaving it up to each individual member to decide whether or not to impose RPM.

A variation of this argument was canvassed in *Hormone Weedkillers*⁶² but the Trade Practices Commission roundly rejected it in favour of a policy of encouraging price competition:

It was submitted on behalf of the manufacturers, at great length and with infinite pains, that these services were both essential and costly. As to the need for these services, there was some cogent evidence from the Agriculture Department and farmer representatives that it was — to say the least — overdone. The Commission feels that the three main companies, and doubtless the others too, were quite genuine in their wish that their products should be understood and wisely sold to and applied by purchasers — and that wish was shared by all responsible distributors.

But what justification was all this for a collusive agreement to assure a fixed price? The Commission thinks — none whatever. It is quite apparent that much of the endeavour of the competing companies is to be simply put down to competition for sales and to 'servicing' of clients. The latter is particularly the concern of the stock and station agents who sell the great bulk of the substances. Hormone weedkiller preparations are 'tricky' substances for the uninitiated and inexperienced to use, but so are many other marketable products and the vendors — unless they have a monopoly — are obliged to explain and advise and generally support their product in competition with others engaged in the sale of like substances.⁶³

It is further argued — and it cannot be gainsaid — that there is vigorous competition between wholesalers and between distributors to sell their wares. But keen as that competition is, it does not intrude into the sacrosanct field of prices, which after all is the aspect of competition which the public wants and the law is designed to bring about.⁶⁴

3. Other Uses of RPM by Manufacturers

In addition to the use of RPM as a means of policing a horizontal price agreement among manufacturers, RPM can be used to co-ordinate oligopolistic behaviour. Price competition in retailing can be an independent source of instability in the individual market shares of a group of oligopolistic suppliers. Retail price competition can destabilize prices at the supplier level, causing competition at that level to be more frequent and intense than otherwise. Thus, it is in the interests of suppliers, proceeding collusively or oligopolistically, to suppress price competition at the retail level. The frequent instances of oil refining companies engaging in RPM are arguably explained on this basis. If this is the case, any relaxation of the per se rule, would only make it more difficult for independently-owned retail outlets to engage in price competition.⁶⁵

⁶² *Re the Pricing and Marketing of Hormone Weedkiller Preparations*. Decision No. 19 of the Trade Practices Commission, February 1, 1965, aff'd by the Trade Practices Appeal Authority, Oct. 2, 1965.

⁶³ *Ibid.* at paras. 37-38 of the Commission's Decision.

⁶⁴ *Ibid.* at para. 41.

⁶⁵ Oil refining companies have featured prominently in Australian RPM litigation. See, e.g., *Commissioner of Trade Practices v. Caltex Oil (Aust.) Pty. Ltd.*, (1977) 4 A.L.R. 133; *T.P.C. v. Mobil Oil Australia Ltd.*, (1984) A.T.P.R. para. 40-482; (1985) A.T.P.R. para. 40-503;

RPM may also feature in more complex marketing arrangements designed to induce dealer loyalty and minimize the threat of new entry. Professor Basil Yamey has explained this strategy as follows:⁶⁶

Individual manufacturers and groups of manufacturers frequently attempt to attach their customers more firmly to themselves as sources of supply. To the extent that the attempts are successful the firms are assured of a more steady demand for their output, and this may enable them to reduce production and certain marketing costs. In addition it insulates the firms against the competition of less favourably placed competitors and of potential competitors; for these rivals either have to be satisfied with the possibly limited market of the unattached customers, or they have to try to dislodge some of the attached ones from their sources of supply. This may be a costly operation with uncertain results.

The introduction of RPM is merely one way in which some tangible benefit may be conferred upon distributors. Often RPM will be accompanied by exclusive dealing and/or a policy of selective distribution. In a small economy like New Zealand's, the use of RPM and other types of vertical restrictions in the manner described is likely to be more harmful than in a large open economy.⁶⁷

IV RELEVANCE OF ECONOMIC ANALYSIS FOR NEW ZEALAND PUBLIC POLICY

The economic analysis of RPM reveals a range of anti-competitive and pro-competitive explanations for the practice.⁶⁸ While scholars recognize the possibility that RPM can have one or more of a number of functions, they dispute the relative probability of the practice being either efficiency-enhancing or anti-competitive — either in individual cases or on balance.

The new learning on RPM has important implications for antitrust policy.⁶⁹ But, as with other areas of antitrust, New Zealand policymakers should exercise caution in applying the new learning to New Zealand conditions. As the case studies discussed above show, the risks of RPM being used for a cartelistic or strategic function at either or both the manufacturer or retailer levels of distribution are significant. The New Zealand decision to make the practice

T.P.C. v. Golden Fleece Petroleum (1985) A.T.P.R. para. 40-528; *T.P.C. v. B.P. Australia Ltd.* (1985) A.T.P.R. para. 40-638; (1986) A.T.P.R. para. 40-701

⁶⁶ B. Yamey, *supra* note 2, at 19. More recently, similar ideas to Yamey's have been developed in the economic and legal literature on strategic behaviour, i.e. conduct that is profit-maximising because of its effects on rivals rather than its social efficiency. See, e.g., M. Porter, *Competitive Advantage* (1985); A. Jacquemin, *The New Industrial Organization: Market Forces and Strategic Behavior* (1987); Kattenmaker & Salop, "Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price" 96 *Yale L.J.* 209 (1986).

⁶⁷ See generally Shefer, "Guidelines for Legislation on Monopolies and Restrictive Practices in Small Economies" 15 *Antitrust Bull.* 781 (1970).

⁶⁸ While I have canvassed the leading pro-competitive theories for RPM, commentators have advanced additional theories to explain RPM in specific markets. See, e.g., R. Fabricant, *Resale Price Maintenance and the California Wine Industry* (University of Washington Ph.D. economics dissertation, 1987) (providing point of sale information to generate repeat wine sales); A. McLaughlin, *An Economic Analysis of Resale Price Maintenance* (U.C.L.A., Ph.D. economics dissertation, 1979) (avoiding opportunism in the selling of unpasteurized beer); Springer & Frech, "Detecting Fraud: The Role of Resale Price Maintenance" 59 *J. Bus.* 433 (1986) (preventing the switching of different qualities of shirts).

⁶⁹ For an exposition of the new learning in the context of Australian vertical restraint law, see Hanks & Williams, "The Treatment of Vertical Restraints under the Australian Trade Practices Act" 15 *Aust. Bus. L. Rev.* 147 (1987).

illegal per se has been strongly influenced by the prevalence of retailer-induced RPM and oligopolistic pricing at the manufacturing level. There are a number of reasons for the historical prevalence of cartelistic behaviour in New Zealand. These include the absence of effective trade practices legislation, the large number of trade associations, the high concentration ratios in many industries, the homogeneous nature of the New Zealand population, the cultural concept of "mateship", the rigidity of prices arising from official price control and the existence of high tariffs and import controls. With the advent of the Commerce Act 1986 with its per se bans on horizontal and vertical price fixing and the emergence of a more competitive environment, cartelistic behaviour is less likely to occur.

Nevertheless, at a time when the New Zealand government is pursuing vigorous pro-competitive policies, it would be premature for the legislature to weaken the per se ban on RPM. This is particularly so as the new theories on RPM are still controversial. Recent scholarship questions the validity of efficiency claims as real additions to welfare and is reassessing the Chicago School analysis of RPM.⁷⁰ What may be privately beneficial need not necessarily be beneficial from a welfare point of view.⁷¹ There is still relatively little empirical evidence that sheds light on RPM's net impact on consumer welfare.⁷² Given our current knowledge of RPM, I would suggest that the most appropriate legal standard in the New Zealand context is the current per se rule modified, however, by a new firm or product exception. The authorisation provisions contained in the Commerce Act 1986 could be amended to allow for an exemption for a limited period of time.

⁷⁰ See generally the Contemp. Pol'y Issues symposium papers, supra note 5.

⁷¹ See Rey & Tirole, "The Logic of Vertical Restraints" 76 Am. Econ. Rev. 921 (1986).

⁷² Most of the empirical evidence is in the form of case studies. For a recent collection of such studies, see *Impact Evaluations of Federal Trade Commission Vertical Restraint Cases* (R. Lafferty, R. Lande & J. Kirkwood, eds. 1984). See also Schneider, "Comment: A Functional Rule-of-Reason Analysis for Resale Price Maintenance and its Application to *Spray-Rite v. Monsanto*" 1984 Wis. L. Rev. 1205 (1984); Ornstein & Hanssens, "Resale Price Maintenance: Output Increasing or Restricting? The Case of Distilled Spirits in the United States" 36 J. Indus. Econ. 1 (1987).