TYING AGREEMENTS—AGAINST PUBLIC POLICY—*PETROFINA (GREAT BRITAIN), LTD.* v. *MARTIN*

The recent decision of England's Court of Appeal in *Petrofina (Great Britain), Ltd.* v. *Martin*[1] is concerned with what is undoubtedly one of the most contradictory and conflicting areas of the common law, i.e. restraint of trade. The case specifically deals with the problem of how far a manufacturer of a product can tie his distributors to dealing only in his product and restrict them from handling those of his competitors. In the present case, the manufacturer is an oil company, Petrofina (Great Britain), Ltd., and the distributor is the local garage outlet. In England, as in Canada, the major oil companies tie the garage outlet to them through tying agreements which take a number of forms. The result, however, is the same in all cases, i.e. the garage proprietor agrees to buy his total requirements of motor fuels from a particular oil company, thus rendering it impossible for him to sell petroleum products of other oil companies. In England, these agreements are referred to as "solus" agreements, and it is such an agreement which came before the courts in the *Petrofina* case.

In *Petrofina (Great Britain), Ltd.* v. *Martin*,[2] the defendant bought the garage in question from vendors who had already tied the garage to Petrofina and who were operating at a loss; Martin bought the garage for £16,000 thus leaving the property free from any charge. The vendors were bound under their own solus agreement to get Martin to sign a new solus agreement on his own account with Petrofina, which he did.

The principal terms of this agreement were as follows: Martin was to buy exclusively from Petrofina all the petrol he required and was not to sell motor fuel manufactured by any other company. He was to sell this fuel at the retail price published by Petrofina[3] and was to promote the sale of Petrofina lubricating oils and greases and to advertise on the premises only Petrofina's motor fuel. He could stock the oil of other companies but was not to advertise it. Martin was to keep the garage open at all reasonable times for the sale of petrol and oil, and was to maintain an adequate stock. If Martin wanted to sell the garage, he was to give Petrofina the first refusal, and if they did not wish to buy he was not to sell unless he first got the prospective buyer to enter into another solus agreement with Petrofina to carry out all of Martin's obligations. Petrofina in return undertook to supply Martin with its petroleum products, lubricating oils, and greases unless prevented by causes outside its control, and to allow him a rebate of five pounds for every 1,000 gallons of motor fuel purchased by him. The agreement was to continue for twelve years from the time of purchase. If at the end of this period Martin had sold 600,000 gallons of petrol, he could determine the agreement thereafter by three month's notice; however, he could not determine it until he had sold 600,000 gallons.

1 [1966] 1 All E. R. 126.
2 *Ibid.*
3 This clause is now unenforceable due to the *Resale Prices Act* 1964, however most dealers continue to sell at recommended prices.

The evidence showed that Martin was selling at a rate of about 30,000 gallons a year, far below the figure of 50,000 which he would have to sell on average annually if his agreement with Petrofina were to be terminable at the end of the twelve-year period. In any event, eight weeks after he purchased the garage Martin broke away from his agreement and began to sell Esso petrol; and on June 5, 1963, he signed a solus agreement with Esso Petroleum Co. which was to run for two years. Petrofina sued for an injunction to prevent Martin from selling and advertising petrol other than their own at the station.

The Court of Appeal, comprised of Lord Denning, M.R., Harman and Diplock, L.J.J. affirmed the trial decisions of Buckley, J.[4]—that such an agreement was in restraint of trade—but did so on fundamentally different grounds. Before analysing the decision of the Court of Appeal it should therefore prove advantageous to examine the trial decision of Buckley, J., especially in view of the fact that it was followed by Mocatta, J.[5] in a similar case wherein the court upheld the validity of a solus agreement. In fact, these recent decisions were preceded by a history of cases wherein tying agreements were upheld.

For instance, as early as 1810 in *Holcombe* v. *Hewson*[6] a tying agreement between a brewery company and the operator of a public house was upheld so long as the brewer supplied good beer. Similarly, in *Courage and Co., Ltd.* v. *Carpenter*[7] the covenant was upheld even though the brewer raised the price, such increase being found to be fair and reasonable. Such decisions have not been confined to the liquor industry. Agreements by the producers of coal[8] and salt[9] to sell all their output to a single company to ensure orderly marketing at a remunerative price have been upheld. In the auto industry, an agreement by the purchaser of a motor coach business to purchase all the petrol required for his business from the vendor, who owned a gas station, was also upheld.[10]

Despite this history of decisions upholding tying agreements, Buckley, J. had no hesitation in finding that this particular agreement was a restraint on trade:

> The contract, in my judgment, clearly contains a restraint on trade, for it limits Mr. Martin to dealing in Petrofina's goods and deprives him of a free choice of the brands of petrol and other petroleum products which he will offer for sale at his filling station.[11]

Buckley, J. recognized that a restraint on trade was not *per se* invalid; however he pointed out that it must meet the clearly established test laid down in *Nordenfelt* v. *Maxim Nordenfelt Guns and Ammunition Co., Ltd.*:[12] that the agreement must be reasonable in the interests of the parties and consistent with the interests of the public.

To determine whether the agreement meets this test, Buckley, J. first inquired what it is that the covenantee is reasonably entitled to

4 [1965] 2 All E. R. 176.
5 *Esso Petroleum Co., Ltd.* v. *Harper's Garage (Stourport), Ltd.*, [1965] 2 All E. R. 933.
6 170 E. R. 1194.
7 [1910] 1 Ch. 262.
8 *A. G. of Commonwealth of Australia* v. *Adelaide Steamship Co., Ltd.*, [1913] A. C. 781.
9 *North-Western Salt Co., Ltd.* v. *Electrolytic Alkali Co., Ltd.*, [1914] A. C. 461.
10 *Foley* v. *Classique Coaches, Ltd.*, [1934] 2 K. B. 1.
11 *Ante*, n. 4, 183.
12 [1894] A. C. 535, 565.

protect himself against. Until this is answered, it is impossible to answer the principal inquiry whether the covenant is reasonable in the particular case. Buckley, J. found that the objective of the restraint was to ensure that none other than Petrofina petroleum products would be sold at Martin's garage, i.e. that they intended to protect their competitive position at the expense of Martin's right to trade in whatever way he might think most advantageous to himself. Despite the fact that Martin could not have acquired the site without entering into the solus agreement—and despite the fact that he entered into this agreement freely and with "open eyes" with no suggestion of compulsion on the part of Petrofina, Buckley, J. still felt bound to find that "it is against the policy of the common law to enforce such a contract unless the contract itself and the circumstances of the case are such as to satisfy the test . . . [above mentioned] . . ."[13] Buckley, J. was of course referring to the test laid down in the *Nordenfelt* case, which is essentially a test of reasonableness. Buckley, J. then went on to hold that the interest which Petrofina sought to protect, i.e. their competitive position, was not an interest which Petrofina is reasonably entitled to have protected. The learned judge further found that even if Petrofina were entitled to protect their competitive position, the solus agreement was a more onerous restraint upon Martin than was necessary for that purpose, especially since its duration was a minimum of twelve years.[14] Buckley, J. further laid stress on the fact that, unlike the restraint imposed in the *Foley* v. *Classique Coaches, Ltd.*[15] type of case, the restraints imposed on Martin were not merely incidental to his business, but affected its very nature.

Before the *Petrofina* case reached the Court of Appeal, it was preceded by two decisions which found that solus agreements were valid. The first of these decisions was delivered by the Court of Appeal, this time comprised of Lord Denning, M.R., and Davies and Russell, L.JJ. The case was *Regent Oil Co., Ltd.* v. *Aldon Motors, Ltd.*[16] Regent Oil Company had advanced £8,750 to the defendants who operated a garage. Of this sum, £8,150 was lent under a solus agreement while the remaining £600 was secured by a mortgage. Both the mortgage and the solus agreement contained clauses whereby the defendants undertook to take all their petroleum supplies from the plaintiff Oil Co. The money lent under the solus agreement was to be repaid in the form of rebates which the defendants would earn through purchase of their petrol requirements at wholesale from Regent Oil Company. The agreement would thus last for an indefinite time, although it was calculated to last about seventeen years. The agreement was entered into in 1960; however, at the beginning of 1965, the defendants decided that they would not take any more petrol from the plaintiff and began selling two other brands. The Regent Oil Company sued for an injunction to prevent this, and the Court of Appeal upheld the trial decision granting the injunction. Between the date of the trial decision and the Court of Appeal decision, the decision of Buckley, J. in the Petrofina case was rendered. The Court of

13 *Ante*, n. 4, 187.
14 *Id*, 190.
15 *Ante*, n. 10.
16 [1965] 2 All E. R. 644.

Appeal, however, distinguished that case. Lord Denning was the most specific:

> As to Buckley, J.'s decision, it seems to me, without saying more about it at the moment, that is distinguishable. In that case, there was no such advance of rebate as there is here. The plaintiffs here are getting no interest on the money which was advanced. The only consideration moving to the oil company was the fact that they had an outlet for their petrol. If you take away the tie, they would get nothing in return for their money. Further, there was no charge on land there, as there is in this case. In addition in that case it is very material to notice that the Petrofina company were seeking to make the defendants operate, and continue to operate at a loss. The oil company was seeking even to restrain the defendants so that they could not even shut down their business. They had to continue to operate at a loss for the benefit of the Petrofina company. All those matters seem to make this case very different from the Petrofina case.[17]

The *Regent* case thus differs from the *Petrofina* case in that Regent had an interest to protect beyond their competitive position, i.e. the advances they had made. However, the Court of Appeal failed to go on to consider the principal question of whether the tying agreement was necessary to protect it.

The *Regent* case was followed by the decision of Mocatta, J. in *Esso Petroleum Co., Ltd.* v. *Harper's Garage (Stourport), Ltd.*[18] The facts of this case were similar to those in the *Regent case.* The tying agreement extended to two garages. On one of the garages, Esso had a mortgage to secure a principal sum of £7,000, the covenant on this garage was for twenty-one years. The agreement on the other garage was to last for four years and five months. The terms of the solus agreements were essentially the same as those in the *Regent* and *Petrofina* cases. Mocatta, J. followed the reasoning of Lord Denning in the *Regent* case. However, he went on to add that the doctrine that a covenant in restraint of trade is contrary to public policy and therefore void does not apply when the covenant merely restricts the use to which certain land may be put without imposing a trading restraint on a man or company personally.[19] This would appear to be valid in theory, but it is clear that most garage proprietors are small operators and would be in no position to open another garage without accepting financial assistance from another oil company. In that case, they would have to submit to another solus agreement.

Against this backgkround, the *Petrofina* case came before the Court of Appeal. Despite its earlier decision in the *Regent* case, the Court of Appeal unanimously held that the solus agreement in the *Petrofina* case was a restraint on trade and therefore invalid.

Lord Denning, who appeared shocked that the defendants in the Regent case had "in effect snapped their fingers at the agreements",[20] found little difficulty in allowing the defendant in the *Petrofina* case to snap his fingers at the agreement. After referring once again to the leading cases on restraint of trade, Lord Denning stated what he considered to be the general principle in these cases:

> Every member of the community is entitled to carry on any trade or business that he chooses and in such manner as he thinks most desirable in his own interests, so long as he does nothing unlawful; with the consequence that any contract which interferes with the free exercise of his trade or business, by re-

17 *Id*, 649.
18 [1965] 2 All E. R. 933.
19 *Id*, 952.
20 *Ante*, n. 16, 648.

> stricting him in the work he may do for others, or the arrangements which he may make with others, is a contract in restraint of trade. It is invalid unless it is reasonable as between the parties and not injurious to the public interest.[21]

Lord Denning was also cognizant of the fact that "as methods of trading change, so do the areas of restraint expand"[22] and that "the law, if it is to fulfil its purpose, must keep pace with them".[23] His Lordship then proceeded to examine the tying agreements in the brewery trade. He found that these agreements had been upheld on the grounds that they were a partial restraint, and that the consideration was adequate, and that the restraint was reasonable. Lord Denning found a close analogy to the *Petrofina* case in the brewery decisions, and was therefore unwilling to find that the solus agreement was automatically bad.

Counsel for Petrofina had argued that the agreement was reasonable for it only restricted one facet of a multiple business, i.e. sale of petrol, and not the sale of cars, parts, and so forth. Lord Denning rejected this, stating: "I do not think that restriction becomes reasonable simply because it is confined to one facet of a business."[24] His Lordship, however, agreed that if Petrofina was to protect itself in such a competitive industry as the petroleum trade, a reasonable way of doing it would be by a solus agreement:

> I hold, therefore, that it is not every solus agreement which is automatically bad. If it is to be held unreasonable, it must be for something more than the restriction on obtaining petrol supplies.[25]

At this point in his judgment there appears to be an inconsistency in that Lord Denning felt that an agreement might be unreasonable merely because it restricted one facet of the business, such as the sale of petrol; yet at the same time he stated that there must be something more than the restriction on obtaining petrol supplies if the agreement is to be rendered unreasonable. In any event, Lord Denning was able to find something more. First, he felt that the duration of the agreement was too long, especially in view of the fact that the operator could conceivably be forced to operate at a loss for up to twenty years. His Lordship felt that if it was for two years, as in the Esso agreement, it might have been reasonable. However, a problem arises in drawing the line. In addition, is it any more valid to make a garage proprietor operate at a loss for two years instead of twenty years? In short, why don't we simply declare these agreements void in principle?

Lord Denning further felt the agreement was unreasonable in prohibiting the advertising of other than Petrofina lubricating oils as well as in forcing the owner, if he wished to sell the garage, to require the purchaser to take on all of his obligations. These again are valid points, but rather than taking the teeth out of the solus agreements, it would seem far simpler to declare them void in principle. This would add certainty in an area that at present seems far from certain.

Harman, L. J., in finding that the agreement was unreasonable, relied mainly on the clause that required Martin, if he wanted to sell the garage, to compel the prospective buyer to assume all his obligations

21 *Ante*, n. 1, 131.
22 *Ibid.*
23 *Ibid.*
24 *Id*, 133.
25 *Id*, 134.

under the solus agreement. Diplock, L. J. also found the agreement to be unreasonable, relying on the same terms of the agreement as had Lord Denning.

Perhaps the most amazing aspect of the Court of Appeal's decision in the *Petrofina* case is the almost total avoidance of its earlier decision in the *Regent* case. Lord Denning, who was the only judge to preside in both decisions, did not once refer to the *Regent* case in his judgment. Admittedly the *Regent* case came before the Court of Appeal on an interlocutory appeal, and the question whether the solus agreement was in restraint of trade did not have to be answered. Nevertheless, the Court of Appeal clearly implied that it was a valid agreement, especially since Regent Oil had their advances as well as their competitive position to protect. Nor did the Court of Appeal specifically disapprove the decision of Mocatta, J. in the *Esso* case.

The result would appear to be that solus agreement solely for the protection of an oil company's competitive position would be struck down as an unreasonable restraint of trade. However, should the oil company take a mortgage on the premises as security for a small advance, such mortgage would provide the additional interest required for the court to find that the solus agreement was a reasonable restraint of trade, the oil company having more than its competitive position to protect. It is to be hoped that future courts will not interpret the *Petrofina* decision in this limiting manner; but at present, there appears to be nothing to prevent them from so doing if they choose.

The majority of the oil companies operating in the United Kingdom and in Canada are of course subsidiaries of American companies. It is interesting to note that these subsidiaries are thus attempting to implement tying agreements which the parent companies in the United States have been prevented from doing through section 3 of the *Clayton Act*.[26] The first American case to specifically disapprove of tying arrangements involving oil companies and their dealers was the decision of the Supreme Court of the United States in *Standard Oil Company of California* v. *United States*.[27] In that case, Mr. Justice Frankfurter speaking for the Court was of the opinion that tying arrangements serve hardly any purpose beyond the suppression of competition, pointing out that if the manufacturer's product is in fact superior to that of competitors, presumably the buyer will choose it anyway.[28] The Court held in the result that such contracts were violative of section 3 of the *Clayton Act*. A more recent case is that of the Eastern District Court of Pennsylvania in *United*

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26 Section 3 of the *Clayton Act* states:

That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

October 15, 1914, Chapter 323, Sec. 3, 38, Stat. 731, 15 United States Code, Sec. 14.

27 (1949) 337 U.S. 293.

28 *Id*, 305-306.

States v. *Sun Oil Company*.[29] The District Court held that Sun Oil Company's exclusive dealing agreements (similar to the solus agreements) with over 6,500 of its independent service stations in the sale of petroleum products and TBA (tires, batteries, and accessories) are in violation of section 3 of the *Clayton Act*. The Court found that as a result of these agreements the sale of competitive brands of gasoline as well as motor oil, lubricants, and TBA had been virtually eliminated from those stations tied to Sun Oil.

While these United States cases are the result of prosecution under a specific statutory provision, they should not be dismissed as irrelevant by Canadian courts. Restraint of trade is essentially an area of public policy and the economic philosophy behind that policy is common to the United States, the United Kingdom and Canada.

At present there is no Canadian jurisprudence in the area of solus or exclusive dealing agreements; however, the recent *TBA Report*[30] makes it clear that the practices carried on in the United Kingdom and the United States are also an integral part of the oil industry in Canada. The Commission concluded by stating:

> This inquiry is concerned with the use by the principal distributors of gasoline and petroleum products of full-line forcing, directed buying and market access agreements in the distribution of gasoline and service station products to their networks of service station dealers . . . . The contracts used to associate the different types of dealers with their principal suppliers indicate that, except where the dealer is employed by the distributor or receives gasoline on consignment, the gasoline is sold to the dealer on an exclusive dealing basis . . . . Thus there have become extablished in this country, networks of service stations which deal exclusively in the gasoline of the associated supplier . . . .[31]

It is apparent, then, that should Canadian courts choose to apply the *Petrofina* decision to the Canadian petroleum industry, they would have no difficulty in finding fact situations to parallel the cases referred to in the United Kingdom and the United States. It is further submitted that prosecution in such a case, presumably through section 32(1)(c) of the *Combines Investigation Act*,[32] which previously would have had little if any chance of success, would now, supported by the common law precedent of the *Petrofina* decision, probably lead to a conviction. The *Petrofina* decision could thus conceivably have far reaching effects, both judicially and economically, on the Canadian oil industry.

As was stated earlier, however, the Court of Appeal has apparently limited the *Petrofina* decision to the situation wherein the oil company has nothing to protect but its competitive position. If other interests are involved, there is a strong possibility, depending on the reasonableness of the agreement, that the solus or exclusive dealing agreement will be upheld. This is unfortunate, not only for the tied dealer, but also for the public which is thus deprived of the benefit of true competition between oil companies.

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29 (1959) 176 F. Supp. 715.

30 *Restrictive Trade Practices Commission Report on an Inquiry into Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products*; R.T.P.C. No. 18, Department of Justice, Ottawa, (1962).

31 *Id*, 287.

32 *Combines Investigation Act*, R.S.C. 1952, c. 314, s. 32(1)(c)
32 (1) Every one who conspires, combines, agrees or arranges with another person (c) to prevent, or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of an article . . . is guilty of an indictable offence and is liable to imprisonment for two years.

Leave to appeal to the House of Lords was granted in the *Petrofina* case. It is to be hoped that the House of Lords will expand the decision of the Court of Appeal and find that solus and other types of exclusive dealing agreements are *void ab initio*. If the House of Lords is not willing to go that far, it can only be hoped that their Lordships will at least uphold the decision on the more liberal grounds advanced at trial by Buckley, J.

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