

## BULLETIN NO. 72



## Economic Regulation of Business and Unfair Competition

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#### Legislative Commission

<u>Assemblymen</u>	<u>Senators</u>
Melvin D. Close, Jr.	B. Mahlon Brown
Zelvin D. Lowman	Carl F. Dodge
Marvin L. White	James I. Gibson
James E. Wood	Archie Pozzi, Jr.

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Senate Concurrent Resolution No. 27--1967 Legislature

SENATE CONCURRENT RESOLUTION--Directing the legislative commission to study the laws concerning the economic regulation of business and unfair competition and to make a report of such study and submit any proposed legislation to the 55th session of the Nevada legislature.

WHEREAS, The economy of the State of Nevada is growing at a rate in proportion to the rapid population growth of the state; and

WHEREAS, The laws of this state concerning economic regulation of business and unfair competition have never been comprehensively studied; and

WHEREAS, Since the Nevada Fair Trade Act was declared unconstitutional in *Zale Las Vegas, Inc. v. Bulova Watch Co.*, a large gap exists in the regulation of business and unfair competition; now, therefore, be it

RESOLVED BY THE SENATE OF THE STATE OF NEVADA, THE ASSEMBLY CONCURRING, That the legislative commission is directed to study the laws concerning economic regulation of business and unfair competition, and make a report of such study and recommend any proposed legislation to the 55th session of the legislature.



## ECONOMIC REGULATION OF BUSINESS AND

### UNFAIR COMPETITION

#### Introduction

Senate Concurrent Resolution No. 27, adopted by the 1967 legislature, directs the Legislative Commission to study the laws concerning economic regulation of business and unfair competition and make a report of such study and recommend any proposed legislation to the 55th session of the legislature.

Since 1964, when the Nevada supreme court, in the case of Zale-Las Vegas, Inc. v. Bulova Watch Co., Inc., 80 Nev. 484, 396 P.2d 683 (1964), declared the state Fair Trade Act to be unconstitutional, Nevada has had virtually no statutory regulation of trade practices. The Fair Trade Act had provided for the establishment of minimum retail prices of trade-marked items through contracts between trade-mark owners and retailers. The court objected to the provision that such contracts were binding upon all persons who sold the trade-marked items in question, even though they were not parties to the contract. The grounds given for invalidating this "nonsigner" provision were that (1) it was an improper delegation of legislative authority; (2) it violated the due process provisions of the constitution; and (3) it was an unlawful exercise of the police power of the state.

There are other areas, however, where laws might effectively be made for the benefit of business and the public generally. These could be classified as follows:

- I. Trade Restraints:
  - A. Contracts in restraint of trade.
  - B. Combinations in restraint of trade.
- II. Advertising:
  - A. Leaders and loss leaders.
  - B. Fraudulent advertising.
  - C. Limited-quantity sales advertising.
- III. Pricing:
  - A. Locality discrimination.
  - B. Sales below cost.

A brief discussion of each of these areas follows.

#### Trade Restraints

Contracts in restraint of trade. Discussion of this area must start with a consideration of the fact that the states cannot,

in most instances, do anything that would impair the obligation of a contract, since such state action is precluded by the United States Constitution. However, it is generally agreed that contracts which unreasonably restrain trade or tend to restrict competition are void as against public policy. Therefore, a law forbidding contracts in restraint of trade would not be invalid under the constitution since there is no obligation thereunder which would be impaired. Although contracts in restraint of trade might be held invalid by judicial declaration if the court were so inclined, statutes prohibiting such contracts would be advantageous in that the prescribed limits of contracts affecting trade could be known in advance. Certain contracts, though restrictive, may be necessary for the protection of a business and may be lawful. Such exceptions to the general rule that contracts in restraint of trade are unlawful could be clearly defined in any statute enacted by the legislature.

Combinations in restraint of trade (trusts). Most states have enacted antitrust laws designed to regulate intrastate commerce, the volume of which is substantial enough to justify state action. (1 Callmann, Unfair Competition, Trademarks and Monopolies § 15.4 (3d Ed. 1967.)) The laws vary in scope and purpose but generally have been upheld against attack under both federal and state constitutions. Generally, such laws would only be effective with respect to intrastate commerce but they could operate in some areas involving interstate commerce. Application of an antitrust law to the gambling industry would, of course, have no useful precedent in laws of other states, but would unquestionably be proper. A state antitrust law would be valid as long as it directed itself to a valid public purpose and was reasonable in its attempt to achieve that purpose and did not conflict with federal law and policy.

### Advertising

Leaders and loss leaders. An article, usually trade-marked and well advertised, offered for sale at a greatly reduced price for the purpose of attracting trade is known as a "leader." If it is offered at less than the seller's cost, it is a "loss leader." It has been said that one of the purposes of leader or loss leader advertising is to lead the public to believe that all items for sale by the advertiser are equally favorable in price, and that leaders are, therefore, actually "misleaders." (Callmann, op. cit. supra, § 20.4(e); Weigel, The Fair Trade Acts (1938), pp. 82, 83, quoting Mr. Justice Brandeis.) If it can be shown



practices on the part of advertisers actually amount to false or misleading advertising, then there should be no constitutional objection to statutes reasonably designed to regulate them.

Fraudulent advertising. Many states, including Nevada (see NRS 207.170), have enacted laws relating to fraud in advertising but most of these laws were enacted with built-in deficiencies that make enforcement difficult. (See Note, 56 Col. L. Rev. 1019, 1057-78 (1956).) The so-called "Printers' Ink Model Statute," drafted over 50 years ago, is the basis for most of these laws although the variations adopted by the states have made most of them unsatisfactory. The Printers' Ink Model requires proof of only three elements: (1) an intent to sell goods or services; (2) the placing before the public, with such intent, of any advertising; and (3) a false, misleading or deceptive statement in such advertising. The advertiser would be absolutely liable, without a show of reliance by the purchaser, intent to deceive or actual knowledge of the improper character of the advertisement by the defendant. Most states have modified that act by requiring, as an element, an intent to deceive on the part of the advertiser, or knowledge of the fraudulent character of the advertisement, and have, thus, made the law unworkable. In view of the fact that such a statute, as proposed by the Printers' Ink Model, would be regulatory as well as punitive (violation is a misdemeanor), such requirements should not be included.

In the Nevada statute, it must be shown that the advertiser knows of the facts which make the advertisement false before he can be convicted for violating the law. This sort of statute has not been successful in other states because of the difficulty in proving the necessary elements of the offense. In addition, enforcement is dependent upon a busy or indifferent prosecutor. In the 50 years the statute has been in effect in Nevada, there have been no instances where it has been considered by the state supreme court.

A draft bill is attached in Appendix B (Sec. 2) which simply requires as elements of the offense a materially false, deceptive or misleading statement in an advertisement intended to induce the public to purchase a product, property or service. Both a criminal and a civil remedy are provided, and injunctive relief is provided to permit enforcement in the public interest where the victim may lack financial resources.

Limited-quantity sales advertising. Statutes in this area are designed to prevent the advertising of the sale of a limited quantity of goods at a greatly reduced price without informing the

intended consumer that it is a limited-quantity sale. The purpose is to prevent advertisers from luring customers into the advertiser's place of business to find a bargain which, in fact, may not exist because the few items at the bargain price may have already been sold out. Senate Bill No. 259 of the 1965 session of the Nevada legislature was introduced to cope with this type of situation but failed to pass. Many state statutes are vague in that they require only that the seller have a "sufficient" quantity of the items advertised. S.B. 259 required that the advertiser specify the number of items for sale at the reduced price and provided that violation of the law would be a misdemeanor. There is no constitutional reason why such a law could not be enacted in Nevada. Section 3 of the draft bill contained in Appendix B contains the substantive provisions of S.B. 259.

#### Pricing

Locality discrimination. More than half of the states have enacted statutes prohibiting price discrimination. The purpose of these statutes is to prevent large companies from selling products at a lower price in certain areas than is generally asked in other areas for the purpose of driving smaller competitors out of business. Some statutes prohibit the purchase of supplies at a higher price in order to deprive a competitor of a source of supply. Such statutes have, with one exception, been upheld against constitutional attack. (See Callmann, op. cit. supra at § 28.2.) The Nevada constitution would offer no peculiar obstacle to the enactment of such a statute.

Sales below cost. Over half of the states have enacted statutes prohibiting sales below the actual cost to the seller. There are four general types of such statutes: (1) those which prohibit such sales with the intent to injure competitors; (2) those which prohibit such sales with the intent or effect of injuring competitors; (3) those which prohibit such sales with the effect of injuring competitors; and (4) those which absolutely prohibit such sales, without reference to intent or effect. (See Callmann, op. cit. supra § 27.2.) Although any of these types of statutes could probably be upheld under the Nevada constitution if properly drafted, a statute would be more secure under the constitution if it required, as an element, an intent to injure competitors. There is more of a tendency to declare the acts invalid as they move away from the intent requirement. The scope of an act providing for strict liability for selling below cost would be narrowed to those areas more nearly affected with a public interest.

Appendix C is a draft of a bill prohibiting sales below cost with the intent to injure a competitor or destroy competition. Violation is a misdemeanor if prosecuted under the penal provisions. A person injured by the unlawful practice may maintain an action to enjoin such practice and may collect treble damages from the offender. The district attorney may seek injunctive relief in the public interest where the victim may lack financial resources.

### Conclusion

The above classification is not intended to be all-inclusive. Other areas could be covered. Nor is it intended as a recommendation that similar statutes be enacted in Nevada. These areas are, however, those most generally covered by statutes in other states.

It is obvious that some of these statutes overlap. In some states, for instance, the pricing statutes and the leader statutes are combined. The separate classifications for discussion purposes as described above would not be considered as a recommendation that any Nevada statutes should be so separated. A decision on composition should be reserved for further study of the desired intent and substance of any such legislation.



## APPENDIX A

There are several principles of constitutional law that should be considered in attempting to predict the validity of any proposed legislation relating to the regulation of business and unfair competition. Again, the following discussion is not intended to exhaust all areas of possible conflict with constitutional law nor is the discussion more than a cursory review of constitutional principles.

Delegation of legislative power. The lawmaking power of the state is vested in the legislature by the state constitution and this power cannot be properly delegated to any person or public agency. This rule does not prevent the delegation of any powers of the legislature that are not legislative in nature, however, and any power that is strictly administrative may be delegated. A law is invalid as an improper delegation of legislative power if it is incomplete as legislation and leaves to someone else the right to determine either the extent of people's rights thereunder or whether there is an infringement of the law. A law which is complete as legislation but which becomes operative only upon a contingency or which requires administrative action outside the legislature to become effective is not invalid as an improper delegation of legislative power. See generally, 16 Am. Jur. 2d, Constitutional Law §§ 240-58.

Police Power. Under most circumstances, private individuals are assured certain personal and proprietary rights. There are circumstances, however, when the preservation of the public order, health, safety and morals requires that such private rights become subordinate to the public good. In such instances the police power of the state may operate as an infringement upon those rights. Although it is difficult to define with precision the scope of the police power, certain general limits may be described. First, the object of the legislation purporting to give rise to the police power must be affected with a public interest. Secondly, the legislation must be reasonable and must not impose any unreasonable restrictions on private rights. Thirdly, the means adopted to accomplish the purpose of the legislation must be appropriate; that is, there must be some reasonable relation between the object of the legislation and the means of accomplishing that object. Whether any of these limits are breached is not strictly a matter of legal interpretation but may depend upon economic, sociological and political circumstances. See generally, 16 Am. Jur. 2d, Constitutional Law, §§ 259-327.

Due process of law. There are two recognized aspects of due process--substantive and procedural. Substantive due process requires that governmental action be reasonable and not arbitrary. Procedural due process requires that such action be fair. Persons may only be deprived of life, liberty or property, therefore, if fair and impartial procedures are followed and if such action is reasonable in light of a higher public purpose. A complete description of due process would be interminable and unnecessary for the purposes of this discussion. See generally, 16 Am. Jur. 2d, Constitutional Law §§ 542-48.

## APPENDIX B

SUMMARY--Prohibits false, deceptive and misleading advertising.

AN ACT relating to advertising; to prohibit false, deceptive and misleading advertising; providing a penalty; and providing other matters properly relating thereto.

THE PEOPLE OF THE STATE OF NEVADA, REPRESENTED IN SENATE AND  
ASSEMBLY, DO ENACT AS FOLLOWS:

Section 1. Chapter 600 of NRS is hereby amended by adding thereto the provisions set forth as sections 2 and 3 of this act.

Sec. 2. 1. Every person who places before the public, directly or indirectly, by any means whatsoever, any materially false, deceptive or misleading advertisement, announcement or statement concerning any product, property or service, with the intent to sell such product, property or service, or to induce any other person to incur an obligation thereto, shall, on conviction thereof, be punished:

(a) For the first or second offense, for a misdemeanor.

(b) For the third offense and all subsequent offenses, for a gross misdemeanor.

2. This section does not apply to any radio or television broadcasting station which broadcasts, or to any publisher, printer, distributor or owner of any newspaper, magazine, billboard or other advertising medium who publishes, prints or distributes such advertising in good faith without knowledge of its false, deceptive or misleading character.

3. The district attorney of the county in which a violation of this section has occurred, or any person injured by any act in violation of this section may maintain an action in the district court to enjoin a continuance of such act, and, if the court determines that the defendant is in fact violating, or has violated, any of the provisions of this section, it shall enjoin the defendant from a continuance thereof.

Sec. 3. Every person who conducts, maintains, operates or advertises at retail any sale of a limited quantity of goods, wares or merchandise at a special price or at a price below cost, if the advertisement thereof does not specify the number of items that are offered for sale and that may be purchased by one person, is guilty of a misdemeanor.

Sec. 4. NRS 207.170 is hereby repealed.





## APPENDIX C

SUMMARY--Prohibits wholesale and retail sales below cost.

AN ACT to prohibit wholesale and retail sales below cost to the vendor; providing a penalty; and providing other matters properly relating thereto.

THE PEOPLE OF THE STATE OF NEVADA, REPRESENTED IN SENATE AND  
ASSEMBLY, DO ENACT AS FOLLOWS:

Section 1. Chapter 598 of NRS is hereby amended by adding thereto the provisions set forth as sections 2 to 7, inclusive, of this act.

Sec. 2. The legislature finds that the practice of selling certain articles and products below cost in order to attract patronage is an unfair method of competition in commerce. Such practice causes commercial dislocations, misleads the consumer, works a hardship upon the producer and directly burdens and obstructs commerce. Bankruptcies among merchants who fail because of the competition of those who use such methods result in unemployment, disruption of leases and nonpayment of taxes and loans, and contribute to many undesirable consequences, including economic depression. It is therefore declared by the legislature to be the policy of this state to protect the well-being of its citizens through the prevention, suppression and elimination of unfair methods of competition. Sections 3 to 7, inclusive, of this act are enacted to carry out such policy in the public interest.

Sec. 3. As used in sections 2 to 7, inclusive, of this act:

1. "Cost" means the invoice or replacement costs, whichever is lower, of the article or product, plus the overhead expenses of the vendor. In the absence of proof of overhead expenses, a markup of 6 percent on such invoice or replacement cost is prima facie evidence of such overhead expenses.

2. "Overhead expenses" means all costs incurred in the conduct of such business, including, without limitation:

- (a) Labor, including salaries of executives and officers.
- (b) Rent.
- (c) Interest on borrowed capital.

- (d) Depreciation.
- (e) Selling costs.
- (f) Maintenance of equipment.
- (g) Delivery costs.
- (h) Credit losses.
- (i) All other miscellaneous expenses directly related to the business.

3. "Retailer" means any person who, for valuable consideration and in the ordinary channels of trade, transfers title to tangible personal property for use other than for resale or further processing or manufacturing, or who transfers such property while retaining title as security for payment of the purchase price of such property, or who prepares and serves food to customers to be consumed at the seller's place of business or elsewhere.

4. "Wholesaler" means any person who, for valuable consideration and in the ordinary channels of trade, transfers title to tangible personal property for resale or further processing or manufacturing, or who transfers such property while retaining title as security for payment of the purchase price of such property.

Sec. 4. Every retailer or wholesaler doing business within this state who sells, offers or advertises for sale any article or product for less than the cost thereof to such retailer or wholesaler with the intent to injure a competitor or destroy competition shall, on conviction thereof, be guilty of a misdemeanor.

Sec. 5. In determining the cost of any article or product, the invoice cost of such article or product purchased at a forced, bankrupt, closeout or other sale outside of the ordinary channels of trade may not be used as a basis for justifying a price lower than the cost of replacement through the ordinary channels of trade as of the date of the sale, unless such article or product is segregated and advertised and sold as merchandise purchased at a forced, bankrupt, closeout or other sale, or by means other than through the ordinary channels of trade.

Sec. 6. The provisions of sections 2 to 5, inclusive, of this act, do not apply to any sale made:

- 1. To close out in good faith the owner's stock for the purpose of going out of business.
- 2. To prevent loss to the vendor through spoilage or depreciation of seasonable or perishable items.
- 3. When the article or product is damaged or deteriorated in quality, and notice is given thereof to the public.
- 4. To carry out the order of any court.

5. To meet, in good faith, the legal prices of a competitor selling the same article or product in the same trade area.

6. For charitable purposes.

Sec. 7. The district attorney of the county in which a violation of sections 2 to 6, inclusive, of this act has occurred, or any person injured by any act in violation of sections 2 to 6, inclusive, of this act, may maintain an action in the district court to enjoin a continuance of such act and, if the court determines that the defendant is, in fact, violating, or has violated, any of the provisions of such sections it shall enjoin the defendant from a continuance thereof. The person injured by the conduct of the defendant may recover from the defendant three times the amount of his actual damages.