A GENERAL PROHIBITION OF TRADING RESTRICTIONS

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The recent High Court decision in *Quadramain Pty. Ltd.* v. *Sevastapol Investments Pty. Ltd.*[1] has been received with considerable disappointment and criticism. Not only has the High Court moved away from an apparently flexible development of the common law rules on restraint of trade[2] but in addition Australia's most recent attempt at flexible statutory regulation of restrictive trading practices has foundered on a judicial method of narrow and cautious statutory interpretation. The High Court has carried directly into s. 45 of the Trade Practices Act, 1974 (Cth), all the technical limitations of the doctrine of restraint of trade at common law.[3]

Section 45 as finally enacted contains prohibitions of contracts, arrangements and understandings "in restraint of trade or commerce" but does not attempt further to define "restraint of trade". With the benefit of hindsight it is arguable that the draftsman of the Trade Practices Bill, 1973, took a wiser approach by combining the general expression, "restraint of trade" in Clause 45(1) with a list (derived from s. 35(2) of the Restrictive Trade Practices Act, 1971) of particular restrictions

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[1] (1975-6) 8 A.L.R. 555; (1976) 50 A.L.J.R. 475. See J. D. Heydon, "Restraint of Trade in the High Court" (1976) 50 *A.L.J.* 475.

[2] *Queensland Co-operative Milling Association Limited* v. *Pamag Pty. Limited* (1973) 1 A.L.R. 47, *per* Menzies and Walsh, JJ.; *Buckley* v. *Tutty* (1971) 125 C.L.R. 353.

[3] W. M. C. Gummow, "Conveyancing Aspects of the Trade Practices Act", *Conveyancing IV*, 1976, Committee for Post-Graduate Studies in the Department of Law, University of Sydney.

in Clause 45(3)[4] which were expressed not to limit the general expression. The list was criticised at the time as creating a technical statute around which lawyers would attempt to draft restrictive arrangements, as had been the case under the 1965 Act and under the U.K. Act. The critics suggested that by using only the general phrase "restraint of trade" the law would be flexible and the Courts would apply the substance of the prohibition in a commercially realistic manner. If it had been interpreting "restraint of trade" in the original Clause 45(3), the High Court may well not have held it to embrace the limitations of the doctrine because that interpretation may not have been consistent with the restrictions covered by the list. Those restrictions appear to include a number not within the traditional common law doctrine.

Some writers[5] predicted that the High Court would be guided by the common law meaning of "restraint of trade". Others argued that the meaning of "restraint of trade" could be gleaned from the Act alone[6] and that there was some risk in looking at the common law because many cases turned on the limits of the doctrine of restraint of trade rather than on the meaning of the phrase.[7] But no writer anticipated that the Court would go beyond seeking the definition of the phrase

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[4] *Clause* 45 (3) of the Trade Practices Bill 1973 provided:—

For the purposes of this Act, a contract, combination or conspiracy in restraint of trade or commerce includes, but is not limited to, a contract, combination or conspiracy that has the purpose or effect of—

(a) fixing, controlling or maintaining the price for any goods or services supplied or acquired by the parties to the contract, or by the persons who are engaging in or are the parties to the combination or conspiracy, or by any of them, to or from persons not being parties to the contract or not engaging in or being parties to the combination of conspiracy;

(b) limiting or discontinuing—

(i) the production manufacture or mining of any goods by the parties to the contract, or by the persons who are engaging in or are the parties to the combination or conspiracy, or by any of them; or

(ii) the supply or acquisition of any goods or services by the parties to the contract, or by the persons who are engaging in or are the parties to the combination or conspiracy, or by any of them, to or from persons not being parties to the contract or not engaging in or being parties to the combination or conspiracy;

(c) allocating or dividing customers, territories, acquisitions, sales or markets, whether on a geographical or other basis, for any goods or services; or

(d) restricting the persons or classes of persons who may be dealt with, or the circumstances in which, or the conditions subject to which, persons or classes of persons may be dealt with.

[5] J. D. Heydon, "The Trade Practices Act, 1974: Section 45: Agreements in Restraint of Trade" (1975) 3 *A. Bus. L. Rev.* 262; G. G. Masterman, "Section 45: contracts in restraint of trade". *Commercial Law Association Proceedings on the Trade Practices Act.* Sydney, 1974, p. 18.

[6] G. J. Samuel, "Contracts in Restraint of Trade", *Monash Trade Practices Lectures,* 1975.

[7] H. M. S. Schreiber, "Trade Practices Act, 1974: A Survey of Part IV" unpublished paper presented to Australian Law Convention, 1975.

"restraint of trade" and limit that phrase according to the limits imposed on the doctrine of restraint of trade under common law.

It is worth pausing over this result if only as a case study in statutory interpretation. The result may be corrected by Parliament, but the fact that it has occurred suggests that a conservative attitude about the High Court's basic approach to the Act should be adopted.

The High Court is not alone in approaching the interpretation of the phrase "restraint of trade" as a term of art taken from the common law. In early Sherman Act cases the same issue presented itself to the U.S. Courts. Peckham, J. in *U.S.* v. *Trans-Missouri Freight Association*[8] rejected the argument that "restraint of trade" in s. 1 of the Sherman Act should be confined by reference to the common law meaning of the phrase. Section 1, because of its unlimited wording, should be read as prohibiting "every" restraint of trade with no exceptions. He retreated from that view in *U.S.* v. *Joint Traffic Association*[9] and began the development of what was, twelve years later, to become the "Rule of Reason". However, he did so partly by developing the concept of "direct and immediate restraint on commerce" (compared with indirect restraints) and partly by accepting that some restraints valid at common law were not covered by s. 1. In the same year Taft, J. in *U.S.* v. *Addyston Pipe & Steel Co.*[10] also considered that restraints which the common law held valid should be excluded from s. 1 of the Sherman Act. It was however, a quite different view of the common law which Taft, J. had in mind. He saw the common law as invalidating all restraints except for five valid restraints: (1) seller of business or property not to compete with buyer in derogation from sale; (2) buyer not to compete with seller; (3) partner not to compete with his firm; (4) retiring partner not to compete with his firm; (5) employee not to compete after service. Even then, such restraints were only valid if additional criteria of reasonable protection were satisfied. In the *Standard Oil Company of New Jersey* v. *U.S.*[11] White, C.J. led the majority in his "Rule of Reason" which was necessary because of the breadth of s. 1 but which derived from the common law. The test held s. 1 to apply only to restraints which unduly restrained competition.

The High Court in *Quadramain* echoes the early U.S. experience but it can be argued that the Court was mistaken in doing so. Section 1 of the Sherman Act was the model of brevity and appeared in a short Act which contained only one other substantive prohibition, namely s. 2, against monopoly. It could never be said of the Trade Practices Act,

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[8] (1897) 166 U.S. 290.

[9] (1898) 171 U.S. 505.

[10] (1898) 85 Fed. 271, Circuit Court of Appeals.

[11] (1911) 221 U.S. 1.

1974 (Cth) that "the act has a generality and adaptability comparable to that found to be desirable in constitutional provisions".[12]

First, s. 51 establishes a long list of exemptions which excludes from Part IV of the Act more restraints than those excluded by Taft, J. from the Sherman Act.

Second, ss. 46-50 deal in specific terms with a number of business practices which are made illegal according to particular tests established in the sections. Those sections do not pose the dilemma that would be posed by imprecise wording without any express gateway. Section 45, prohibiting "restraints of trade", does not define that term but makes it clear that not all contracts or arrangements are unlawful restraints, only those meeting certain anti-competitive criteria specified in s. 45(3) and (4).

Finally, Part VII of the Act sets up a system for authorising otherwise unlawful practices where public benefit can be demonstrated.

In view of that legislative structure it is surprising to find Gibbs, J. in *Quadramain* saying (admittedly in *obiter dicta*) that

> . . . it was submitted that Section 45 of the Act applies to any covenant in restraint of trade, even to a reasonable restraint. If that is so, the section, if valid, would have the drastic result that a contract to which the section applies will be invalid even though it is demonstrably reasonable both in the interests of the parties and in the interests of the public.[13]

It should be observed that a remedy for the drastic effects of the Act is provided in s. 87(3) which allows the Court to remake contracts and adjust rights that pre-date the Act.

The majority of the High Court did not even analyse whether the common law was intended to govern. They went much further however and made observations equating the phrase "restraint of trade" with "that which falls within the doctrine of restraint of trade at common law".[14] The majority then chose the test of the majority of the House of Lords in *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.*[15] namely that the doctrine applies only where a person cuts down some existing freedom and does not apply where he gains some new right to trade even though in a restricted form. In particular, restrictions on lessees and *Tulk* v. *Moxhay*[16] covenants are outside the ambit of the doctrine and hence outside s. 45. The decision suggests that the legislature intended merely to replace the common law test of "reasonableness in the parties' interests and for the public benefit", with the competitive

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[12] *Per* Hughes, C.J. speaking of s. 1 Sherman Act in *Appalachian Coals, Inc.* v. *U.S.* (1933) 288 U.S. 344.

[13] (1975-6) 8 A.L.R. 555 at 564; (1976) 50 A.L.J.R. 475 at 480; *c.f.* the unreported judgment of Wootten, J. in *Hollywood Premiere Sales Pty. Ltd.* v. *Faberge Australia Pty. Ltd.*, 27th August, 1976, N.S.W. Supreme Court.

[14] (1975-6) 8 A.L.R. 555 *per* Barwick, C.J., at 557; *per* McTiernan, J., at 559; and *per* Gibbs, J., at 562-564 (Mason, J. agreeing on this point).

[15] [1968] A.C. 269.

[16] (1848) 2 Ph. 774.

impact tests in ss. 45(3) and (4), always subject to administrative determination of the public benefit test in the authorisation process. This is a strange view to take of a comprehensive law which makes a frontal assault on a broad range of restrictive and unfair practices.

This decision seems quite inconsistent with the rest of the Act and with s. 47 in particular. Section 47 strikes, amongst other things, tying arrangements or exclusive dealing arrangements whereby a person is supplied with a product "on the condition, or subject to a contract, arrangement or understanding", that he not deal with competitors of the supplier or is limited in dealing with them. Thus, if a trader in petrol or beer receives supplies from the manufacturer on condition that he not trade with other people, s. 47 subjects that conduct to its own anti-competitive test (s. 47(5)) and prohibits the conduct if competition is likely to be substantially lessened as a result of the conduct. It would be a forced construction indeed of s. 47 if it were held not to apply when a supplier supplies goods to a person and the condition limiting the recipient as to dealing with competitors of the supplier was contained in a lease or licence or even in a restrictive covenant on the land. The conduct of supplying on condition or subject to an understanding has taken place, regardless of where the condition is to be found. It is clear that tying arrangements are intended to be scrutinised under the Trade Practices Act, but according to the test in s. 47(5) rather than the narrower test in s. 45(4). To say, as do some members of the High Court, that tied leases are clear cases where the doctrine does not apply and that therefore s. 45 may be interpreted in light of the validity of such restrictions, simply fails to take s. 47 into account. Tied leases are not to be valid if anti-competitive in the sense described in s. 47(5).

Of course, the High Court could go the full distance and reject the argument that s. 47 applies where the restriction is contained in the lease (or other proprietary document or perhaps even in a memorandum and articles of association). It could say that the goods are simply "supplied" unconditionally and that the existence of restrictions elsewhere is not relevant. In commercial terms, these propositions are unrealistic because the purchaser is effectively tied regardless of where the condition is found. Yet as a result of the decision in *Quadramain* such propositions are becoming the basis of legal advice.

If *Quadramain* remains, the Act will be substantially narrowed. The Trade Practices Commission in its Second Annual Report saw *Quadramain* as an "enormous derogation" from the principle underlying the Act. The Trade Practices Review Committee fully agreed that the High Court had taken an "unduly legalistic approach to the interpretation of this economic legislation".[17] The Committee recommends that Parliament start again, making no reference to "restraint of trade".

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[17] Trade Practices Review Committee, *Report to the Minister for Business and Consumer Affairs*, August 1976, p. 15.

The Proposed General Statute

The Committee recommended that a return should not be made to the "list" method, as in the 1973 Bill, and specifically (even if reluctantly) rejected all proposals for an exhaustive list of prohibitions. Some particular matters should be specially treated, namely price agreements, joint ventures, aspects of commercial leases, multi-level buying groups and collective boycotts, with tests of legality and rights to seek authorisation varying from case to case. For all other restrictions there is proposed a general prohibition upon:—

> an agreement which prevents or restricts or is likely to prevent or restrict, the engaging in of competitive conduct by all or any of the parties to the agreement, whether among themselves or with other persons, where that agreement has, or is likely to have, a substantial adverse effect on competition in the market or markets in which any of the parties to the agreement operate or, but for the existence of the agreement, would or would be likely to operate.[18]

The Committee indicated that it was attempting to bring a degree of certainty to this area of the law, while recognising the need for generality. But does the attempt impose inappropriate limits on the general prohibition, and does it only appear to achieve certainty?

The proposal, although stated generally, sets definite limits for the new s. 45 in two principal respects:—[19]

(a) An agreement is only within the prohibition if it restricts the conduct of any of the parties. This imposes two important limits. It excludes from the ambit of the proposed section those covenants that run with the land where one or both original parties have transferred their interests and there is no longer privity of contract. This was an important point in *Quadramain*. The Committee's recommendation is contradictory, since at paragraph 4.40 of the Report it has recommended that a covenant be covered regardless of whether or not it has run with land. The limitation also excludes third party restrictions such as those in *Buckley* v. *Tutty*,[20] and *Nagle* v. *Feilden*.[21] Thus if an agreement restricts the competitive activity of other persons it would not be touched by the proposal. The Committee gives no reasons for excluding non-party restrictions.

(b) Illegality only occurs when the anti-competitive effect is felt in markets where the parties operate or would otherwise operate. Thus if the restriction damages persons in other markets it would not be

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[18] *Ibid.* para. 4.118.

[19] Another limit which may have been an oversight is the reference to "the market or markets". This could imply that it only applies where a party or parties compete in a single market. It should read "a market . . . ." Further, the Committee presumably intends "agreement" to be expanded to include "arrangements and understandings."

[20] (1971) 125 C.L.R. 353.

[21] [1966] 2 Q.B. 633.

caught under the proposed new section. The Committee may have been prepared to accept this second limitation because it believed that damage in other markets has been predominantly caused by collective boycotts. Special treatment is recommended for collective boycotts in paragraph 4.116 of the Report. However, the proposed regulation of them selects a "parties" test of anti-competitive impact which again would not provide a remedy where the damage was felt in a market where none of the parties compete.

The need to limit the general prohibition may be due to the proposed method of regulating vertical practices. In place of the present clearance and authorisation procedures for s. 47 conduct under ss. 93 and 88(6) respectively, a new registration procedure is proposed. The new system will confer immediate legality on the registering party. This can only be upset if the Commission establishes that the vertical restriction has a substantial adverse effect on competition and produces no public benefit. Therefore vertical restraints of the type covered by the proposed s. 47 are much more favourably treated than those restrictions covered by the general prohibition. The Committee probably felt that it should therefore seek to limit the restrictive agreements to which immediate illegality attached under s. 45, if vertical restrictions were granted immediate legality by registration.

However, this only explains why the limitations are imposed. It does not justify their imposition. It is suggested that the proposed limitations have such an important narrowing effect on the general section that they should not be imposed unless they produce a high degree of certainty.

Does the Committee's proposal produce real or only apparent certainty? The first point to note is that the proposal only creates certainty with respect to the markets to be examined and the parties to be affected by a restrictive agreement. There is no certainty for the type of agreements to be covered; the Committee considered that the attempt to achieve that degree of certainty would unacceptably limit the scope of the Act. As to market certainty, the writer suggests that the Committee's proposal does not confer any greater degree of certainty than if there was no specific limit. Persons engaging in restrictive agreements are usually aware of the markets affected by an agreement even if they do not operate in those markets. The test of illegality would always be stated in terms of a "likely" effect and thus commercial likelihood would create its own limitations upon the markets to be examined to determine legality, without needing to rely on any statutory language. As to certainty of parties, the same comments apply.

With these observations in mind, the following concise general prohibition to replace the existing s. 45 is suggested by the writer.

45. (1) In this Act "arrangement restricting competition" means any contract, term in a contract, covenant, arrangement or understanding that is likely to prevent or restrict competitive

conduct and to have a substantial adverse effect on competition in a market for goods or services.

(2) An arrangement restricting competition which but for this subsection would be enforceable shall be unenforceable in so far as it confers rights or benefits or imposes duties or obligations on a corporation whether the arrangement was entered into before or after the commencement of this subsection.

(3) A corporation shall not be party to or involved in an arrangement restricting competition whether the arrangement was entered into before or after the commencement of this subsection.

The following points should be noted concerning this draft.

(a) The deletion of references to parties excludes both major limitations imposed by the Committee.

(b) By prescribing a market test rather than a test concentrating on competition affecting the parties, the facts in *Buckley* v. *Tutty* and *Nagle* v. *Feilden* themselves may or may not be covered. However the draft preserves an opportunity for striking down serious abuses constituted by agreements which affect the competitive position of non-parties and thereby substantially adversely affect competition in a market.

(c) The draft specifically includes a covenant in the definition of "arrangements". It also may be appropriate to include in s. 4 of the Act a definition of "covenant" specifically including covenants running with land which have their impact as non-contractual rights and obligations.

(d) The difficult proviso at the beginning of sub-section (2) of the draft is necessary because not all "arrangements" as defined could be enforced.

(e) Sub-sections (2) and (3) of the draft preserve the constitutional option of ss. 45(1) and (2) of the present Act.

(f) Concerning severance it is suggested that the draft adequately ensures that only those provisions of the contract which are restrictive will be unlawful. However, a cautious draftsman would add an additional sub-section preserving the common law rules of severance in a case where a contract contains a term which restricts competition.

(g) Matters such as those technical ancillary aspects in the present ss. 45(5)-(8) would still need to be covered.

Special Treatment

The Committee's Report recommends special treatment for the following three classes of restriction on competition.

1. Pricing.
2. Collective boycotts.
3. Commercial leases (three aspects).

In the writer's opinion, the Act, despite *Quadramain*, should make yet another attempt at flexible generality without special treatment of particular cases unless absolutely necessary. The statute must remain an economic statute and Australian lawyers must resist the temptation to turn it into lawyers' law.

1. Pricing.

Price fixing agreements must be prohibited absolutely. However, rather than dealing with pricing matters in the general prohibition section, any special substantive cover of pricing agreements or arrangements should be set out in a separate section, possibly using the space that would be vacated by the recommended repeal of s. 49. In terms of substantive provisions the Committee's recommendations only require a continuation of the absolute prohibition of arrangements fixing or controlling prices of competing suppliers[22] together with a proviso allowing joint advertising of selling prices by buying groups[23] to be subject to a market test. All other recommendations in the Report as to pricing could then fall into the general s. 45[24] with special authorisation provisions being necessary for joint and recommended pricing.[25]

2. Collective boycotts.

Special treatment for collective boycotts as suggested in paragraph 4.116 of the Report, seems unnecessary. A boycott which is powerful enough to close off market outlets or sources of supply such that a person cannot operate, must involve virtually all significant market participants or suppliers. In that case a Court would be likely to find a substantial adverse effect on competition in the whole market in that the market was able to close ranks against the source of effective competitive behaviour. The fact that this action removed only a small competitor is considered unlikely to negate the conclusion that the action represents a substantial adverse effect on competition in the market. Whenever threatened the market can protect itself. If it is believed that a Court would come to an opposite view then it must also follow, under the proposed "parties" test, that the departure of a small competitor would not be held to be an unlawful result. It would not have a substantial adverse effect on competition between the parties to the restriction or on competition faced by them from other persons (i.e. the general body of the competitors in the market). In other words, the "parties" test of anti-competitiveness that is proposed, seems unlikely to provide any better remedy for the victims of the boycott than a market test.

A market test would be more flexible and would cover significant abuses.

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[22] *Supra* n. 17 para. 4.59.

[23] *Id.* para. 4.85.

[24] *Id.* paras. 4.82 and 4.83 as to joint acquisition.

[25] *Id.* para. 4.65 (multi-level buying and selling groups); 4.61, 4.69, 4.70 ("true" recommended price agreements); 4.63, 4.81 (joint venture pricing).

3. Commercial leases.

The Committee selected[26] three aspects of commercial leases for scrutiny under a "parties" test of anti-competitive impact rather than under the market test. The particular restrictions are:—

(i) restrictions as to the commercial use to which the land can be put;

(ii) restrictions on advertising by the lessee;

(iii) restrictions relating to Merchants Association membership and rules.

In the writer's view there is insufficient justification for creating a special class for these restrictions. They should simply be subject to the general market test.

(i) *Use restrictions.* Presumably the Committee has in mind the restrictions imposed on a lessee as to the use of the land; it appears not to be including restrictions often imposed by a major tenant which secures clauses in its lease controlling the landlord in leasing nearby or adjacent premises to other tenants who may be competitors of the major tenant. If so, then it should be noted that even the Commission has accepted the need for a landlord to be able to specify use to a tenant.[27] In a large shopping centre the mix of shops is important both for the landlord's return and for the lessee's. Also, in a small, say, two shop building, the small landlord is anxious that his two tenants remain commercially viable and therefore would not want them competing with each other. A "parties" test of anti-competitive impact seems misconceived for these restrictions because it almost always strikes them down.

(ii) *Advertising Restrictions.* In most planned shopping centres the power of the lessor to control the mix of shops makes any control over advertising within a shop of relatively minor importance, even between parties. Total prohibitions on common area advertising are considered by the Commission to be justified because there can be no discriminatory treatment of tenants.[28] In main road suburban shops it is suggested that unreasonable restrictions on advertising are less likely to occur because the tenant, if facing a nearby competitor, will usually find his landlord equally concerned about the tenant's ability to compete with neighbouring premises which the landlord does not own.

(iii) *Merchants' Association Rules* would not normally be struck down by a "parties" test when properly analysed, even though the Commission says they are:—

(a) *Levies*:—Even if levies are discriminatory they seldom discriminate within a class of tenants and furthermore any variation is unlikely to be a significant factor in competition.

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[26] *Supra* n. 17 para. 4.45.

[27] "Guidelines Relating to Commercial Leases and 'Shopping Centre' Leases", para. 5.5, *Information Circular No.* 7, Trade Practices Commission, 12 May, 1975.

[28] *Id.* para. 6.2 of the Guidelines is virtually a total prohibition.

(b) *Voting Rights*:—The only rules which appear to raise a problem are those conferring the voting rights on the members of the Merchants' Association. Large tenants may be favoured over small tenants, producing fear of anti-competitive discrimination against small tenants if they operate in the same market as the large tenants. It is feared that small tenants will not be able to mobilise against decisions of the Association such as to spend funds for the benefit of the large tenants only, or to control use by some or all tenants of their premises.

Two responses can be made. First, the developer who is concerned with the profitability of the whole complex usually retains substantial power in an Association. Second, the Committee is prepared to accept a market test for other commercial lease restrictions such as a restriction by a large tenant upon the developer controlling leasing of space to a competitor of that large tenant. The latter restriction would be of equal concern for a small tenant wishing to expand as would be the possible discriminatory abuse of the voting formula. There appears no convincing need for voting rules to be specially treated.

For these reasons it is urged that there is insufficient justification for special treatment of collective boycotts and the three noted aspects of commercial leases. The benefits of uniform law far outweigh the marginal benefits of a "parties" test in those cases. A market test would be adequate to control serious abuses.

Conclusion

There is an urgent need for Parliament to amend the general prohibition of trading restrictions and to prevent a repetition of *Quadramain*. The proposals of the Review Committee may, however, lead the law back into a limited and technical approach to regulation. A flexible general section that is readily understood but which does not impede commercial activity must be developed.