THE MONOPOLIES AND MERGERS COMMISSION

Full-Line Forcing and Tie-In Sales

A Report on the Practice of Requiring any Person to whom Goods or Services are Supplied to acquire Other Goods or Services as a Condition of that Supply

Presented to Parliament in pursuance of Section 83 of the Fair Trading Act 1973

Ordered by The House of Commons *to be printed*
19 March 1981

LONDON
HER MAJESTY'S STATIONERY OFFICE

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CHAPTER 1

Introduction

1.1. On 17 April 1979 the Secretary of State sent the following reference to the Commission:

FAIR TRADING ACT 1973

FULL-LINE FORCING AND TIE-IN SALES

The Secretary of State in exercise of his powers under section 78(1) of the Fair Trading Act 1973 hereby requires the Monopolies and Mergers Commission to submit to him a report on the general effect on the public interest of the following practice, which appears to him to be a practice within section 78(1)(*b*), that is to say, the practice of requiring any person or class of persons to whom goods or services of any description are supplied to acquire other goods or services as a condition of that supply: provided that the Commission shall not consider for the purposes of their report—

(*a*) any supply of goods or services to or for export from the United Kingdom;

(*b*) any condition solely relating to the quantity supplied.

In this reference the above practice includes making the supply of goods or services available at prices or upon terms as to credit, discount or otherwise which are so disadvantageous as to be likely to deter that person or class of persons from acquiring those goods or services without acquiring other goods or services.

(*Signed*) D N Byrne

An Under Secretary of the Department of Prices & Consumer Protection

Dated this 17th day of April 1979

1.2. On 25 April 1979 the Chairman of the Commission, acting under section 4 of the Fair Trading Act 1973 and paragraph 10(1)(*b*) of Schedule 3 thereto, directed that the functions of the Commission should be discharged through the group of members indicated in the preface to this report.*

1.3. Section 78 (1) of the Fair Trading Act 1973 empowers the Secretary of State to require the Commission to submit to him a report on the general effect on the public interest of 'any specified practices which appear to him to be uncompetitive practices'. Uncompetitive practices are defined in section 137 as 'having the effect of preventing, restricting or distorting competition in connection with any commercial activities in the United Kingdom'.

* Professor H Street was appointed a member of the group, but ceased to be a member of the Commission on 31 May 1980.

Origin of the reference

1.4. The Green Paper, 'A Review of Restrictive Trade Practices Policy' (Cmnd. 7512) presented to Parliament in March 1979, highlighted tie-in sales (tying the sale of one product to the sale of a different product) and full-line forcing (the practice of forcing a purchaser to buy a full range of goods offered by a supplier and not just those the purchaser wishes to buy) as practices which had been found by the Monopolies and Mergers Commission in the course of monopoly investigations to be undesirable in almost all cases. The authors of the Green Paper went on to say that although they believed that these practices would invariably be found to be against the public interest, the evidence was limited to a small number of cases actually considered in the Commission's reports. They recommended, therefore, making them the subject of a general reference to the Commission, with a view to prohibition if that were shown to be justified.

1.5. This recommendation was based on five reports by the Commission: Petrol (1965), Colour Film (1966), Films for Exhibition in Cinemas (1966), Metal Containers (1970) and Indirect Electrostatic Reprographic Equipment (1976) (copying machines), which had been listed in an earlier Green Paper (Cmnd. 7198), 'A Review of Monopolies and Mergers Policy'. Some of the practices which were noted were in process of change even at the time of the inquiry into them and others had since been amended in accordance with safeguards proposed by the Commission or stopped. They were therefore taken as examples only and not as current practices in the businesses concerned. The relevant points made in the Commission's reports were as follows:

(a) *Petrol.* The Commission commented on agreements and arrangements under which suppliers required petrol retailers to sell also their lubricants and other petroleum products and anti-freeze preparations.

(b) *Metal containers.* The Metal Box Company rented closing equipment on very advantageous terms provided that only cans supplied by the company might be closed on the equipment. The Commission commented that as far as the arrangements failed to be self-supporting and to yield a reasonable rate of profit to the company and insofar as they restricted the customer's freedom to use the machines and led to his restricting his purchase of metal containers from any alternative supplier, they might have been expected to operate against the public interest.

(c) *Colour film.* The Commission found that the practice on the part of manufacturers and importers of selling one or more types of reversal colour films only at prices which included a charge for processing, operated against the public interest.

(d) *Films for exhibition in cinemas.* The Commission found that the practice of film distributors of sometimes making the hire of one film conditional, in effect if not formally, upon the acceptance of other films caused unnecessary difficulty for the small exhibitors and directly affected the interest of the cinema-going public; there was also an indirect effect on film production.

(*e*) *Indirect electrostatic reprographic equipment.* Rank Xerox operated a system under which the rent for a machine covered servicing, toner and supplies (developer, filters, webs, drums and all spare parts) but not paper. The Commission found that the control of servicing and materials and parts where the use of unauthorised supplies could materially affect the performance of the rented machines was allowable. In the case of toner, however, although the company recognised that products other than its own might be used, it did not offer the option of 'toner-out' terms to all customers. The Commission concluded that the company's policy for the supply of toner operated against the public interest. They therefore recommended that the company should charge for the toner separately and should not include it in the rent for the machines.

Conduct of the inquiry

1.6. At the beginning of our inquiry a press notice was issued, on 19 June 1979, which was carried by several national and trade papers. Copies of the terms of reference, with a covering letter, was sent by us to over one thousand trade and professional associations and consumer organisations; further circulation was given by several of the associations to their membership, directly or in their publications.

1.7. These and other sources led to information which was followed up by correspondence, meetings and questionnaires with approximately a further six hundred organisations and individuals. The results, classified either as general practices or practices of particular areas of business, are described in Chapters 4 to 12.

1.8. We are grateful to the very many organisations and individuals who contributed to our inquiry.

1.9. At a fairly early stage in our inquiry it appeared to us that there were many instances in which, contrary to the expectation of the Green Paper, tying arrangements were on balance not adverse to the public interest. It seemed to us therefore that, in order to reach a conclusion (as required by the reference) on 'the general effect on the pubilc interest' of the practice referred to us, we should endeavour in this inquiry to evaluate the general effect of tying arrangements by considering the effects of the particular ties and groups of ties which came to our notice. In some cases, however, we found that it was impossible within the scope of a general inquiry such as this to reach firm conclusions about particular tying arrangements. To have done so would have necessitated far more detailed investigation than was appropriate and would have extended the duration of our inquiry unduly. For this reason we did not attempt to reach a firm conclusion on, for example, the tying of insurance agency to the granting of mortgage loans (see Chapter 9). Similarly we found that with many categories of tie it was practicable only to state the principles by which individual ties should be judged and not to attempt to apply the principles to individual cases. To stop short of firm conclusions in cases where these could be reached only by detailed and perhaps prolonged investigation appeared to us more particularly the right course to take when, during our inquiry,

the Competition Act 1980 came into operation, since one of the principal purposes of the Act is to facilitate detailed inquiries into individual acts of precisely this kind. The implications of the Competition Act are considered further in Chapter 13 (see particularly paragraphs 13.30 and 13.31).

1.10. There are two cases of possible tying arrangements which came to our notice, but which for particular reasons we did not examine. First, we did not enquire into possible ties within the franchise system of distribution of car parts to which attention had been drawn by the Price Commission report published in October 1979 because of the possibility of the matter being referred separately to the Commission; this has now been done. Secondly we did not pursue the supply of terminal equipment attached to the telecommunications network once proposals for legislation to relax the Post Office's present monopoly were made known.

1.11. In cases where tying arrangements had been considered in earlier reports and had been found to be acceptable subject to certain conditions (eg in the distribution of petrol), we restricted our examination to ascertaining whether those conditions were being observed.

CHAPTER 2

The Nature of the Practice Referred

2.1. The practice referred to us is that of 'requiring any person or class of persons to whom goods or services of any description are supplied to acquire other goods or services as a condition of that supply'. This clearly covers the kind of transaction, generally understood by the expression 'tie-in sale', in which the supply of one good or service (the tied good or service) is tied to that of another (the tying good or service) generally, but not necessarily, from the same supplier. Examples of this would be a requirement by the supplier of a machine (tying good) that consumable articles used with it (tied goods) must also be acquired from him or that a maintenance contract (tied service) must be entered into with him. We interpret the reference as covering also the kind of transaction in which, although there is no specific identifiable tying goods, a customer cannot acquire supplies of any single item of the supplier's goods but must accept a range of them (range forcing or line forcing) or even the full range offered by the supplier (full-line forcing).

2.2. Tie-in arrangements, including line forcing, may be an expressly stated condition of supply, or they may be brought about (in ways which we consider below) without being expressly stated. When a tie is the result of an expressly stated condition, this condition may be simply that additional goods (or services) must be acquired from the same supplier; but a tie may be the result of an expressly stated condition which is expressed in terms of exclusive dealing—that the customer shall not acquire particular goods (or services) from any other supplier. If the exclusive dealing relates to a range of goods and the nature of the customer's business is such that he must stock a range (for example, a wallpaper retailer, who must carry a range of patterns), then the exclusive dealing condition would in effect be range forcing. If the exclusive dealing condition relates to a product which is necessary for use with, for example, the same supplier's equipment or machinery (as when can closing equipment is supplied on condition that only the supplier's cans are used with it), then the exclusive dealing would in effect be a tying arrangement. The practice referred to us may therefore in some cases be equivalent to and indistinguishable from what is commonly regarded as exclusive dealing.

2.3. As we have said, tie-in arrangements can be brought about without being expressly stated. The Reference states that the practice referred 'includes making the supply of goods or services available at prices or upon terms as to credit, discount or otherwise which are so disadvantageous as to be likely to deter [the customer] from acquiring those goods or services without acquiring other goods or services'. Clearly pricing or discounts can be used in such a way that a level of price or discount acceptable to a customer can be obtained only when more than one of the supplier's products is bought. When this is done there is in effect a tie even though the customer

is not expressly required to take more than one product. Ties of this kind, brought about by pricing arrangements or by discounts, are likely to be in the nature of line forcing. They may be difficult to identify since it will be a matter of degree whether any particular pricing arrangement or discount structure goes beyond being an incentive to increase turnover and becomes a means of implementing a tie or line forcing.

2.4. Clearly ties or line forcing brought about by pricing arrangements or discounts reflect market power on the part of the supplier and may have anti-competitive effects contrary to the public interest; but in principle their effects do not differ from those of ties generally and for this reason, and also because no clear examples came to our notice, we have not regarded them as an individual category requiring separate consideration.

2.5. There is another type of situation, brought to our notice by some complainants, in which there is no tie expressly imposed by the supplier but where the customer feels himself to be the victim of a tie. An example of this is where a user of equipment is forced to accept the servicing facilities of the supplier because there is no alternative in the part of the country concerned or because the equipment is so sophisticated that no competitive servicing facilities have yet emerged. Situations of this kind may be undesirable in that they may lead to a monopoly price being charged for servicing, but they are the result of circumstances and are not a 'practice' on the part of the supplier and do not therefore fall within the terms of our Reference. However, if a supplier took steps to monopolise servicing, preventing the emergence of competing facilities by, for example, refusing to make spares or maintenance manuals available, this might well (whether or not it is regarded as covered by the practice referred to us) be an anti-competitive practice meriting investigation (see paragraph 4.17).

2.6. A category of tie, which undoubtedly exists but which is excluded from the terms of our Reference, is the grant of a lease or licence relating to real property on condition that certain goods are also taken by the lessee or licensee. The effects of such ties on competition are unlikely to single them out as being different in principle from other ties, but since leases and licences are not goods or services we were unable to consider these cases. This meant that we were unable to give full consideration to a range of tying practices within the licensed liquor trade and in the distribution of petroleum products (see Chapter 8). There also appeared to be ties in connection with the leasing or licensing of pitches in caravan sites and of space in exhibition halls, which for the same reasons we were unable to consider; and there may be other similar cases which did not come to our notice.

2.7. In retail markets there are many forms of special or premium offers made in order to attract custom, and we considered whether some or all of these amounted to tie-in sales on the ground that when the purchaser of an article is offered some additional article free or at a favourable price he is in reality being required to take both, or at least to pay for both whether or not he actually takes the additional article. However, we think that this is an unrealistic view of premium offers, since they do not generally lead to any direct increase in the price of the article being promoted. Premium offers

are generally more appropriately considered as a form of advertising or promotion rather than as tying transactions; and, inasmuch as they are likely to be found where there are competitive conditions in the market for the article being promoted, and are also likely to be short-lived, they are not likely to have any material anti-competitive effect. If they raise any public interest issues they are unlikely to be those typically raised by tie-in sales, and we have not therefore taken premium offers into account in the course of our inquiry. If any particular premium offer did appear to be lasting and to raise some substantial competition issue it would be suitable for investigation under the Competition Act.

2.8. There are many cases where it may be a matter of argument whether or not there is any tie because of the difficulty of determining whether what is being supplied is a single item or a combination of two or more. For example, is there a tie when a car is sold with a radio, or is the radio merely one of many components making up the complete car as offered by the supplier? Should a dinner set be regarded as a single item or a collection of items? It might be necessary to attempt to resolve questions of this kind if there were ever to be any control of tie-in sales by legislation; but for the purposes of our inquiry, we did not attempt to identify any dividing line. There are also many cases in which two or more articles are supplied together which would undoubtedly come within a strict interpretation of the practice referred to us, but which appear to be either trivial or a matter of usual custom and therefore probably acceptable to the public. It is a matter of judgement in any particular case whether a tie is trivial or not in its effects, and again we did not attempt to identify any dividing line.

2.9. In borderline cases such as those mentioned in the previous paragraph, as indeed in all transactions with tying characteristics, what is important is the effects of the transactions in question, and these will be likely to depend on the nature of the goods concerned, the structure of the market concerned and the nature and extent of competition in them.

CHAPTER 3

The Consumer Organisations

3.1. It seemed evident from the nature of this reference that the most likely source of information on tying transactions, except for those which were obvious or readily justifiable, would be the customer for goods or services rather than the supplier. Enquiries of suppliers for information on possible tying conditions therefore included ties to which they themselves might have been subjected and, in addition, a number of consumer organisations were asked to comment on any such practices about which they had knowledge and which they considered to be against the public interest. We found it significant that none of these organisations had responded to the publication of the terms of the inquiry and when approached directly the majority were unable to offer any examples. Of those that were reported the majority were admitted to be trivial. We were forced to conclude that tie-in sales do not affect, or are not noticeable to, the individual consumer.

3.2. One view, put forward by the National Consumer Council, was that it is virtually impossible to enforce any systems of tie-in sales directed at the consumer and it is also difficult for consumers to recognise tying practices at the point where they are themselves affected. Range stocking, for example, will increase the choice available to the shopper and the sale of small items in sets, while perhaps irritating for the customer who wants one only, might be the most economical method of marketing, say, buttons or screws, when the handling costs are high in relation to their individual value. Although some sets may be regarded as a form of tie there is nothing to stop competitors from selling the items individually if it is economic to do so and such an option is normally to be found except in trivial cases.

3.3. We asked the National Consumer Council and the Consumers Association for their views on a number of examples of tie-ins which had come to light from other sources and these have been reflected in the appropriate sections of this report.

CHAPTER 4

Servicing Agreements, Guarantees, Conditions relating to the use of Consumables and Equipment Compatibility

4.1. In this chapter we discuss some trading practices which have tying characteristics and on which we have reached some general conclusions as to their likely effect on the public interest. In later chapters we look in greater detail at particular examples of them.

Service agreements and guarantees

4.2. There is a complex group of arrangements concerned with guarantees and with maintenance agreements for machines, the supply of spare parts for them and the use of associated consumable products. During our inquiries we received many complaints from users who considered themselves to be tied by specific conditions, by implication or by circumstances to the use of materials, either spare parts or consumables, even though they might be confident that there are competitive products equally suitable for their purpose.

4.3. The user might find himself in one of four situations:

(*a*) he might be tied to the use of certain materials by the terms of a guarantee ;

(*b*) there might be a disclaimer of responsibility should a fault be caused by the use of 'unsuitable' materials.

Where equipment is rented and the supplier provides a maintenance service either included in the rental charge or under a separate agreement:

(*c*) the conditions under which servicing is provided might stipulate that only consumables of the supplier's own manufacture should be used ;

(*d*) there might be no such condition but the user might fear that, if other consumables are used, faults which occur might be attributed to them and servicing under the agreement refused.

Situations (*a*) and (*c*), where there are explicit conditions, are comparatively straightforward ; the tying effect of the others, if any, will depend on the application in practice of the disclaimer in (*b*) and on whether the user's self-imposed restriction of choice in (*d*) is reasonable.

4.4 A related complaint by some users concerns their dependence on the servicing facilities provided by the manufacturers of their equipment because of the lack of competition, especially in parts of the country which are not well served. While there is no tie in the terms of this reference the users suffer a dependence which enables the suppliers in some cases to charge what users regard as unreasonable rates for the service provided.

4.5. In considering this subject in the light of the terms of reference and of the public interest there are some natural divisions: the distinction between a sale and lease or rental and between servicing and maintenance and the use of consumable products.

Rented equipment

4.6. Leasing and rental of equipment is an important and growing business. Under leasing arrangements ownership remains in the hands of the supplier, who retains rights over the equipment which would be surrendered if he sold it.

4.7. A common example, of which we have had no indication of public concern, is the rental of a television set. The circumstances have been described by the trade association as 'provision of television service in the home, in the form of the set, incorporating servicing and maintenance'. In other words, the householder is paying for the reliable reception of programmes and drawing no distinction between the set itself and the service which ensures that it will be kept working or otherwise replaced.

4.8. According to this interpretation there is a single transaction and therefore no tie. We consider, however, that this is a simplification which cannot be accepted for leasing arrangements generally. In effect two things are being provided and the most important consideration is whether or not there are anti-competitive effects; this will depend on such factors as the nature of the service, the general conditions in the market, the availability of alternative servicing organisations, the rights of rental firms to maintain sets which belong to them and the options, including purchase, open to the customer.

4.9. In some circumstances lessees of equipment might argue that conditions requiring that servicing should be carried out by the supplier make it impossible to seek competitive alternatives. The arguments of the suppliers can be summed up by one who told us that he was 'concerned to ensure that [the company's] own property will be serviced with proper skill and care and at such intervals as will protect the equipment from incurring avoidable damage through a neglect of maintenance'.

4.10. In previous reports the Commission have recognised the strength of this argument. In their report on Footwear Machinery in 1973 they conceded that

> 'there is force in the argument that it is necessary for the company to provide free service for leased machines because it must be in a position to ensure that its property is maintained in good order throughout the period of the lease. This consideration is relevant especially, but not only, when the lease includes a rent which depends upon the extent to which the machine is used'.

And in their report on Indirect Electrostatic Reprographic Equipment (1976) the Commission observed:

> 'So far as servicing is concerned we accept that, because rented machines remain the property of Rank Xerox and their continued earning capacity

must depend on efficient servicing, it is not unreasonable for the company, if it so wishes, to retain machine servicing in its own hands.'

4.11. Whether the arrangements for servicing by the supplier of rented equipment are seen as a single transaction with no tie or, as we would argue, two transactions with the servicing agreement tied in to the agreement for the hire, a condition that servicing should be carried out by the supplier or his nominated agent cannot be held to be against the public interest, providing that the service is efficient. The supplier is protecting his legitimate interest in his property. If the market is not competitive and the supplier is a monopolist abusing his market power, for example by excessive pricing, considerations of public interest could arise.

4.12. A condition relating to the use of consumable items with rented equipment is not quite so straightforward. The Commission, in the Copying Machine report (1976), also stated that:

> 'As regards consumable materials and replacement of parts, we are satisfied that Rank Xerox should be allowed to control the provision to rental customers of those *materials and parts where the use of unauthorised supplies could materially affect the performance* of the machines rented.'

4.13. Some suppliers stipulate that the hirers of their equipment should use it solely with products purchased from them, without necessarily giving any reason for the condition. Whether ties of this kind are against the public interest depends on whether they are essential to the proper functioning of the equipment or are merely a means of ensuring the continuing sale of consumables which could be obtained competitively elsewhere. This is a matter of technical assessment and can only be decided by reference to the facts in individual cases. If a supplier cannot establish that his tie-in condition is necessary for the proper functioning of the equipment then it may be against the public interest. Some suppliers, while not laying down such explicit tying requirements, may state that they 'will not be responsible for faults occasioned through the use of items not supplied by the company' or point to the problems which could be caused by the use of 'inferior' products. Wording of this sort may deter the hirer from using competitive consumables and therefore have a tying effect. Indeed we had several complaints from users who regarded themselves as tied to the supplier's consumables by such statements, the need to depend upon their supplier's servicing organisation preventing them from using cheaper, and in their view satisfactory, products. We did not, however, receive evidence of the extent to which such complaints are justified. A warning against the use of unsuitable materials cannot as such be said to be against the public interest; the use of such a warning, backed up by discriminatory action, to make sure that only the supplier's own materials are used can, however, be an anti-competitive practice.

Equipment which is sold

4.14. When an item is sold the transaction is complete and there is not, as in the case of a lessor, the continuing interest in the goods which would

justify laying down conditions. A seller may, however, impose ties through guarantees and servicing contracts. During a period of a guarantee, usually to cover the failure of parts, the guarantor will have the right to fit what necessary relacements he thinks best, usually his own, and during the currency of the guarantee he will hope to build up customer loyalty. This is unobjectionable. Guarantees may, however, be used with tying effect by laying down conditions about the use of consumables by the purchaser during the guarantee period. Some guarantees contain a clause to the effect that they bind the guarantor only if consumables recommended by the manufacturer are used.

4.15. Such conditions create an explicit tie-in ; in other transactions a purchaser might be deterred from using materials of his own choice where there is no such contractual obligation. While this might not amount to a tie within our terms of reference, for a supplier to take discriminatory action to ensure the use of his own materials can be an anti-competitive practice.

4.16. We received several complaints from purchasers of equipment who, without any tying obligation being imposed upon them, felt that they were effectively forced into servicing agreements with the suppliers of the equipment, at what they considered to be high rates, because of the lack of available alternatives or the inability of competitive servicing organisations to obtain the necessary spares from the makers. The increasing complexity of equipment and systems and the dependence of the users on their reliable performance adds to the pressure.

4.17. Both the National Consumer Council and the Consumers Association drew attention to this matter and both wish to see more competition in the production and availability of spare parts and, where applicable, maintenance manuals for individual users and servicing specialists. Some manufacturers, by refusing to supply spare parts or manuals, effectively tie in the after-sales service of their products to their own maintenance organisation or that of their distributors. In the views of the consumer organisations this practice restricts the growth of a servicing industry and the production of competitive spare parts, depriving the user of the benefits of competition and, in the case of imported equipment, increasing imports.

4.18. Though there might be tying effects this is a subject more directly concerned with refusal to supply and we did not investigate it. In the case of newly introduced equipment, the back-up offered by the supplier might be the only service available, especially in remoter parts of the country, and competition may take time to build up even without restrictions. The ready availability of suitable spares is generally desirable. If they were deliberately withheld, or the production and use of competitive items prevented, issues of public interest would arise.

The purchase of a consumable product tied to the supply of storage or dispensing equipment

4.19. It is usual in several industries, in which products call for special storage facilities at point of sale or point of use or which require special

equipment for their sale or application, for the supplier to provide storage or dispensing equipment on favourable terms in return for an undertaking that it will be used only in connection with the supplier's products. Examples are to be found in the supply of storage tanks, pumps and lubrication bay equipment by oil companies, storage and spraying equipment for agricultural/horticultural chemicals and liquid fertilizer, and refrigerated cabinets for the sale of food. Such agreements have been noted in previous Commission reports on Petrol (1965), Frozen Foodstuffs (1976) and Ice Cream and Water Ices (1979). It is possible to argue that some, if not all, such arrangements are not tie-ins, on the ground that the supplier is merely offering a package as an inducement to the potential customer for the consumable product. As one oil company put it, ' The position is rather that in order to persuade the retailer to enter into a sales agreement we have to offer a package of terms, not all necessarily relating to the goods the Company wants the retailer to buy, which the retailer will perceive as more attractive than the package of terms offered by competitors'.

4.20. The aspect of these transactions which appears to us to be relevant to this inquiry is the fact that the customer who wishes to acquire the equipment on the favourable terms is required also to acquire the supplier's consumable product; that is, the supply of the consumable product is tied to the supply of the equipment. The Commission in the past, while recognising the arguments put by the suppliers, have found a number of such agreements to be anti-competitive. An exception was the Ice Cream and Water Ices Report (1979) in which they found that the practice of supplying refrigerated cabinets at a nominal rate to small shops with no other sale for frozen products on condition that they stocked that supplier's ice cream was not against the public interest, except where the retailer was formally prevented from stocking other manufacturers' products when the provider of the cabinet was unable to supply. They considered that if cabinets were not provided the number of retailer outlets might fall, reducing competition and customer choice.

4.21. Generally, however, whether arrangements of this kind are against the public interest will depend on the degree of competition faced by the supplier and the conditions attaching to the loan, hire purchase or other terms of the supply of the equipment. In the Petrol Report (1965) the Commission were concerned that the supplier should not be able to extend his agreement for exclusive supply and that the retailer should be able to gain freedom from the arrangement by, for example, paying any outstanding balance of its purchase price or, in the case of loaned equipment, that portion of the actual or notional price appropriate to the unexpired part of the original term of the agreement.

4.22. In general and partly as a result of such earlier reports suppliers aim to satisfy these, or equivalent, standards. There could be similar tie-in arrangements which have not been considered under earlier references and which have not been uncovered or brought to our attention during this inquiry. However, we consider the guide lines to be clear. Any arrangement under which the supply of a consumable product, whether or not on

an exclusive basis, is tied to the provision of equipment, may be against the public interest unless it is for a reasonable term and is terminable by the customer on the payment of any outstanding balance of the purchase price or value of the equipment, the terms of such payment being in the agreement.

Equipment compatibility

4.23. Our terms of reference attracted several complaints of equipment being so designed as to be usable only in conjunction with related attachments or consumable items of the same manufacturer. This is a wide field, ranging from ball point pens and their refills to main frame computers and their peripherals.

4.24. It is clearly possible for a manufacturer to tie the supply of attachments or consumables to the supply of equipment by making the equipment in such a way that other attachments and consumables are not compatible with it. However, our reference is essentially addressed to ties which result from contractual obligations and we do not regard the tying effect of incompatibility as within the reference.

CHAPTER 5

Copying Machines and the Computer Industry

Copying Machines

5.1. One of the examples of tie-ins which gave rise to this reference came from the Commission's 1976 report on Indirect Electrostatic Reprographic Equipment. The Commission commented that all-in pricing arrangements operated by a seller with market power gave him an advantage in the supply of tied products which 'may be unrelated to efficiency and by impeding the development of independent sources of supply may add to the difficulties of entering the market faced by new suppliers of the main product'. The Commission accepted that it was reasonable for Rank Xerox to retain servicing of rented machines in its own hands and also for it to control the provision to rental customers 'of those materials and parts where the use of unauthorised supplies could materially affect the performance of the machines rented'. They did not consider toner to be in this category and recommended that it be sold separately.

5.2. Since the 1976 report there has been increased competition in the copying machine industry with about 24 companies marketing some 80 models, of which most are imported. Machines can be purchased or rented and in the rental business there are several types of agreement to be found including arrangements which provide an inclusive service of machine rental, maintenance and consumable supplies, the charges being based on output or usage. Other rental arangements separate the machine rental from the sale of consumables. Different considerations apply to sale agreements, as we have seen in paragraph 4.14, but the public interest might well be affected, depending on market conditions and the choice available to customers, particularly where consumable products are involved.

5.3. Competition in consumable products, particularly paper and toner, is becoming more open. There is compatibility between most coated papers and the use of plain paper copying is spreading, though machines might be designed to take different roll sizes and the grade of a paper can be a factor in efficient working. There are competitive manufacturers of toner.

5.4. Suppliers of machines on sale or rental naturally try to ensure that their customers for their machines also obtain from them their requirements of profitable consumable items. In the main this takes the form of advice, but unequivocal conditions are to be found. One supplier whose terms were investigated obliged dealers to 'sell, handle, use and distribute only the products recommended and supplied, in order to maintain the proper operation and functioning of the machines' to the exclusion of competitive items; one rental agreement contained a clause that 'to ensure the proper and efficient functioning of the machine the renter agrees that it shall use the supplies provided by the owner for the machine and shall also use only

the copy paper supplied, or approved, by the owner of the machine '. The effects of a requirement for exclusive dealing by distributors and tying obligations on the end customer are to prevent purchasers of that supplier's machines at all levels from seeking any competitive source of ancillary items.

5.5. In one form or another all such agreements which we examined advise the customer of the particular suitability of the suppliers' products for use with their machines, indicating that should any fault occur which was attributable to the use of ' unsuitable ' or ' non-approved ' products servicing might be provided only at extra cost. Where machines are sold rather than rented similar advice is to be found in guarantees or in servicing agreements entered into after the completion of the guarantee period. We received several complaints about the deterrent effect of such advice from users, dependent upon the continuing efficiency of their equipment and on the servicing network of the manufacturer or distributor, who considered themselves prevented from buying competitive products, of a quality with which they were themselves satisfied, at lower prices. The effectiveness of this form of restriction applies to paper as well as to toner and is felt by both large and small users.

5.6. We consider that conditions aimed at controlling the use of consumable items by rental customers are unlikely to be against the public interest if they are limited to ' those materials and parts where the use of unauthorised supplies could materially affect the performance of the machines rented ' as stated by the Commission in their 1976 Copying Machines report. From the complaints we received it appears that advice against the use of other products might have an anti-competitive effect equivalent to that of an express restriction. If the supplier, when drawing attention to the suitability of his own products and warning against inferior materials, adds a general specification of the characteristics and quality required of consumables in order to work efficiently with his machines, the grounds for criticism would be removed.

The computer industry

5.7. In the course of this inquiry complaints were received about ties, explicit or resulting from other conditions, in the hire or purchase of computer equipment. The effects of compatibility or incompatibility of one item with another, a supplier's conditions as to the use of his products and the provision of servicing can all have elements which a user might see as restraints on his freedom of action or as devices whereby a supplier can strengthen or extend his hold. The complexity of the equipment, its cost and his dependence on reliable performance can all contribute to the user's concern and feeling of compulsion.

5.8. Our inquiries into the computer industry were limited. Where tying conditions or circumstances which could give rise to them are to be found, a full investigation of the technical factors involved and of the economic effects on the public interest would, in such an industry, be beyond the scope of a general inquiry such as this.

5.9. Inquiries were made into servicing arrangements and into ties brought about by the compatibility of units and by more specific conditions of sale. These showed that most computer equipment is sold rather than hired and that manufacturers and suppliers all offer servicing back-up to their customers, though the larger users might have servicing teams of their own. The suppliers of equipment on hire generally retain the responsibility for servicing although in some cases they are prepared to make available the necessary training, diagnostic software and manuals for competent users to do it themselves; this type of support is, however, more readily available to purchasers. Similar co-operation with independent servicing organisations which could offer competition is less often to be found, particularly in the provision of diagnostic aids which might have been produced at a significant cost to the manufacturer in research and development.

5.10. In practice it seems that, as might be expected, most maintenance is carried out by the supplier's servicing organisation, though some of the larger customers undertake their own maintenance. In particular, users of computers in the more isolated parts of the country are likely to find no alternative to servicing by the supplier and, where computer installations are leased from finance houses, maintenance by the manufacturer is likely to be stipulated in the leasing agreement. It is likely that as a result independent servicing organisations find it difficult to enter the market, particularly to work on what manufacturers regard as their current equipment.

5.11. Where conditions in agreements are based on the compatibility of one unit with another of the same manufacture or of software with associated hardware they are almost invariably presented by the suppliers as resting on technical considerations such as optimum performance, ease and reliability of maintenance or perhaps the need to have a suitable configuration for diagnostic programmes to be run. The evaluation of any such condition is beyond the scope of this inquiry and is a matter for individual investigation in any particular case. For the purposes of this inquiry it is not possible to do more than draw conclusions from a broad assessment of the industry. The Computer Users Yearbook for 1980 lists some 1,100 manufacturers and importers with some 27,000 machines in use in 9,600 locations and a growth rate of about 20 per cent a year; but any summary is itself misleading without taking into account the changes being brought about by rapid technological development. A great variety of equipment is produced, including processors, peripherals, software and consumables, by manufacturers ranging from multinationals concerned with all types of facility to small establishments producing perhaps a single item of equipment.

5.12. The general impression gained from our inquiries was that, while there are conditions which can give rise to tying restrictions which are not justified by technical considerations, these are the exceptions rather than the rule. There may, however, be circumstances, such as the absence of competitive servicing, which restrict a user's choice and have the same effect as ties. The fact that many manufacturers and importers are in the business of providing a great variety of equipment usable in many combinations is an indication of healthy competition which, if it continues, is likely to lessen the opportunity for imposing ties and to reduce the adverse effects of such ties as do exist.

5.13. That is not to say that there might not be justifiable complaints and that the conditions governing servicing might be preventing or slowing the growth of a healthy and competitive servicing industry in this country. We believe that general conclusions which we have reached or which have been reached by the Commission in other inquiries provide valid guidelines for the examination of individual cases in this as in other industries which market in similar ways:

(*a*) it is reasonable that a supplier of rented equipment should, as owner, retain responsibility for its maintenance provided that the maintenance is supplied on reasonable terms;

(*b*) a condition that a customer should use specified consumable products might or might not be against the public interest, the test being whether the use of other products would materially affect the performance of the equipment;

(*c*) even if there is no such explicit condition other terms or circumstances of the transaction might produce a tying effect; the test of public interest remains the same;

(*d*) where equipment is sold the tying-in of maintenance is likely to be against the public interest, as is that of consumables as a condition of a guarantee, unless it is a genuine requirement for technical reasons; the test is the same as in (*b*).

5.14. The designing by a manufacturer of related pieces of equipment so that they are compatible only with each other and only with the manufacturer's own consumable items used in conjunction with them is not a tie-in within the terms of our reference, though the restrictive effects of doing so could be the same as those of a tie.

5.15. Undoubtedly complaints can arise to which the guidelines cannot be applied without a full investigation of the circumstances and of the possible justifications, and these may merit investigation under the Competition Act.

CHAPTER 6

Agencies

6.1. It is a common practice for retailers to arrange with manufacturers that they will stock particular ranges of the manufacturers' products. This enables the manufacturer to ensure that a selection of the goods he advertises will be found in shops displaying his trade mark and provides him with the means of introducing new products to the public ahead of established demand; the retailer obtains the custom and perhaps loyalty of customers attracted by the manufacturer's advertising or reputation and the customer can expect to find a range from which to choose, related products which he might wish to match, with informed advice and after-sales service from, or through, the retailer.

6.2. Such arrangements are usually called agencies but in practice they can vary from formal agreements with detailed undertakings on both sides to completely informal relationships. Though this type of trading is widespread few were drawn to our attention and we looked at some examples to assess the effects of such tying conditions as might be involved.

Cosmetics, toiletries and perfumery

6.3. It seemed likely that retailers of cosmetics are required to stock full lines or ranges, if only because many are inter-connected by perfume, shade or other common quality. We did not receive any direct complaint of such practices being onerous but we did see some evidence of concern in the trade press and we investigated the subject by discussion with the Cosmetic Toiletry and Perfumery Association, a questionnaire to manufacturers and some investigation of the retail trade. Where manufacturers market their products through their own retail outlets or agents there is of course no tying condition within the terms of the reference.

6.4. The industry is one of great variety. Manufacturers range from the large to very small and make a wide range of products or few. They market products under their own labels or work on contract for distributors with no production capability. Distribution is, in the main, direct to retailers but wholesalers also play a significant part. A proportion of the business, particularly with the more expensive and widely advertised products, is through appointed agents who in some but not all cases enter into formal agreements with the manufacturers. In department stores, which account for about half of the market, cosmetics and perfumery might be sold by the manufacturer's own employees, the same products on sale in a chemist shop being handled as any other stock. Our interest was confined to transactions in which the distributor, in order to obtain a supply of goods, must accept a restriction on his freedom of choice in product or quantity. The distributors with which we were concerned are retailers; we found no evidence of concern or complaint from wholesalers.

6.5. We found few manufacturers who require their distributors to stock a complete range of their products and many, particularly the smaller ones, allow retailers the freedom to order what they choose. The majority of the better known manufacturers allow some flexibility. Typical answers to our inquiries were:

'Our written agreement does not require a distributor to stock all our lines although normally he will wish to stock a comprehensive range in order to compete efficiently in the market.'

'We are currently giving our approved stockists the opportunity either to stock our full inventory or to carry a much more limited product range . . . determined by the Company.'

'Depending on the size and style of the retail outlet we will encourage him to stock certain ranges and products. There is no compulsion to stock all products of all ranges.'

The pressure to carry a range of items is generally limited to cosmetics and perfumery, the manufacturers' argument being that the consumer wants to buy combinations such as matching lipstick and nail varnish or a foundation with a matching powder.

6.6. Although we did not receive any direct complaints, it is clear that terms of sale differ from one manufacturer to another. Provided that, in order to ease the difficulties which might be experienced by some of the smaller reasonable retailers, manufacturers allow a choice of lines to stock within their complete range and also stipulate reasonable and clearly expressed conditions under which unwanted goods can be returned, range stocking arrangements of the kind we are considering are unlikely to be against the public interest. Individual cases failing to reach this standard would be open to investigation under the Competition Act.

Shoe retailing

6.7. We made enquiries at both the manufacturing and the retail ends of the shoe industry, discussions being held with representatives of Clarks and of K Shoes. At the retail end of the market the Footwear Distribution Federation and their constituent body the National Shoe Retailers Council were consulted. In their view the stocking requirements involving ranges of styles, sizes and fittings and the service provided are necessary to ensure that a reasonable selection and a standard of service is available to the public and are not anti-competitive.

6.8. The retail trade is dominated by large multiples, some of which are owned by manufacturers and are direct outlets for their branded shoes ; these manufacturers also sell through independent retailers appointed as their agents. Generally such retailers are required to carry a representative stock but there is usually considerable flexibility in deciding what the appropriate range should be ; the manufacturer might cater for a much wider demand than that represented by an individual retailer with a local or specialised market.

6.9. The manufacturers argue that their complete ranges are so large and varied the full-line forcing would in any case be impracticable although one retailers' organisation expressed the view that the stocking requirements of some manufacturers do have the effect of tying up excessive capital. We recognise the need of the manufacturers to ensure a good service in line with their national advertising, but their reputation can give them market strength in dealing with their retail agents and their range stocking requirements are inherently anti-competitive. Whether they act against the public interest however will depend on the effects on both retailers and their customers and where those effects are sufficiently adverse to cause concern the Competition Act is available to provide a safeguard.

The marketing of paper patterns

6.10. The system by which most paper patterns are sold is for the retailer to maintain an agreed range of stock, the manufacturer having the right to add new designs and to withdraw those which have become outdated. The range to be held is a matter for agreement between manufacturer and retailer and will depend on likely turnover. A typical choice might be between one of every current design and size, one of each design in medium sizes only and one of each design in the best selling sizes only. There are other arrangements such as the maintenance of a restricted rack display or the holding of a catalogue only from which patterns can be ordered by post. The retailer, having agreed on a certain range, has his stock replenished in line with sales returns, new patterns are introduced up to twelve times a year and lists of discontinued patterns, returnable for credit, are circulated at rather longer intervals.

6.11. We received a complaint from the Drapers' Chamber of Trade that in some cases manufacturers' discard lists did not equate to the introduction of new patterns, resulting in an increase in the number and value of patterns held in stock, tying the retailer to purchasing on a scale for which he had not bargained.

6.12. The DCT and some manufacturers also objected to agreements for longer than a year and to the use of loans or favourable credit terms to restrict competition.

6.13. The present system used by most suppliers for the distribution of paper patterns amounts to line forcing but we are not convinced that the system is operating unreasonably. There were indications of vigorous competition, such as the provision of stocks to retailers on sale or return, which would make the imposition of oppressive terms by the larger suppliers difficult to maintain. Should the situation change, however, investigation under the Competition Act would be the appropriate course.

General

6.14. Many types of merchandise are marketed by means of such agency systems and we have only touched on some everyday examples; another which came to our notice was that of agricultural and garden machinery.

Although the appointment of agents is anti-competitive in so far as it implies a limitation on the number of outlets and of retailers who can obtain particular goods, the practice is not necessarily against the public interest. The retailer forfeits a degree of freedom in the choice of stock he carries; although the actual range he undertakes to hold is normally negotiable and dependent on his location and type of business, once it is agreed he will be expected to maintain that level. On the other hand, he will have the advantage of the manufacturer's market experience, the benefit of product advertising and reputation and, if applicable, training in the technicalities, selling and support of the product. The customer might be limited to perhaps a single outlet for the product in his area but should benefit from a better choice in the manufacturer's range and more experienced advice and support than would otherwise be available. It is only when the negative factors become onerous or potential competition is unreasonably restricted that the public interest is likely to be involved, and the response to our enquiries did not reveal any general problem. Any that may arise would therefore be individual and suitable subjects for Competition Act investigation.

CHAPTER 7

Franchises

7.1. The term franchising is used to describe a wide variety of distribution arrangements from tied houses in the licensed trade to what is in effect the appointment by a manufacturer of agencies for the display and sale of his products in an independently owned shop. In this chapter we are concerned with what is commonly called the 'business format' franchise. Particularly in the United States, but now increasingly in this and other countries, this form of business is becoming a feature of retailing. Members of the British Franchise Association include 'fast food' catering establishments, cleaning contractors, car rental and servicing firms, printing shops, hairdressers and several others; Wimpy, Kentucky Fried Chicken, DynoRod, Budget Rent-a-Car, Ziebart and Prontaprint are among the widely known names.

7.2. Most of these operations have the following features:

(*a*) the ownership by the franchisor of a name, a process, a type of equipment, a product or a method of doing business;

(*b*) the granting of a licence to franchisees permitting the use of the "names, etc," subject to their agreement to adhere to certain rules, standards etc in the conduct of business;

(*c*) provision to the franchisees of services such as training, continuing advice, market research, national or regional advertising, central negotiation for equipment or supplies;

(*d*) in return the franchisee will usually provide the capital to set up his business including the payment of a lump sum to the franchisor, for initial advice, training and perhaps capital equipment. He may be obliged to obtain supplies of particular products from the franchisor. He will pay to the franchisor a continuing royalty which might be based on turnover, profit or a surcharge on the price of goods supplied by the franchisor.

7.3. The creation of a business format franchise normally starts with the development of a business which then appears suitable for expansion. Typically the operator sets up a franchise company offering would-be small businessmen his expertise, pattern of business, possibly essential equipment and the supply of key products, so that they can set up outlets similar to the parent model. While the franchisee is enabled to start up in a business with a proven likelihood of success and with continuing support, the franchisor is able to expand his outlets rapidly with the individual operators providing the capital.

7.4. For the purpose of our inquiry it is convenient to distinguish between those franchise operations which are confined to the provision by the

franchisor of name, operating method, training, management advice, quality control and combined promotion and marketing and those which involve in addition a supply of products to the franchisee for use in the service he provides or for sale to his customers.

7.5. In the former case there is simply the supply of various services which together constitute the franchise arrangement. Though a number of separate services are supplied they are part of a complete package, and it would be unrealistic to regard them as involving any ties for the purpose of this inquiry.

7.6. Where, however, a franchise arrangement includes an obligation on the franchisee to acquire goods from the franchisor the situation may be different. In such cases this obligation may well have the character of a tie; but the situation is not clear-cut.

7.7. It can be argued that the essence of a franchise is the grant of a licence to trade in accordance with the franchisor's business. This is a view which may well be valid for many, or indeed most, business format franchises, and in cases where the supply of goods can reasonably be regarded as an essential part of the franchise it may be unrealistic to regard their supply as tied to the other parts of the franchise package. It is impossible to provide any precise rule for determining whether goods should be regarded as an essential part of a franchise, but generally goods would be in this category when they are a unique product supplied only by the franchisor or when the precise nature of the goods and their quality standards are important. In such cases it is reasonable that the franchisor who allows his trade name to be used should be able to ensure that the standards associated with that name should be maintained. Whether or not it might be considered that there is a tie in such a case, we do not consider that any public interest issue is likely to be involved.

7.8. Where the obligation to obtain goods from the franchisor involves goods which could readily and without any disadvantage be obtained elsewhere or where the goods cannot be regarded as an essential part of the franchise package, then the obligation may rather more clearly amount to a tying transaction of the kind with which this inquiry is concerned. In such cases the arrangement could undoubtedly be anti-competitive, since it might restrict the ability of the franchisee to compete with other businesses selling the same goods and, by foreclosing outlets for them, restrict the ability of other suppliers of the goods to compete with the franchisor.

7.9. Franchising is a growing system of distribution which has features which merit approval, and which is not necessarily anti-competitive. We are not concerned in this inquiry with the economic effects of franchising itself, but only with the effects of such ties as may sometimes be found in franchise arrangements. Even where a franchise does involve an obligation to obtain goods which is in principle anti-competitive, the extent to which competition is in practice restricted and to which the public interest is affected is likely to depend on the general competitive situation in the trade concerned and the number of alternative and competing outlets available, the Competition Act being appropriate for dealing with any particular case which might appear to need investigation.

CHAPTER 8

Brewers and Suppliers of Petroleum Products

Brewers

8.1. Tenants of brewery-owned public houses are subject to a number of tying conditions relating to the supply of beer and, sometimes, wines and spirits, minerals and soft drinks, and other products such as tobacco and amusement machines. These, however, are contained in tenancy agreements which are outside our terms of reference. About two-thirds of public houses come under this heading. The 'free' trade includes both public houses and clubs which together account for about 45 per cent of beer sales by volume against 55 per cent through the brewer's licenced estate.

8.2. It is common in the free trade for brewers to make loans to both public houses and clubs to enable them to buy or improve their properties, and these loans are used by the brewers as a means of competing one with another and promoting sales.

8.3 We were informed by the Brewers' Society that about one-third of the free trade in beer goes through outlets which have such loans. The average new loan is for about £7,000 for a term of about five years. Some loans are made only in the hope of attracting goodwill, in others the borrower might agree to purchase all his beer from the lender so long as the loan is outstanding. We understand that about a quarter of loans are made on the latter terms. In other cases the borrower will be free to sell another brewer's draught ale also and some will have loans simultaneously from more than one brewer. We were told that a borrower usually can terminate his obligation by repaying the loans.

8.4. The making of loans by brewers to the free trade may on occasions put at a competitive disadvantage smaller brewers who do not have the financial resources to compete in this way. But there are undoubtedly advantages to the borrower in these free trade loans and we received no complaint from the retail trade concerning them; provided that the supply agreements associated with them cease with the repayment of the loans, we think that they are not likely to be against the public interest.

8.5. Free trade loans relate only to a small part of the total trade of brewers, about 15 per cent of all beer sales going through outlets which have such loans. Ties in tenancy agreements, which are outside the terms of our reference, appear to be much more significant from the point of view of the public interest.

The distribution of petroleum products

8.6. The distribution of motor fuels and related products by the oil companies is a business in which supply agreements and associated ties play a

large part. It is, however, not fresh ground ; in their report on the supply of petrol to retailers in the United Kingdom published in 1965 the Commission examined solus agreements and made recommendations which were translated into undertakings given by the industry to the Board of Trade in 1966 and revised in 1976.

8.7. As with brewers' agreements, the fact that tying conditions attaching to leases and licences of real property are outside the terms of reference confines our attention to the 'free' retailer. Nevertheless, enquiries were made of all the major companies as a check on their present practices. In some agreements the retailer might undertake to purchase a particular fuel in return for a guarantee of continuity of supply on certain price terms ; in others extra inducements might take various forms such as hire purchase agreements for equipment, loans secured by mortages, interest free unsecured loans, loan of equipment and grants of money.

8.8. There are also distributor and agency agreements. The various agreements contain ties within the terms of our reference but the recommendations of the 1965 report were directed to ensuring that such ties did not restrict the retailer for an unreasonable period and that he should have reasonable provision for terminating them by, for example, paying off the outstanding balance of a loan.

8.9. All the agreements we examined were drawn up in the light of of the 1966 and 1976 undertakings. The possibility of anti-competitive practices not at present covered by the undertakings should not, however, be ruled out and the working of the distribution arrangements should be monitored from time to time.

CHAPTER 9

Building Societies and Insurance Agency

9.1. Under section 101 (1) (ii) of the Law of Property Act 1925 mortgagees have the power to insure and keep insured against loss or damage by fire any buildings (etc) forming part of a mortgaged property, the premiums to be a charge on the mortgaged property. It is usual therefore for building societies, as mortgagees, to include in their rules provisions as to insurance which are binding on borrowers.

9.2. The practice of limiting the choice of insurer to a company or companies nominated by the society providing the mortgage has given rise to complaints by borrowers and, as a result of discussions between the Director General of Fair Trading and the Building Societies Association, the Association in 1975 recommended that new borrowers should be given the choice of at least three insurance companies plus the opportunity to nominate companies of their own choosing, with societies retaining the right to reject any proposed policy falling short of cover equivalent to that provided by the companies they recommend and lacking safeguards in the event of a borrower failing to maintain the premiums. The recommendation was extended to existing borrowers in 1979. The Association circulars containing these recommendations are registered with the Registrar of Restrictive Trade Practices but are not binding on members.

9.3. In addition, the Association issues Model Rules to guide member societies in framing their own. Rule 21 (Insurance), which is generally followed in the rules of individual societies, states, in summary, that all property mortgaged to a society shall be insured by the society, in the name of the society and the mortgagor, with such insurers as the society may require or approve and the mortgagor shall not insure on his own behalf. Sums allowed by way of commission shall belong absolutely to the society which shall not be required to account to the mortgagor for them.

9.4. Mortgage deeds in use by the building societies normally specify that insurance is to be placed through the societies' agency. Since the publication of the Building Societies Association circulars, borrowers who wish to make individual arrangements for insurance at a lower premium have complained to the Office of Fair Trading about the continuing retention of the agency for buildings insurance by the societies.

9.5. A proportion of the complaints are also against the societies' requirement that the insurance cover should be for the full rebuilding cost rather than for the amount of the outstanding mortgage: some borrowers would like the freedom to insure risk above the limit of the debt on their own initiative particularly where the difference is great.

9.6. The Director General of Fair Trading has not contested the retention of agency by the societies, since they have the right to require properties

mortgaged to them to be insured, and the most direct and possibly the most convenient system for the generality of borrowers is for the societies themselves to effect the insurance, surplus arising from the commission earned over the administration expenses being used in the main to improve the terms offered to both borrowers and investors. However, as the situation is not entirely clear, the Director General has drawn the practice to the attention of the Commission for consideration under this reference.

9.7. We obtained the views of the Building Societies Association, British Insurance Association, British Insurance Brokers Association and the Corporation of Mortgage, Finance and Life Insurance Association; 67 individual building societies, representing 80 per cent of borrowers, were consulted by questionnaire and all complaints from the public to the Office of Fair Trading during 1979 were examined.

9.8. A summary of the replies by societies to the questionnaire showed that while a high proportion indicated that they would consider accepting policies other than through their own agency, this would be only in exceptional circumstances such as an unusual property for which a specialist insurer could offer a premium much lower than that of the societies' nominated companies. A substantial proportion of societies, including some of the largest, offered no such concession.

9.9. Few societies were willing to consider limiting their interest to the amount of the mortgage loan rather than the full replacement value, and those societies indicated that they would do so reluctantly and only in special circumstances as perhaps when the site value exceeds the outstanding debt. We found that only few, small, societies brought the advice of the 1975 and 1979 circulars directly to the attention of prospective borrowers.

9.10. There is no doubt in our minds that the practices of building societies with regard to buildings insurance agency is an example of one service tied to another and therefore relevant to our inquiry. The public interest issues are, however, far less clear. While in favour of freedom of choice for the customer and open competition, we believe that the borrower from a building society is generally well satisfied with the service with which he is provided and in the organisation that exists for the settlement of claims. Also split policies could cause serious problems for the insured when making claims. Most complaints against the present restriction are from borrowers who have unusual properties to insure or who are in a position to obtain especially favourable terms through brokers who would act for them.

9.11. The main arguments that are advanced in support of the retention of insurance agency by the societies are:

—continuity and adequacy of cover is assured and the method of payment is convenient for the mortgagor;

—the coverage of risk is good and the societies' bargaining power has enabled them to negotiate improvements from time to time without increasing premiums;

—in normal cases the settlement of claims can be handled expeditiously by local offices of a society and insurance company who are familiar with the standard policies;

—administration is economical because of block policies handled along with routine society/borrower transactions, the profits from commission above administration costs benefiting members of the society.

The main arguments against are:

—brokers have special expertise and act independently in the best interests of their clients, being able to give their attention to the characteristics of individual properties and to local conditions;

—insurance of some properties can be better and more cheaply covered by such individual treatment;

—a borrower should at least be free to limit the insurance arranged through the agency of a building society to the amount of the loan outstanding, insuring the balance of the value of the property where he can obtain the best terms.

9.12. It is not possible within the compass of a general inquiry such as this to assess these factors and particularly the effect on mortgage rates of prohibiting societies from insisting on the retention of insurance agency. We were given estimates indicating a rise in rates of 0·15 to 0·25 per cent due to loss of commission income and increase in administration costs; but these are contested. We can go no further than to say that it is possible that the tie could act against the public interest but that this could not be ascertained without detailed inquiry. We appreciate that the tying of insurance agency, by one means or another, extends beyond building societies and to the providers of finance generally. However, we draw attention to the building societies only because they are the principal lenders for house purchase.

9.13. We consider that there is less likely to be any adverse effect on the public interest if the Building Societies Association Circulars of 1975 and 1979, numbers 1940 and 2233, are implemented by building societies generally and if the choice of insurers with which a society has block policies and the conditions under which an alternative might be put forward and considered are brought clearly to the attention of prospective and existing borrowers; also if, when the insurer has been agreed upon between society and borrower, the latter is provided with a copy of the policy covering his property and for which he is paying the premiums.

CHAPTER 10

Tie-in Conditions in Farming

10.1. In the farming industry agreements between feed and chemical suppliers, marketing organisations and farmers are common and of great variety. In many instances they contain obligations on farmers to purchase feed or chemicals in return for financial backing, supply of storage equipment on loan, hire or hire purchase, or marketing outlets for their produce. We had few indications of dissatisfaction from farmers but our investigations indicated two areas of most likely interest to this inquiry. These are the provision of equipment and livestock agreements.

10.2. Bulk delivery of feed, chemicals and fertilisers for horticulture and livestock is economical and producers of these products operate schemes under which their supply is tied in with the provision of equipment to facilitate bulk storage. There are also arrangements under which dispensing equipment, for example, for spraying, is supplied provided that the product used with it is also taken. As we have argued in paragraphs 4.19 to 4.22 above, arrangements of this kind are not likely to be objectionable if, as is the case with similar arrangements in other industries, certain principles are applied. The initial term of supply agreement should not be unreasonably long, taking into account the nature of the equipment, its cost and mobility, and there should be reasonable provision for the termination of the supply agreement by the customer on payment of any outstanding balance of debt or by returning equipment of which the ownership remains with the supplier. In those specimen agreements we examined these principles were followed.

10.3. In livestock schemes the farmer is assisted, in many cases by finance, in obtaining stock and, subject to quality and specification, provided with a market. In return he agrees to the exclusive use of the supplier's feed. There are several types of agreement mainly concerned with pigs, calves or poultry. By their nature they involve ties restricting the freedom of action of the individual farmer and access to his custom by competing suppliers. However, the lack of response to our publicity and our invitations to give information indicates that there is generally a fair measure of mutual interest and a lack of onerous terms. The specimen agreements we examined contained reasonable provision for their termination. The National Farmers' Union checks current agreements and has a scheme of certification which is intended as a guide to its members in choosing schemes and an encouragement to good practice on the part of the suppliers.

10.4. The effects of these ties on the wider public interest are more complex, depending on the extent to which there are dominant suppliers with market power. Possible adverse consequences are the diminution of competition, increasing concentration of suppliers, and resulting higher prices to the farmer which might ultimately be passed on to the consumer. On the other

hand, it may be that the provision of a package arrangement by the suppliers is well suited to the farmer's needs and it is one of the ways in which the suppliers can usefully compete with one another.

10.5. We did not investigate individual schemes in detail, but where there is limited competition, livestock schemes for example could act against the public interest and should be watched. If in these schemes a particular problem should come to light through complaints from individual farmers or from the National Farmers' Union, then investigation under the Competition Act would be appropriate.

CHAPTER 11

The Pharmaceutical Industry

11.1. A particular example of full-line stocking is to be found in the distribution of drugs; full-line forcing might be too strong a term. The emphasis is on prescription medicines for human use and medicines for animal health used by veterinarians, but over-the-counter human and animal medicines can be subject to similar requirements.

11.2. There are some 12,000 lines in the pharmacist's inventory but the average retail chemist is able to carry only one to two thousand lines, due to limitations of space and capital. The demand for individual drugs differs greatly, and it has been estimated that 80 per cent of the turnover of drugs is from no more than 20 per cent of the inventory. There is, however no limitation on the drugs that doctors can prescribe and there is a statutory requirement that prescriptions should be filled 'with reasonable promptness'. The definintion of reasonable must take into account the possible urgency of a patient's need and it is therefore necessary for the dispensing pharmacist to have ready access to the whole drug inventory.

11.3. There are some 10,000 retail pharmacies in the United Kingdom and it would be impracticable for each manufacturing chemist to maintain a nationwide direct delivery service capable of the necessary speed and reliability. In addition, at the prices paid to retail pharmacists for prescription medicines (as determined through the medium of the Pharmaceutical Price Regulation Scheme agreed between the industry and the Government) certain drugs in the inventory are uneconomic for retail pharmacists to carry as individual items because of slow turnover, storage requirements and in some cases licensing obligations. A network of wholesale distributors has therefore grown up capable of making daily deliveries within their areas and several deliveries a day in larger towns. The Code of Practice of the National Association of Pharmaceutical Distributors, to which about 90 per cent of the wholesalers belong, requires as a condition of membership the carrying of comprehensive stocks of prescription medicines produced by those manufacturers with whom each of them deals. Manufacturing chemists also seek to ensure full-line stocking, increasingly by the use of formal agreements with wholesale distributors.

11.4 The need for full-line stocking by wholesalers appears to have been recognised by the Restrictive Practices Court and accepted as a justification for maintenance by manufacturers of wholesalers' resale prices for ethical drugs. In 1970 the Court considered that the removal of price maintenance would result in competition which would lead to contraction of stocks and curtailment of delivery services, decreasing the ability of retail chemists to fill the more difficult prescriptions at short notice.

11.5. At present the public interest appears to be well served by the existing distribution system based on full-line stocking by wholesalers, which is itself achieved by a mixture of forcing and consent. This involves conditions imposed by some manufacturers on their customers, the Code of Practice of the National Association of Pharmaceutical Distributors and general agreement at all levels in the distribution chain that it is necessary.

11.6. However, in recent years resale price maintenance has been effectively breached by a number of means, mainly various forms of discount allowed by wholesalers, and some of the effects predicted by the Restrictive Practices Court are occurring. If this process continues, and the pressures of discounting and competition become sufficiently strong, one or more of the influences which support full-line stocking could weaken or disappear and wholesalers might seek to reduce the number of lines they carry. The future is uncertain, but if through the collapse of resale price maintenance, or for any other reason, full-line stocking by wholesalers were to cease there could be a significant adverse effect on the distribution of drugs, unless some alternative system evolved or were imposed. Possible alternatives could involve bulk delivery of fast moving items and a special service for slow moving items no doubt at higher cost and, in the more remote areas, with loss of speed. It might also be necessary for a new pricing structure to be developed to encourage retailers to increase the range of their stocks.

11.7 It is by no means clear that any alternative system of distribution would be preferable. In the context of our inquiry we note that this is an example of full-line stocking, with an element of forcing, in which suppliers have a good defence against a charge that their conditions might act against the public interest.

CHAPTER 12

The Sale of TV Advertising

12.1. The subject of the sale of television advertising time was drawn to our attention by the Institute of Practitioners in Advertising who, in a paper on the subject, singled out the practice of the programme companies of selling packages made up of choice and low-rated spots. In the view of the Institute this amounted to a tying condition, the effect of which was exacerbated by the companies' manipulation of the system by which bids for spots can be pre-empted to force up the selling price.

12.2 The sale of advertising time is based on rate cards, issued independently by each programme company. The cards list prices for spots of different length and by time band throughout the week, for example for 30 seconds betwen 18.00 and 22.25 on a weekday. Each single rate quoted, however, is in effect a point on a scale of perhaps six steps; bids can be made at points below the top rate on the scale but are accepted by the programme company subject to the possibility of pre-emption by another advertiser offering a higher rate. The rate cards also contain a number of special discounts and packages with which we are not concerned here; they are bargain offers which can be taken up or not and are not the subject of any objections by the advertisers.

12.3. The IPA had two complaints. First, that the sale of individual spots sought by an agency was made conditional upon the acceptance of a package which included low-rated spots inefficient for the agency's purpose; second, that when an agency requested a schedule of spots, some in prime time and some in cheaper off-peak times, the programme company might stipulate that off-peak spots should be booked at one or two levels above that which the agency judged to be necessary and that the prime spots should be booked at one level below the top rate. As a result prime spots would be liable to pre-emption and the agency left with an inadequate schedule of over-priced off-peak times.

12.4. Of these complaints it appeared that the linking of the sale of spots in high demand to those less readily saleable might be a practice within our terms of reference, but that the manipulation of the pre-emption system, as described, was of doubtful relevance.

12.5. Our enquiries into the buying and selling of air time presented a rather more complex picture which did not support the simplified concept of desirable spots being used to force the sale of the less desirable by the use of tie-in conditions. Programme companies aim to sell their air time so as to bring in as much revenue as they can; advertisers and agents for their part aim to obtain the best possible coverage for the budget allocated to a particular campaign. Television advertising is distinguished by one main feature: it is fixed in amount at six minutes per hour of air time

and the quantity cannot be increased to meet demand as can the number of newspaper pages. Over a period the market has varied but at present the general position is that the programme companies can sell all of the time they have to offer but not all at the top rates of the current rates cards. There is therefore room for bidding and negotiation.

12.6. Depending on the requirements of a client's campaign, an agency might seek particular days or time bands or coverage of a selected type of audience. The programme company will have certain times available during the required period and is under an obligation to the Independent Broadcasting Authority and to the generality of advertisers to avoid discrimination. There is therefore an element of rationing. There may be several exchanges between agency and programme company before a schedule is finally agreed and even then there is the possibility that some of the individual spots will be pre-empted before the transmission, calling for a further revision.

12.7. Many factors enter into the negotiation of a package and in the case of some programme companies the selection of a collection of spots to meet a particular requirement is largely a computer operation. It is quite possible that what a seller might see as a fair allocation of available times tailored to the customer's need can be seen by the buyer as a forced sale of poor times with good, and advice offered as to the most likely level on the rating scale to avoid pre-emption in the existing state of the market as a device to raise the price unduly.

12.8. Each transaction of this sort is individual and between representatives of sophisticated organisations which are often in virtually continuous contact, each trying to get the best terms. Among the elements in negotiating a deal might well be an intention to tie the acceptance of one time to that of another but this would be difficult to isolate and prove.

12.9. Television advertising is a monopoly of the programme companies and the supply of air time is limited. There are therefore dangers which are recognised in the Independent Broadcasting Authority Act 1978. The Act imposes responsibility on the IBA for ensuring that there is no discrimination against or in favour of particular advertisers and that charges for advertisements accord with tariffs produced and published in a form determined by the Authority. Both agencies and programme companies are used to the system under which they have worked for a number of years. The anxieties which the advertisers put to us may be alleviated by the new Broadcasting Bill which includes an intended safeguard in the form of an IBA Advertising Liaison Committee on which both advertisers and advertising agencies will be represented, with a requirement for the Director General of the IBA to report annually to Parliament on problems which have arisen and how they have been resolved.

12.10. Our view of the present procedures in the buying and selling of air time is that it appears to be inherent in the system that an advertising campaign must be made up of a package of spots, the precise content of

which cannot be determined in advance but must be arrived at by a process of negotiation. Since this is accepted by both buyers and sellers, it would be unrealistic to regard the system as one which simply involves the tying of the supply of some spots to that of others. It is possible that the system could be manipulated so as to sell spots that would otherwise remain unsold, but we are not in a position to say if an alternative system would be feasible or preferable, and, since there are proposals for statutory provision concerning discrimination and charges as well as for a Liaison Committee for resolving problems, we think that no further investigation or intervention should be necessary.

CHAPTER 13

Conclusions

13.1. As we have already explained in paragraph 1.4, the reference to us of full-line forcing and tie-in sales was made as a result of a recommendation in the Green Paper 'A Review of Restrictive Trade Practices Policy' (Cmnd 7512) that these practices should be made the subject of a general reference to the Commission with a view to prohibition if that were shown to be justified. The Green Paper took the view that these practices might merit prohibition because they seemed likely invariably to be found against the public interest and because this appeared to distinguish them from the generality of anti-competitive practices, the effect of which might sometimes be neutral or even beneficial.

13.2. Our reference requires us to report on the general effect on the public interest of full-line forcing and tie-in sales. In considering this we have had principally in mind the question whether the practices are in fact invariably, or almost invariably, against the public interest and therefore merit being singled out for special treatment.

13.3. We are aware that academic investigation of the subject has drawn attention to various reasons for the practices and has also identified various possible economic effects. This literature is mainly American, and reflects the fact that in the United States tied selling is among practices which in some circumstances are regarded as anti-competitive *per se* and therefore under American law unlawful.

13.4. The cases discussed in the literature fall analytically into four main classes, where:

(1) the supplier's monopoly power in the market for product A can be extended to the market for product B by tying the supply of good B to that of good A;

(2) the supplier can effectively charge different consumers different prices for good A on the basis of their use of the tied good B;

(3) the supplier can ensure a standard of performance of good A, thus maintaining consumer goodwill, by insisting that it is only to be used in conjunction with the tied good B;

(4) the supplier can supply good B at a lower price than he otherwise could because, by tying its supply to that of good A, economies of scale can be realised.

13.5. The tying practices we have examined can be classified in this way. Although the economic literature, particularly that in the United States, concentrates upon the first type, we found no clear examples; though if, as it was suggested, some computer manufacturers were attempting to tie the supply of peripheral equipment to that of their mainframe computers, such practices would fall under this heading of extending

monoply power. The tying of punchcards to punchcard machinery is a well-attested case in the literature on the second type. The supplier of punchcard machines may charge a uniform price to all customers both for machines and for punchcards; but by tying punchcards he is able in effect to charge a higher price for the machine to those customers who make more intensive use of it (ie those who use more cards). Insistence that the user of a rented photocopying machine uses only certain tied supplies falls into the third type; though if alternative, competing, supplies did not in fact materially diminish the machine's performance, the supplier would in reality be trying to extend his market power (case type 1). An example of the fourth type occurs where a supplier provides bulk storage or handling equipment on favourable terms to farmers in return for their obligation to purchase certain feed, chemicals or fertilizer from him. The favourable terms for the equipment may be justified by the supplier's consequent economies of scale in delivery.

13.6. Broadly speaking, the literature suggests that cases which fall squarely into types (3) and (4) are unlikely to have harmful economic effects. The more closely a case approaches types (1) or (2) the more likely it is that competition will be inhibited, output reduced, and prices raised in the market for the tied good. The extent to which these detriments will occur will depend upon the power which the producer or supplier disposes in the market for good A, the tying good, and his ability to enforce the tie and so foreclose competition in the market for the tied good, B.

13.7. In this inquiry we have proceeded not by considering the potential effects of tying in these *a priori* situations, but by examining the actual effects of the various practices we have discovered. Throughout we have considered how far tying transactions are in practice likely to be against the public interest. In particular we have concentrated on the need to reach a conclusion on whether the practices seem so generally against the public interest that their prohibition would be justified.

13.8. The Green Paper stated that when tying arrangements had come to light in the course of monopoly inquiries in the past they had invariably been found by this Commission to be against the public interest. These are the five cases briefly described in paragraph 1.5. It is not surprising that Commission reports have found ties to be against the public interest since those that have come to light have been connected with monopoly situations and may have been, in part, the reason for a reference having been made.

13.9. In fact, however, the Commission's reports did not wholly condemn the ties concerned in each case. The 1965 report on Petrol objected not to the requirement that petrol retailers should sell also the supplier's lubricants and certain other products but to the requirement that they should sell these things exclusively (ie not sell other brands). The 1976 report on Indirect Electrostatic Reprographic Equipment objected to the tying of one particular product to the supply of machines, but did not object to the tying of certain other products and of servicing*. The fact that in two cases out of five

* Paragraphs 420 and 421.

either the ties themselves were not condemned or only some of them were condemned is wholly consistent with the conclusion which emerges from our review of tying situations in Chapters 4 to 12 that ties are by no means always against the public interest.

13.10. In Chapters 4 to 12 we have described the main ties and groups of ties that came to our notice as the result of very wide-ranging inquiries (see paragraph 1.6). A significant feature of these inquiries was the low level of response, which might be taken to indicate that there is no generality of practice which customers and users at any level in the distribution chain find noticeably oppressive. Ties that are simply the exercise of monopoly power to insist that if a customer wishes to buy one product he must also buy some other product, without there being some other factor or consideration involved. are in our view likely to be generally against the public interest. Such cases appear to be relatively rare. However, ties as a whole are not uncommon, and in the following paragraphs we consider a number of broad groups of ties of which the effects on the public interest are not self-evidently adverse on balance or in all cases.

13.11. There is a wide range of transactions, occurring in, for example, farming and in the distribution of petrol, which involve the supply of storage or dispensing equipment, on loan, lease or credit, on condition that the supplier's consumable products are also taken. There are also transactions in which no equipment is supplied but a cash loan is made on the same condition, as for example where brewers lend money to the free trade to be used for the improvement of premises. Transactions of this kind may be anti-competitive and against the public interest unless the supply agreement provides the option for the recipient to be released from his obligation after a reasonable period specified in the agreement, on return of the equipment or payment of any amount outstanding for it, or on repayment of a loan. As a result of the Commission's 1965 report on the supply of petrol to retailers, appropriate guidelines have already been laid down for petrol distribution, and are apparently being generally followed. These guidelines should be broadly applicable to transactions of the same kind in other industries.

13.12. Another substantial group of ties is the supply of consumable materials and spares tied to the supply of machines by means of servicing contracts or guarantees or as a rental condition. Good examples of ties of this kind, some justified and others against the public interest, are to be found in connection with copiers ; the Commission in its 1976 report on the subject, already mentioned in paragraph 13.9, found that it was justifiable for Rank Xerox to control the provision of those materials and parts where the use of unauthorised supplies could materially affect the performance of machines rented, but that it was against the public interest for it to insist on the use of its own toner. These examples illustrate the general conclusion on the tying of consumables and spares that the ties may well be against the public interest, but that they may be justified if it can be established that it is reasonable on technical grounds to require that the supplier's consumables and spares be used exclusively.

13.13. It is a simple matter to state the principle that the tying of consumables and spares is justifiable in such a case and likely to be against the public interest in other cases, but in practice the principle is not easy to apply, and we consider that a case by case approach with proper consideration of the individual technical and other factors involved is preferable.

13.14. There are certain groups of ties which have *prima facie* objectionable features but where there are also strong arguments to the contrary and the issues are too complex to be resolved in the course of a general inquiry. An example of this is the tying by building societies and other lenders of insurance agency to the provision of mortgages. As we have pointed out in paragraph 9.12 of our discussion of this subject it is not possible without a detailed inquiry to determine where the balance of advantage lies.

13.15. There is also a group of ties which, because they are conditions imposed in return for the grant of a lease, which is neither the supply of goods nor the supply of services, are outside the terms of our reference. An example of this is the requirement by petrol companies that, as well as petrol, retailers sell other items, such as oil, anti-freeze, tyres and batteries supplied by them, at rented filling stations. Another example is the requirement of brewers that tenants of rented houses sell wines, spirits, minerals and other products supplied by them as well as beer. There appear to be ties in these cases but since they are outside our terms of reference we formed no view on their effects on the public interest. We note, however, the conclusion in the 1965 Petrol report (already mentioned in paragraph 13.7), that in the circumstances of the market then being investigated the tying of certain other products to the supply of petrol was not objectionable unless it involved exclusivity.

13.16. Ties that arise in the course of business format franchising operations are discussed in paragraphs 7.1 to 7.9, where we have concluded that there is no clear-cut dividing line between franchising arrangements which involve ties and those that do not. Broadly there is a tie if the franchisee is required to purchase from the franchisor some product which is not an essential part of the franchise. This can be determined only by examination of individual cases, and even where such examination shows that there is a tie the effect on the public interest will itself depend on individual circumstances. Such ties may in principle have anti-competitive effects, but the extent to which this is so depends on the general competitive situation in the trade concerned, and we believe that the effect on competition may often be negligible.

13.17. Instances of full-line forcing seem, on the basis of information obtained by us, to be rare. Indeed the only clear case which came to our notice was in the pharmaceutical industry, where wholesalers are required to carry the whole range of drugs supplied by those manufacturers with whom they deal (see paragraphs 11.1 to 11.7). As we have pointed out in paragraph 11.4, the Restrictive Practices Court in its 1970 judgment on price maintenance in the pharmaceutical industry recognised the need for full-line stocking by pharmaceutical wholesalers and accepted it is a justification for maintenance by pharmaceutical manufacturers of wholesalers' resale prices

for ethical drugs. The element of forcing does not, however, seem to be a major consideration, and all the submissions we received from the industry were in agreement that full-line stocking is necessary. It is possible to argue that any full-line forcing has undesirable anti-competitive features; but in the case of the pharmaceutical industry there is a powerful argument that the present arrangements under which pharmaceutical wholesalers stock a full range are desirable in the interests of quick distribution and ready availability of drugs. However, for our purposes it is sufficient to state the limited conclusion that the only clear case of full-line forcing (or full-line stocking) which came to our notice is far from being unequivocally against the public interest.

13.18. In other cases which came to our notice the practice might be described as line forcing rather than as full-line forcing. A good example of this occurs in the distribution of cosmetics, toiletries and perfumery (see paragraphs 6.3 to 6.6). In this trade retailers are commonly expected, or required, to stock a range, though not necessarily the full range, of a manufacturer's products. The requirement is often flexibly applied and the extent of the range which must be stocked is likely to depend on the type of retail outlet being supplied and may be negotiated with the retailer rather than arbitrarily imposed. There are similar situations in other trades, such as the marketing of shoes (see paragraphs 6.7 to 6.9) where retailers are required to stock a range of styles, sizes and fittings, though not necessarily the full range available.

13.19. It is an essential feature of the trades in which arrangements of this kind are to be found that the retailer in any case needs to stock an adequate range in accordance with the characteristics of the particular trade, and the compulsion does not necessarily result in the retailer stocking a range which is materially different from what would be the range of his own choice. Nor is the retailer necessarily prevented by range stocking arrangements from stocking the goods of other suppliers.

13.20. On the other hand, insofar as there is compulsion range stocking arrangements in connection with agencies are inherently anti-competitive particularly because of the difficulties they may place in the way of small retailers or potential retailers. Whether they are against the public interest in particular cases depends on such factors as the commercial circumstances of the trade concerned, the structure of the market and the relative bargaining strengths of the retailers and of their suppliers.

13.21. Our general conclusion on tie-in sales and line-forcing is that the practices frequently take their character from the circumstances in which they occur and that their effect on the public interest is not consistently harmful, beneficial or neutral but depends on those circumstances. There would be no case for legislation to prohibit the practices unless there were not only a preponderant proportion of instances in which the practices operated against the public interest but also only a small absolute number of instances in which they did not operate against the public interest. Our review of the practices does not show that there is in fact at present a sufficiently high proportion of instances of their operating against the public interest to

justify general prohibition. Our inquiries were inevitably incomplete and it is possible that there are instances which, if they come to light, would modify this conclusion. However, irrespective of any ties which may not have been brought to light, our inquiries have shown that the number of cases in which the practices do not operate against the public interest is substantial; in our view it is sufficient to make prohibition of the practices inappropriate.

13.22. If there were to be legislation making the practices unlawful, there would have to be provision for exemption where it could be shown that in particular cases the practices were beneficial in one or more of certain specified ways. This is the approach to resale price maintenance adopted in the Resale Prices Act 1964 (and subsequent legislation). This method of control appears to have worked satisfactorily in the case of resale price maintenance, and it has the advantage that where a particular practice is widespread the process of bringing it under control is greatly speeded up and might otherwise be unduly prolonged. It may also be argued that to make a particular practice unlawful has the advantage of affording greater certainty than there is with a case-by-case neutral approach.

13.23. However, resale price maintenance differs significantly in character from the practices we are considering. It is a relatively easily definable practice, with clear-cut boundaries and relatively consistent effects. Tie-in sales and line-forcing are much more diffuse and varied both in their nature and in their effects on competition.

13.24. The principal reason why we consider that legislation on the lines of the Resale Prices Act would not be appropriate for tie-in sales and line-forcing at present is that there are too many cases in which their effects would not be against the public interest. Moreover, because a large number of cases would have to be considered on their merits there would be little prospect that this method would in the event lead to the practices being speedily brought under control or that it would achieve greater certainty.

13.25. To operate legislation making the practices unlawful it would be necesssary to define the practices it was intended to control. The form of words used in our terms of reference gave rise to considerable argument whether particular kinds of transaction were covered by it or not; moreover it certainly covers transactions where the effect is trivial or at least arguably beneficial and may exclude some where the effect is damaging. We believe that a satisfactory definition would be difficult to achieve, and that any attempt at definition would tend to lead to argument about whether a particular practice was covered by the definition to the exclusion of consideration of its economic effects.

13.26. A further practical difficulty which might arise from making the practices unlawful and from the consequent necessity to define them is that suppliers who impose ties might find alternative ways of achieving their objective which would not be caught by the prohibition, thus frustrating the purpose of the legislation. The adoption of alternative strategies seems less likely if control of tying arrangements is on a case-by-case neutral basis.

13.27. In the Appendix to this report we have reviewed legislation in some foreign countries under which full-line forcing and tie-in sales can be controlled. Foreign legislation which makes particular practices unlawful either *per se* or on some specified condition (eg that they involve substantial restriction of competition) appears always to be concerned with a wide range of practices and we have found no legislation singling out full-line forcing or tie-in sales for special treatment. In the one case where foreign legislation specifically mentions tie-in arrangements, it does so by way of listing them with a number of other anti-competitive practices.

13.28. Some countries have indeed made tie-in sales unlawful as part of a range of practices declared to be unlawful. But the legislation at present existing in this country has adopted a case-by-case neutral approach to anti-competitive practices. The definition of anti-competitive practices in the Competition Act is very wide and does not single out any particular practices or types of practice. Not merely a specified range of practices, but all anti-competitive practices (except those of public sector undertakings), are within the scope of the Act; no practice is outlawed and no presumption is created against any practice. Furthermore, the Act clearly allows for any particular practice to be found against the public interest in some circumstances but not in others.

13.29. There would in our view have to be compelling reasons for singling out particular practices for different treatment. It will be apparent from what we have already said that our inquiries have not revealed such reasons in the cases of full-line forcing and tie-in sales that we have considered.

13.30. However, there still remains the question whether existing legislation which can be used for controlling tie-in-sales and line-forcing—that is the relevant provisions of the Fair Trading Act 1973 and of the Competition Act 1980—is adequate for the purpose. Before the coming into force of the Competition Act the practices could be controlled only by making references under the Fair Trading Act, and this was no doubt unsatisfactory because the practices could occur in circumstances where a reference either could not be made or was unlikely to be made because the procedure was too cumbersome. However, with the coming into force of the Competition Act the position is substantially different since the Act has, as one of its principal purposes, provided a method of bringing under control a wide range of practices in the private sector ('anti-competitive practices') in which full-line forcing and tie-in sales can clearly be included. The procedure can be brought into operation without the necessity (which there is under the Fair Trading Act) of establishing that there is a statutory 'monopoly situation'. The anti-competitive practices provisions of the Competition Act are, however, directed towards the control of such practices on the part of a specified 'person' and may not therefore be appropriate for the control of tie-in sales or line forcing (or, indeed, other anti-competitive practices) where these practices are to be found throughout an industry or trade and need to be controlled across the board. But where this is the case it is likely that the appropriate course would be a limited reference

under the 'complex monopoly situation' provisions of the Fair Trading Act—sections 6(i)(*c*) and (2) or section 7(1)(*c*) and (2).

13.31. It is possible that inquiries under the existing legislation into individual ties in greater detail than has been appropriate in this inquiry may indicate the practicability and desirability of legislation to ban some categories of ties; but we believe that the existing provisions of the Competition Act and, where necessary, of the Fair Trading Act are sufficient in general for adequate control of tie-in sales and line forcing and that at present no further legislation is needed. Only experience of the operation of the Competition Act will show, in due course, whether this belief is correct; but if any strengthening of the legislation should ultimately be found necessary it is likely that this would be because of some inadequacy in the provisions for controlling anti-competitive practices generally and we see no reason to suppose that it would be because of any factors peculiar to tie-in sales and line forcing.

13·32. Since we conclude that there is at present no need for any further legislation to control tie-in sales and line forcing, it follows that we think that the responsibility for initiating action against the practices in individual cases should remain, as it is now, with the Director General of Fair Trading as part of his similar responsibility in respect of anti-competitive practices generally.

13.33. The information available to us as a result of our inquiries suggests certain guidelines which might usefully be borne in mind in the process of identifying tie-in sales and line forcing and of deciding when to initiate action against them. These are as follows:

(*a*) Tie-in sales and line forcing are unlikely to be found, or are unlikely to persist, except when the supplier has some degree of market power in the supply of the tying goods or service, and any adverse effect on the public interest is likely to depend on the extent of the market power. Where there is little market power (because for instance there are alternative goods or alternative suppliers available) a tie may be difficult to operate and, to the extent that it is operated may not have any significant effect on the public interest.

(*b*) Where a supplier has substantial market power in the tying good or service the exclusionary effect on competitors is likely to be against the public interest, but how far this is so in practice is likely to depend on the structure of the market for the tied good or service and the extent to which it may be changing. If a tie forecloses only a small part of the market and there are numerous other outlets available the effect on competitors in the supply of the tied good or service may be negligible.

(*c*) Tie-in sales and line forcing may simply represent the exercise of monopoly power in one market to restrict competition in another market, with no additional factors being involved. Any such cases are likely to be almost invariably against the public interest.

(*d*) The anti-competitive effects of tie-in sales and line forcing are likely to be much more significant if the practices are associated with an insistence on exclusive dealing.

(*e*) Ties which are potentially anti-competitive may often be defended on technical grounds, as in the case of tying of spare parts and consumable materials. These ties may be hard to evaluate and may often require detailed examination.

J G Le Quesne (*Chairman*)

R G Aspray

E A B Hammond

T M Rybczynski

E S Simpson

R G Smethurst

J Gill (*Secretary*)

28 January 1981

Overseas Legislation

1. In the course of our inquiry we examined the treatment of tie-in sales and full-line forcing under the competition laws of the United States of America, Canada, Australia, Sweden, West Germany, Ireland and the European Economic Community.

2. Tie-in sales are mentioned specifically in the legislation of Canada only. There 'tied selling' is one of a group of practices which can in individual cases be prohibited if after examination it is found that 'competition is or is likely to be lessened substantially'.

3. Australian legislation, though not specifically mentioning tie-in sales, prohibits (subject to a procedure for exemption) 'exclusive dealing' if it has the purpose or effect of 'substantially lessening competition'. Since exclusive dealing is in many cases indistinguishable from tied selling or range forcing (see paragraph 2.2) the legislation has the effect of prohibiting some (but not all) cases of the latter practices.

4. In the United States of America tied selling is not specifically mentioned in any legislation, but there are a number of legislative prohibitions of broadly described practices which may be held to include tied selling. Practice in the United States differs from that in other countries because of a tendency on the part of the courts to regard tied selling as automatically involving a lessening of competition.

5. In other countries where there is controlling legislation each case is examined on its merits.

United States of America

6. In the United States of America tie-in sales are regarded as belonging to a group of exclusionary practices, that is practices which are anti-competitive because they tend to exclude competitors from a part, or the whole, of a market. Other exclusionary practices include refusals to deal, exclusive dealing arrangements and vertical mergers.

7. Tie-in sales may be prohibited under four areas of US anti trust law:

(i) A tie-in sale might be regarded as a contract in restraint of trade or commerce and prohibited under section 1 of the Sherman Act.

(ii) A tie-in sale might be regarded as an attempt to monopolise trade in the tied market and hence would be illegal under section 2 of the Sherman Act.

(iii) Tie-ins might be regarded as excluding competitors from a part of the market for the tied goods thereby substantially lessening competition and creating an offence under section 3 of the Clayton Act.

(iv) Tie-ins might be regarded as an unfair method of competition under section 5 of the Federal Trade Commission Act.

8. Most cases involving tie-ins have been brought under section 3 of the Clayton Act. These have covered a wide variety of types of ties including ties of consumables to machines, ties through storage equipment, through cheap loans, through physical compatibility and in franchising. The court decisions have been complex, involving numerous interpretations and re-interpretations of the law. The fundamental issue has concerned the interpretation of the requirement in section 3 of the Clayton Act that unlawful exclusionary agreements must 'substantially lessen competition' or 'tend to create a monopoly'. The *rule of reason* interpretation is that each case involving a tie-in should be examined on its merits to determine the competitive effects of the restriction. The *per se* interpretation is to argue that whenever the tie-in is practised by a supplier with market power in the tying market or a substantial volume of sales in the tied market, then a substantial lessening of competition automatically follows and it is sufficient to establish the *facts* of the tie-in without examining the effects. The trend has been to move from a *rule of reason* to a *per se* approach.

9. It is argued that a major weakness of the *per se* approach which has been developed by the courts is that it seems impossible to define a tie and to decide when a sale is a combination of separate products or a single product made up of components. The absence of any clear definition of what constitutes tie-in sales will, it is argued, in effect make many cases into *rule of reason* cases. The focus of the case then becomes the question of what combinations of components should be considered as a single good as opposed to divisible sale items.

10. There have been many criticisms of the courts' failure to distinguish between tie-in arrangements which lead to an extension of monopoly power in the tied good market and those which do not. It is also argued that where there is a significant extension of monopoly power reasons for the tie such as cost savings and the maintenance of quality should be taken into account.

Canada

11. Tied selling is a business practice which since 1976 has been specifically mentioned in Canadian competition law. Under the terms of the Combines Investigation Act 'tied selling' means:

(*a*) any practice whereby a supplier of a product, as a condition of

supplying the product (the 'tying' product) to a customer, requires that customer to

(i) acquire some other product from the supplier or his nominee, or

(ii) refrain from using or distributing, in conjunction with the tying product, another product that is not of a brand or manufacture designated by the supplier or his nominee, and

(*b*) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (*a*)(i) or (ii) by offering to supply the tying product to him on more favourable terms or conditions if the customer agrees to meet the condition set out in either of these sub paragraphs.

12. The practice falls within a group of practices coming under the heading of 'Matters Reviewable by the Restrictive Trade Practices Commission'. Under section 31.4 of the Act tied selling, with other practices, is subject to review by the Commission on a case-by-case basis and where the tie-in is found to have led to a substantial lessening in competition the Commission can order prohibition or make a remedial order that will restore competition.

13. The origins of this law on tie-ins lie in the Restrictive Trade Practices Commission's Report on the Distribution and Sale of Automotive Oils, Greases, Anti-freeze, Additives, Tyres, Batteries, Accessories and Related Products (The 'TBA Report') of 1962.

14. The report was concerned with the practice whereby the major suppliers of petrol required their retailers (normally supplied under a fixed term exclusive supply agreement) to purchase TBA either from the petrol company (described as full-line forcing by the Commission) or from a nominated supplier (described by the Commission as 'directed buying'). The central issue in relation to the distribution policies of the oil companies with regard to products other than petrol was whether they 'close-off or fence-in a substantial part of the service station market in a way . . . which is likely to be against the interest of the public in a system of free competition'.

15. The Commission concluded that full-line forcing and directed buying arrangements, when applied by the larger oil companies, each of which has a substantial share of the market, do have exclusionary effects which are likely to lessen competition directly and indirectly to the disadvantage of the public The disadvantages will arise not only from a lessening of competition in the narrowing of the range of products offered to and sold by service station dealers, but from the limiting of opportunities for manufacturers and distributors not possessing contracts with oil companies to enter the service station market. The Commission therefore recommended that the Combines Investigation Act should be amended to include prohibition of tying arrangements which are likely to lessen competition substantially, tend to create a monopoly or exclude competitors from a market to a significant degree.

16. In 1966 the Economic Council of Canada was requested by the Federal Government to study the country's competition policy and in particular the

recommendations of the Commission. The Council's recommendation was that tying arrangements (including full-line forcing), together with other exclusive dealing practices, refusals to deal, basing-point pricing, predatory pricing and consignment selling, should form a group of practices which would not be *per se* illegal but could be examined on a case-by-case basis to determine whether in the individual circumstances they were harmful to the public. These recommendations formed the basis of the current law.

Australia

17. The competition law of Australia is contained in the Trade Practice Act of 1974 (extensively amended in 1977). The principal prohibitions are contained in sections 45 to 50 of the Act. These declare the following unlawful where they have the effect or the likely effect of substantially lessening competition :

contracts, arrangements or understandings which restrict competition ;

monopolisation and monopoly abuses ;

price discrimination ;

exclusive dealing ;

resale price maintenance ;

mergers.

18. The authority responsible for enforcing the Act is the Trade Practices Commission. The Commission have the power to investigate alleged contraventions of the Act and they may initiate actions in the Federal Court of Australia. An important part of the Commission's work is the notification procedure. Under this a company may continue a practice unless and until the Commission decide that the conduct has the purpose or effect of substantially lessening competition in a market and that the anti-competitive effect is not outweighed by benefits to the public resulting from the conduct.

19. Tie-in sales and full-line forcing may be covered by the general prohibition of exclusive dealing in subsections (2) and (3) of section 47. Subsection (2) makes it illegal to make supply (or a discount) conditional upon the purchaser not acquiring goods or services from a competitor of the supplier. Subsection (3) makes it illegal to refuse supply (or a discount) on the grounds that the purchaser has acquired or not agreed not to acquire goods or services from a competitor of the supplier. If a tie-in sale involves a restriction on the purchaser on buying the tied goods from a competitor, the tie-in has the exclusionary effect which brings it within the scope of subsections (2) and (3).

20. Subsections (6) and (7) are concerned with the practice of 'third-line forcing', that is the supply or price or discount being made conditional upon the purchaser acquiring some other good or service from a third party. Unlike conduct under subsection (2) and (3) third-line forcing is *per se* illegal

and is not dependent upon there being a 'substantial lessening of competition'.

21. Another form of tying arrangements which has been of particular significance in Australia is specifically covered by subsections (8) and (9). This is where the offer of the lease of a retail outlet by a supplier is made conditional upon the lessee acquiring goods or services from the lessor. The offer of the lease or licence on condition that goods and services are purchased exclusively from the lessor is a practice which was general in the supply of petrol and supply of beer.

22. While neither tie-in arrangements nor full-line forcing are specifically referred to in the legislation it is clear from various commentaries on the Act that section 47 was intended to cover these practices. Indeed in a report on the working of the Act the Trade Practices Act Review Committee felt it desirable to distinguish particular types of tying practices :

> 'A distinction is often drawn, when considering the practice of full-line forcing, between situations where the "tying" product and the "tied" product are related (such as spare parts, or different models of essentially the same product) and situations where the "tying" and "tied" products are completely unrelated. No such distinction is drawn by the Act at the present time. The Committee would have preferred to recommend that the Act takes a stronger position in respect of the latter practice than in respect of the former practice, but found that it was not able to devise a sufficiently precise line of demarcation between the two situations' (Report page 30).

23. As yet no case of a tie-in sale or full-line forcing has been taken to court, but court action was successfully taken by the Trades Practices Commission in a case of third-line forcing. This involved the practice of Australian Building Societies obliging borrowers to take out property insurance from specified insurance companies. Because the law prohibits such practices *per se* the building society defence rested on whether they were actually covered by the terms of the Act. There was no discussion of the competitive consequences.

24. Under the notification procedure the most important cases involving restrictions on the freedom of purchasers have been the exclusive distribution arrangements in beer, petrol and motor vehicles. All these cases have involved some elements of tie-ins and full-line forcing but there has not developed a set of guidelines to deal with these practices as such. However, they do show the importance which the Commission attach to the quantitative effect on competition. Where the market is small and restrictive distribution arrangements are being imposed by a supplier with a modest market share the Commission have concluded that competition is not substantially lessened. It is also notable that the Commission have given little weight to the argument that restrictive distribution arrangements are necessary in order to maintain product quality.

Sweden

25. The present competition law of Sweden is based on two statutes :

(1) *The Act to Counteract Restraints of Competition* (1970) which

(*a*) prohibits resale price maintenance and price fixing agreements in relation to tenders for contracts, and

(*b*) specifies other ' restraints on competition ' which in individual cases ' shall be deemed to have a harmful effect if, contrary to the public interest, it unduly affects the formation of prices, restrains productivity in business, or impedes, or prevents the trade of others' (Sect 5).

(2) *The Marketing Act* (1975) which makes ' improper marketing activities' that adversely affect consumers' interests subject to prohibition in individual cases.

Tie-in sales and full-line forcing would be regarded as potential ' restraints on competition ' which might be harmful to the public interest in so far as these practices might ' impede ' or prevent the trade of others.

26. Under both Acts the judicial authority is the Market Court, which is a specialised court with no provision for appeal. Proceedings are initiated by the Antitrust Ombudsman in the case of competitive restrictions and by the Consumer Ombudsman in the case of matters affecting the consumer interest. Most competitive restrictions are investigated and decided upon by the Antitrust Ombudsman who has the power to negotiate the termination of restrictions. Normally not more than 10 cases out of 400-500 a year are brought to the Market Court.

27. In practice neither of the Acts mentioned has been extensively used against tie-in sales or full-line forcing. The Market Court has not heard any case of this kind so far and the Antitrust Ombudsman's experience of them is limited. One case examined was the offer by certain suppliers of copying machines of a maintenance contract with regular service calls at a fixed price per annum on the condition that the customer used exclusively consumables furnished by the supplier. No action was taken by the Ombudsman because customers could also get non-contracted service without the condition on use of consumables. Full-line forcing by two cosmetic firms has also been investigated and the Ombudsman concluded that provided a choice of different ranges was available and unsold goods could be returned there was no need for further action.

West Germany

28. Competition law in West Germany is administered by the Federal Cartel Office, which has wide powers of investigation and may hold hearings which can result in the office issuing prohibitions and imposing fines. Parties have a right of appeal to the courts.

29. Section 18 of the Act against Restrictions of Competition covers agreements which impose certain types of restrictions, and empowers the Cartel Office to declare such agreements void in particular cases if they unfairly restrict entry or substantially impair competition. The wording of the section clearly covers tie-ins where the tied and tying goods are unrelated and might cover other tie-ins and full-line forcing if they have the effect of preventing a purchaser from acquiring goods from a third party (ie if they involve exclusive dealing). Unfair restriction of entry or substantial impairment of competition have, however, proved difficult to establish, and reliance has been placed on other sections of the Act.

30. Section 22 of the Act empowers the Cartel Office to control abuse of market power by market-dominating enterprises. Tie-ins and full-line forcing of by market-dominating enterprises might be regarded as abuses, but it is understood that the Cartel Office has preferred to use section 26, which provides that market-dominating enterprises may not unfairly hinder the business of or discriminate against other enterprises.

31. Two significant features of the relevant West German law are, therefore, first that tie-ins and full-line forcing are subject to control only insofar as they may fall within certain broadly described types of practices; and secondly that in the implementation of the law it is considered sufficient to rely on provisions controlling practices by market-dominating enterprises.

Republic of Ireland

32. Irish competition legislation is contained in the Restrictive Practices Act 1972, which amended and consolidated the Restrictive Trade Practices Acts of 1953 and 1959. The Act established the Restrictive Practices Commission as the adjudicatory authority and the Examiner of Restrictive Practices as the person responsible for initial investigations and for administering the operation of legislative orders under the Act. Under the Act no form of conduct is declared illegal but general powers to investigate the supply of particular goods or services and to make recommendations are conferred upon the Commission, who proceed on a case-by-case basis.

33. On the recommendation of the Examiner the Commission investigate and report to the Minister describing the conditions of supply and distribution of a particular good or service and state 'whether (and if so how) any of those conditions involve restrictive practices including arrangements, agreements or understandings which prevent or restrict competition or restrain trade or the provision of any service or involve resale price maintenance.' The Commission must then state 'whether any of those conditions involves practices (including arrangements, agreements or understandings) or methods of competition (whether or not relating to price) which are unfair or operate against the common good'. On the basis of this report (which may include specific recommendations to the Minister) the Minister may make an order prohibiting the practices or take any other action deemed necessary to remedy the situation.

34. In exercising their functions the Commission and the Examiner are required to take note of the list of 'unfair practices' which appears in the Third Schedule of the Act. Tie-ins or full-line forcing are not specifically referred to in the list, but both of these practices could be viewed as measures which

'(*a*) have or are likely to have the effect of unreasonably limiting free and fair competition ;

(*e*) secure . . . a substantial or complete control of the supply . . . of goods . . . or the provision of services, or
and fair competition ;

(*h*) impose unjust or unreasonable conditions in regard to the supply or distribution of goods or the provision of services.'

35. The only cases involving tie-ins have been in the distribution of petrol and office equipment. In 1961 the Fair Trade Commission found that the practice of major oil companies of tying the supply of lubricants to the supply of motor spirit through solus agreements was undesirable in that it imposed unreasonable restrictions upon the petrol retailer and foreclosed the market to independent suppliers of lubricants.

36. In 1970 the Commission looked at the practice on the part of suppliers of office equipment of putting pressure on their customers to use only consumable materials and accessories supplied by themselves. The pressure took the form of the inclusion of a clause in the supplier's guarantee and maintenance contracts which invalidated the contracts if materials other than those prescribed by the supplier were used. The Commission found that though these restrictions were not rigidly enforced they were capable of interfering with competition and were *prima facie* unfairly restrictive.

European Economic Community (EEC)

37. The objectives of competition law of the EEC differ from the objectives of competition law in individual countries. While individual countries are interested primarily in the contribution of competition policy to national goals of prosperity and welfare, competition policy in the EEC has been aimed in the first instance at removing impediments to the freedom of trade between member countries.

38. The competition law of the EEC is established in Articles 85 and 86 of the Treaty of Rome (see end of Appendix). Article 85 prohibits agreements, decisions by groups of undertakings and concerted practices which affect trade and restrict or distort competition in the Common Market. The third paragraph of the Article, however, establishes conditions under which such agreements, decisions and concerted practices are permissible. Article 86 prohibits the abuse by a firm of a dominant market position within the EEC.

Article 85

39. Tie-in sales and full-line forcing are not mentioned specifically. However they may fall within the general prohibition of Article 85(1) as being restrictions of competition ; they may also be covered by one or more of the

non-exhaustive examples set out in the Article as being either a limitation of markets or as imposing acceptance of supplies which have no connection with the subject of a contract.

40. Regulation No. 67/67 of the Commission of 22 March 1967 concerns the application of Article 85(3) to exempt certain exclusive dealing practices from the coverage of Article 85(1). The Regulation notes that exclusive distribution agreements are essential for manufacturers, particularly smaller ones, to achieve distribution in more than one EEC country in view of the difficulties arising from linguistic and legal differences. In view of the benefits of exclusive dealing agreements to wider distribution in the Community a bloc exemption was granted to agreements which either require a distributor to purchase exclusively from the manufacturer, or require the manufacturer to supply exclusively to that distributor in some defined area of the Common Market (Article 1). Moreover it is established that the manufacturer may require the distributor 'to purchase complete ranges of goods or minimum quantities' [Article 2(2)].

Article 86

41. Article 86 specifies several types of abuse of market power. The first, 'directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions', might be considered to cover restrictions such as tying arrangements or line-forcing. The fourth, 'making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts', would seem to apply specifically to tie-in sales.

42. Regulations adopted by the Council of Ministers implement the principles contained in Articles 85 and 86. The most important of these regulations is Council Regulation No. 17 of 1962 which outlines the powers of the Commission to investigate possible contraventions of Articles 85 and 86, to undertake inquiries into pricing and competition in particular economic sectors and to impose fines on undertakings. Most agreements, decisions and concerted practices which fall under Article 85(1) were required to be notified to the Commission if it was desired that an exemption from the prohibition therein should be granted by the Commission. The decisions of the Commission were made subject to review by the Court of Justice.

43. Despite the fact that tie-ins and full-line forcing appear to fall clearly within the ambit of Article 86, no actions have been taken under the Article specifically against the practices.

44. Few of the cases of exclusive distribution which the Commission have investigated under Article 85 have involved elements of full-line forcing. However, the general approach of the Commission is to examine whether, in the case of distribution arrangements which restrict the ability of other suppliers to compete with a tying or forcing supplier or with a tied customer, the restrictions have significant effects on the market. If so, such arrangements are likely to be prohibited.

Articles 85 and 86 of the Treaty (as amended) establishing the European Economic Community

Article 85

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have their object or effect the prevention restriction or distortion of competition within the common market, and in particular those which:

(*a*) directly or indirectly fix purchase or selling prices or any other trading conditions ;

(*b*) limit or control production, markets, technical development, or investment ;

(*c*) share markets or sources of supply ;

(*d*) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competititive disadvantage ;

(*e*) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

—any agreement or category of agreements between undertakings ;

—any decision or category of decisions by associations of undertakings ;

—any concerted practice or category of concerted practices ;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(*a*) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives ;

(*b*) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 86

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as in-

compatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:

(*a*) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(*b*) limiting production, markets or technical development to the prejudice of consumers;

(*c*) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(*d*) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

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