

CHAPTER 8

EXCLUSIVE DEALING

I. Introduction

Exclusive dealing describes an arrangement whereby one party's willingness to deal with another is contingent upon that other party (1) dealing with it exclusively or (2) purchasing a large share of its requirements from it.¹

Exclusive dealing is common and can take many forms.² It often requires a buyer to deal exclusively with a seller. For example, a manufacturer may agree to deal with a distributor only if the distributor agrees not to carry the products of the manufacturer's competitors.³ And many franchise outlets agree to buy certain products exclusively from a franchisor.⁴ But it also may involve a seller dealing exclusively with a single buyer.

Exclusive dealing also occurs between sellers and consumers, as when a consumer agrees to purchase all its requirements of a particular product from a single supplier. Firms may agree to deal exclusively in contracts

prohibiting one party from dealing with others,⁵ or the exclusive-dealing arrangement can take other forms, as when a seller enacts policies effectively requiring customers to deal exclusively with it.

Exclusive dealing is frequently procompetitive, as when it enables manufacturers and retailers to overcome free-rider issues misaligning the incentives for these vertically-related firms to satisfy the demands of consumers most efficiently. For example, a manufacturer may be unwilling to train its distributors optimally if distributors can take that training and use it to sell products of the manufacturer's rivals. Other benefits can occur as well, as when an exclusivity arrangement assures a customer of a steady stream of a necessary input.

But exclusive dealing also can be anticompetitive in some circumstances. For example, exclusive dealing may allow one manufacturer, in effect, to monopolize efficient distribution services and thereby prevent its rivals from competing effectively. As then-Judge Breyer explained, exclusive dealing can harm consumers by thwarting entry or inhibiting the growth of existing rivals:

Exclusive dealing arrangements may *sometimes* be found unreasonable under the antitrust laws because they may place enough outlets, or sources of supply, in the hands of a single firm (or small group of firms) to make it difficult for new, potentially competing firms to penetrate the market. To put the matter more technically, the arrangements may "foreclose" outlets or supplies to potential entrants, thereby

¹ See, e.g., 1 SECTION OF ANTITRUST LAW, AM. BAR ASS'N, ANTITRUST LAW DEVELOPMENTS 210 (6th ed. 2007) ("Exclusive dealing describes a set of practices that have the effect of inducing a buyer to purchase most or all products or services for a period of time from one supplier."). Firms sometimes engage in bundling and loyalty-discount practices with competitive effects similar to those of exclusive dealing. Chapter 6 discusses those practices.

² See, e.g., Sherman Act Section 2 Joint Hearing: Exclusive Dealing Session Hr'g Tr. 41, Nov. 15, 2006 [hereinafter Nov. 15 Hr'g Tr.] (Marvel) ("It is obvious that exclusive dealing is a very common thing . . ."); *id.* at 121 (Lipsky) ("Exclusive dealing is a very elastic label. It applies to a lot of different things."); Richard M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101, 101 (1983) ("Exclusive dealing is one of the most common practices within the sweep of the antitrust laws . . .").

³ See, e.g., Nov. 15 Hr'g Tr., *supra* note 2, at 41 (Marvel); see also, e.g., Steuer, *supra* note 2, at 102.

⁴ See, e.g., HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 202 (2005).

⁵ See also Nov. 15 Hr'g Tr., *supra* note 2, at 64 (Jacobson) ("I think the 'no contract, no problem' scheme is a problem . . ."); *id.* at 117 (Calkins) ("[I]t should be possible for a short-term contract or contract that is cancellable still to be . . . unlawful.").

raising entry barriers. Higher entry barriers make it easier for existing firms to exploit whatever power they have to raise prices above the competitive level because they have less to fear from potential new entrants.⁶

Sometimes exclusive dealing can both provide benefits and at the same time impede the ability of a manufacturer's rivals to compete effectively. In those situations, determining whether the arrangement should be illegal can be difficult because "what makes exclusive dealing potentially harmful is the very same mechanism that makes the arrangement efficient and may lead to lower prices for consumers."⁷

Historically, Supreme Court exclusive-dealing jurisprudence has focused on whether the arrangement "foreclose[s] competition in a substantial share of the line of commerce affected."⁸ Current practice in the courts of appeals, however, assesses the legality of exclusive dealing by examining a broad set of factors.⁹ This chapter reviews exclusive-dealing law, discusses exclusive dealing's potential anticompetitive and procompetitive effects, and sets forth the Department's view on certain legal issues regarding the treatment of exclusive dealing.

II. Background

Courts have condemned exclusive dealing under four provisions of the antitrust laws: (1) section 1 of the Sherman Act, which prohibits contracts "in restraint of trade,"¹⁰ (2) section 2 of the Sherman Act, which makes it illegal to "monopolize,"¹¹ (3) section 3 of the

Clayton Act, which prohibits exclusivity arrangements that may "substantially lessen competition,"¹² and (4) section 5 of the FTC Act, which prohibits "[u]nfair methods of competition."¹³ "The extent to which exclusive dealing jurisprudence under Section 2 differs from exclusive dealing claims in other contexts is not precisely clear."¹⁴ Some courts, however, find that the different statutory provisions create different standards of legality.¹⁵

This chapter discusses exclusive-dealing cases arising under both section 2 of the Sherman Act and other statutory provisions. Courts today consider a wide variety of competitive factors when assessing the legality of an exclusive-dealing arrangement.¹⁶ Among those factors, one panelist asserted that the three most significant are (1) "the nature of the product and relationship" between the parties to the arrangement, (2) the "percentage of the market" foreclosed to rivals as a result of the arrangement, and (3) the "duration" of the arrangement.¹⁷ Professor Hovenkamp states that exclusive dealing requires "a plaintiff to show that the defendant has significant market power, that the exclusivity agreement serves to deny market access to one or more significant rivals, and that market output to consumers is lower (or prices higher) as a result."¹⁸ These considerations, however, are broader than those addressed in older Supreme Court precedent, which, as described below, focused on whether the exclusive dealing foreclosed a substantial amount of trade, a focus that would

⁶ *Interface Group, Inc. v. Mass. Port Auth.*, 816 F.2d 9, 11 (1st Cir. 1987) (Breyer, J.) (emphasis in original) (citations omitted).

⁷ Nov. 15 Hr'g Tr., *supra* note 2, at 53 (Jacobson); *see also, e.g., id.* at 138 (Farrell) (noting the difficulty of "disentangling all of these difficult concepts").

⁸ *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).

⁹ *See, e.g., Nov. 15 Hr'g Tr.*, *supra* note 2, at 72-73 (Steuer, Jacobson, Wright); *id.* at 122-23 (Lipsky).

¹⁰ 15 U.S.C. § 1 (2000).

¹¹ *Id.* § 2.

¹² *Id.* § 14. Among other limitations, section 3 applies only to "goods, wares, merchandise, machinery, supplies, or other commodities." *Id.*

¹³ *Id.* § 45(a)(1). This report does not address section 5, which is beyond the scope of this report.

¹⁴ SECTION OF ANTITRUST LAW, *supra* note 1, at 248.

¹⁵ *See, e.g., United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 197 (3d Cir. 2005).

¹⁶ *See, e.g., id.* at 187, 196; *United States v. Microsoft Corp.*, 253 F.3d 34, 71-74 (D.C. Cir. 2001) (en banc) (per curiam); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236-37 (1st Cir. 1983) (Breyer, J.).

¹⁷ Nov. 15 Hr'g Tr., *supra* note 2, at 72-73 (Steuer); *see also* SECTION OF ANTITRUST LAW, *supra* note 1, at 217-20.

¹⁸ HOVENKAMP, *supra* note 4, at 206.

prohibit many exclusive-dealing arrangements that courts today uphold.

A. Supreme Court

In its first decision condemning exclusive dealing under the antitrust laws, the Supreme Court considered a contract prohibiting one of Standard Fashion's retailers from carrying other manufacturers' garment patterns. After the retailer began carrying another line of patterns, Standard Fashion sought damages from the retailer for breach of contract. The Court affirmed dismissal of the action on the ground that the contract violated the Clayton Act. Noting that Standard Fashion controlled forty percent of the pattern retailers in the country, the Court found that Standard Fashion's exclusive-dealing arrangements "'must in hundreds, perhaps in thousands, of small communities amount to . . . a monopoly.'"¹⁹

In its 1949 *Standard Oil Co. of California v. United States (Standard Stations)* decision, the Court similarly upheld an injunction prohibiting Standard Oil from enforcing contractual provisions requiring gas stations in seven states to purchase only Standard Oil gas.²⁰ The Court noted that exclusive dealing "may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public,"²¹ but found these potential procompetitive justifications irrelevant because (1) Congress did not intend the courts to weigh "in each case the ultimate demands of the 'public interest'"²² and (2) courts are "ill-suited" to the task of ascertaining pro- and anticompetitive effects.²³ Because "the affected proportion of retail sales of petroleum products [was] substantial"²⁴—Standard Oil had exclusive-dealing contracts with "16% of the retail gasoline outlets" in the seven-state area²⁵—the Court held that the contract violated

the Clayton Act.²⁶

Shortly thereafter, the Court considered a newspaper's refusal to sell advertising to firms that also bought advertising from a new radio station.²⁷ Some commentators view this practice as an attempt by the newspaper to be its customers' exclusive supplier of local advertising.²⁸ The Court found that section 2 of the Sherman Act prohibited the newspaper's attempt to "regain" its "substantial monopoly" by forcing the radio station out of business,²⁹ holding that the newspaper violated the antitrust laws "when it use[d] its monopoly to destroy threatened competition."³⁰ Some commentators assert that this case is an example of an exclusivity arrangement with clear anticompetitive effects but no redeeming procompetitive effects.³¹

In 1961, the Court upheld a contract whereby Nashville Coal agreed to sell all the coal Tampa Electric required to operate some of its power plants. When Nashville Coal refused to honor the contract, Tampa Electric sued. Nashville Coal defended on the ground that the Clayton Act prohibited the exclusive-dealing contract, which required, over a twenty-year period, delivery of coal worth about \$128 million, about one percent of the relevant market. Although analyzing the issue under the substantiality framework set forth in *Standard Stations*, the Court stated that the legality of the arrangement depended on many

²⁶ *Id.* at 314.

²⁷ *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).

²⁸ Compare, e.g., Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311, 321 (2002) (characterizing defendant's conduct as "an exclusive dealing policy"), with John E. Lopatka & Andrew N. Kleit, *The Mystery of Lorain Journal and the Quest for Foreclosure in Antitrust*, 73 TEX. L. REV. 1255, 1287 (1995) ("Perhaps the most productive way to explore the *Lorain Journal* case is through application of a tying paradigm.").

²⁹ *Lorain Journal*, 342 U.S. at 153.

³⁰ *Id.* at 154.

³¹ See, e.g., 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 768e3, at 155 (2d ed. 2002) ("A supplier's requirement that a customer not deal with a specific rival seems particularly hard to justify.").

¹⁹ *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 346, 357 (1922) (quoting circuit court).

²⁰ 337 U.S. 293, 314 (1949).

²¹ *Id.* at 306.

²² *Id.* at 311.

²³ *Id.* at 310.

²⁴ *Id.* at 314.

²⁵ *Id.* at 295.

factors that it had deemed irrelevant in *Standard Stations*:

To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein.³²

Applying these competitive factors, the Court upheld the arrangement, noting that the contract assured a steady source of supply for Tampa Electric and enabled Nashville Coal to reduce selling expenses.³³

Despite the Court's less hostile treatment of exclusive dealing in *Tampa Electric*, the Court soon thereafter condemned, under section 5 of the FTC Act, Brown Shoe's exclusivity arrangements with approximately one percent of U.S. shoe retailers. Finding that these arrangements required "shoe retailers . . . substantially to limit their trade with Brown's competitors," the Court held that the exclusivity program "obviously conflicts with the central policy of both § 1 of the Sherman Act and § 3 of the Clayton Act against contracts which take away freedom of purchasers to buy in an open market."³⁴

Finally, the Supreme Court mentioned exclusive dealing in its 1984 *Jefferson Parish Hospital District No. 2 v. Hyde* decision, observing that an "exclusive-requirements contract . . . could be unlawful if it foreclosed so much of the market from penetration by . . . competitors as to unreasonably restrain

competition in the affected market."³⁵ Although the case was decided under the rubric of tying, the four concurring Justices noted that the contract at issue "unquestionably does constitute exclusive dealing."³⁶ They would have found no liability under section 1 of the Sherman Act because the arrangement—between four anesthesiologists and one of several hospitals in the area—affected "only a very small fraction of the total number of anesthesiologists whose services are available for hire by other hospitals."³⁷

B. Courts of Appeals

With no Supreme Court case ruling on exclusive dealing since *Brown Shoe*, jurisprudence has developed in the courts of appeals. The courts of appeals have interpreted *Tampa Electric* as abandoning the Court's narrow focus in *Standard Stations* on substantiality, and they thus consider a variety of competitive factors when assessing exclusive dealing. A theme throughout these cases is that the extent to which rivals are foreclosed from the market is only one factor in the analysis; courts also consider procompetitive justifications when assessing the practice's legality.

In 1983, the First Circuit upheld a series of contracts whereby Grinnell agreed to purchase from Pacific Scientific a high portion of Grinnell's expected demand for snubbers, which are safety devices used in nuclear facilities. Barry Wright, a competing snubber manufacturer, sought damages from Pacific (which historically held an eighty-percent share of the snubber market) under section 2 of the Sherman Act. Barry Wright characterized the contracts as exclusive-dealing arrangements that effectively precluded it from selling snubbers to Grinnell, which purchased about fifty percent of all snubbers. Noting that "courts have judged the lawfulness of [exclusive dealing] not under per se rules but under a 'rule of reason,'"³⁸ the court upheld the

³² *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 329 (1961).

³³ *Id.* at 334.

³⁴ *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321 (1966); see also *In re Brown Shoe Co.*, 62 F.T.C. 679, 716 (1963) (noting that "[t]he stores under the franchise plan constitute approximately one percent" of all U.S. "retail shoe outlets").

³⁵ 466 U.S. 2, 30 n.51 (1984).

³⁶ *Id.* at 44 (O'Connor, J., concurring).

³⁷ *Id.* at 46.

³⁸ *Barry Wright Corp. v. ITT Grinnell Corp.*, 724

arrangements, asserting that the relevant inquiry was “whether the ‘size’ of the contract to purchase is reasonable”³⁹ in view of “both the extent of the foreclosure and the buyer’s and seller’s business justifications.”⁴⁰ The court found the arrangements justified in view of, among other things, “their fairly short time period”⁴¹—the longest covered a two-and-a-half-year period—and the existence of “legitimate business justifications”⁴²—Grinnell’s desire for “a stable source of supply” and “a stable, favorable price” and Pacific’s desire to engage in “production planning that was likely to lower costs.”⁴³

The next year, the Seventh Circuit vacated a preliminary injunction under the Clayton Act prohibiting a manufacturer from terminating a dealer that had begun carrying a competing line. Without deciding the issue on the merits, the court noted that exclusive dealing may increase welfare by “lead[ing] dealers to promote each manufacturer’s brand more vigorously than would be the case under nonexclusive dealing” and “prevent[ing] dealers from taking a free ride” on one manufacturer’s promotional efforts.⁴⁴ The decision is known particularly for the court’s statement that “[e]xclusive-dealing contracts terminable in less than a year are presumptively lawful.”⁴⁵

In another important First Circuit decision, that court approved an exclusivity arrangement challenged under sections 1 and 2 of the Sherman Act in 1993. The arrangement here involved a seller’s commitment to sell its output only to a specified buyer: approximately twenty-five percent of New Hampshire’s primary-care physicians agreed to sell their services to Healthsource and no other

health maintenance organization (HMO). The court found no section 1 violation since plaintiff (a competing HMO) failed to offer “proof of substantial foreclosure,” which the court characterized as the “cardinal requirement of a valid claim.”⁴⁶ The court rejected the section 2 claim on the ground that plaintiff failed to establish “a properly defined product market in which [defendant] could approach monopoly size.”⁴⁷ The court noted that exclusivity arrangements may have “benign” purposes, including “assurance of supply or outlets, enhanced ability to plan, reduced transaction costs, [and] creation of dealer loyalty.”⁴⁸

Four years later, the Ninth Circuit upheld, under section 3 of the Clayton Act, a manufacturer’s policy of refusing to sell its equipment (a variety of products used at gasoline stations) to retailers carrying competing equipment on the ground that the arrangement only “foreclosed roughly 38% of the relevant market.”⁴⁹ In reaching its conclusion, the court stated that “exclusive dealing arrangements imposed on distributors rather than end-users are generally less cause for anticompetitive concern”⁵⁰ because rivals can sell directly to end-users. Further, “the short duration and easy terminability” of an exclusivity arrangement “negate[s] substantially [its] potential to foreclose competition.”⁵¹

Two prominent decisions condemning exclusive dealing followed. In 2001, the D.C. Circuit upheld under section 2 of the Sherman Act the condemnation of several exclusivity agreements between Microsoft and original equipment manufacturers, internet access providers, independent software vendors, and Apple on the ground that they “bar[red]” Microsoft’s rivals from “means of distribution”

F.2d 227, 236 (1st Cir. 1983) (Breyer, J.).

³⁹ *Id.* at 237.

⁴⁰ *Id.* at 236–37.

⁴¹ *Id.* at 238.

⁴² *Id.* at 237.

⁴³ *Id.*

⁴⁴ *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 395 (7th Cir. 1984) (Posner, J.).

⁴⁵ *Id.*

⁴⁶ *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 597 (1st Cir. 1993) (Boudin, J.).

⁴⁷ *Id.* at 599.

⁴⁸ *Id.* at 595.

⁴⁹ *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162 (9th Cir. 1997).

⁵⁰ *Id.*

⁵¹ *Id.* at 1163.

that were “cost-efficient.”⁵² The court stated that in a monopoly-maintenance case, two important concerns are whether the exclusive dealing “‘reasonably appear[s] capable of making a significant contribution to . . . maintaining monopoly power’”⁵³ and whether competing firms that wanted to use the distribution channels subject to the exclusivity arrangement “constituted nascent threats” to defendant’s monopoly power.⁵⁴

Similarly, in *Dentsply*, the Third Circuit held in 2005 that Dentsply’s practice of refusing to sell to distributors that carried other manufacturers’ artificial teeth violated section 2 because it unlawfully maintained Dentsply’s monopoly power.⁵⁵ This practice left Dentsply’s rivals with distribution methods entailing “significantly higher transaction costs, extension of credit burdens, and credit risks,”⁵⁶ thereby “keep[ing] sales of competing teeth below the critical level necessary for any rival to pose a real threat to Dentsply’s market share.”⁵⁷ Finding that Dentsply’s policy “exclude[d] its rivals from access to dealers,”⁵⁸ the court held that Dentsply’s proffered efficiency justifications were “pretextual” and “did not excuse its exclusionary practices.”⁵⁹ Notably, the *Dentsply* court distinguished several other courts’ assertions that short-term exclusive-dealing contracts are presumptively legal,⁶⁰ explaining that a policy of not dealing with customers also patronizing a rival can “realistically make the arrangements . . . as effective as those in written contracts.”⁶¹

⁵² *United States v. Microsoft Corp.*, 253 F.3d 34, 64 (D.C. Cir. 2001) (en banc) (per curiam); *see also id.* at 70, 72, 73.

⁵³ *Id.* at 79 (quoting 3 AREEDA & HOVENKAMP, *supra* note 31, ¶ 651c, at 78 (1996) (alteration in original)).

⁵⁴ *Id.*

⁵⁵ *United States v. Dentsply Int’l, Inc.*, 399 F.3d 181, 191–93 (3d Cir. 2005).

⁵⁶ *Id.* at 193.

⁵⁷ *Id.* at 191.

⁵⁸ *Id.* at 185.

⁵⁹ *Id.* at 197.

⁶⁰ *Id.* at 194 n.2.

⁶¹ *Id.* at 193.

Finally, some lower courts reviewing other exclusivity arrangements have implied a safe harbor for arrangements that in the aggregate affect less than thirty to forty percent of existing customers or distribution. For example, the First Circuit stated that “[f]or exclusive dealing, foreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent.”⁶² Similarly, in *Minnesota Mining & Manufacturing Co. v. Appleton Papers Inc.*, the court noted that “[g]enerally speaking, a foreclosure rate of at least 30 percent to 40 percent must be found to support a violation of the antitrust laws.”⁶³

III. Analysis

Panelists described and discussed conditions under which exclusive dealing can be anticompetitive and procompetitive.⁶⁴ As discussed below, assessing in practice whether the net effect of exclusive dealing is anticompetitive or procompetitive can at times be difficult. Notwithstanding that difficulty, the Department believes that the general approach used by lower courts today—focusing on whether the exclusive dealing allows a firm to acquire or maintain monopoly power and also taking into account procompetitive effects in those situations where harm to competition is likely—is the appropriate way to determine the legality of exclusive dealing.

A. Potential Anticompetitive Effects

Some have argued that exclusive dealing can never have anticompetitive effects because it is against buyers’ interests to help a seller acquire or maintain monopoly power. Implicit in this argument is the presumption that, if buyers enter into exclusivity arrangements, it must be because the arrangements create efficiencies. Buyers will demand to be fully compensated by

⁶² *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 68 (1st Cir. 2004) (Boudin, C.J.).

⁶³ 35 F. Supp. 2d 1138, 1143 (D. Minn. 1999); *see also, e.g.*, Nov. 15 Hr’g Tr., *supra* note 2, at 75–76 (Steuer); *id.* at 96 (Jacobson); 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1821c, at 176 (2d ed. 2005).

⁶⁴ *See, e.g.*, Nov. 15 Hr’g Tr., *supra* note 2, at 18 (Steuer); *id.* at 31–39 (Wright); *id.* at 50 (Marvel); *id.* at 53–54 (Jacobson); *id.* at 127 (Lipsky).

the seller before entering into an arrangement subjecting them to future monopoly power. If the arrangement is anticompetitive, the monopoly profit to the seller will be less than the harm to the victims, and the would-be monopolist will not be able to compensate its potential victims fully. Hence, they would never agree.⁶⁵

But it is now generally accepted that the assumptions necessary to support this argument do not always apply. For example, when buyers are “unable to coordinate their actions to defeat the tactic,” a monopolist “can scare victims into selling cheaply; no single victim can stop the exclusion by itself, so no single victim has any bargaining power.”⁶⁶ Put another way, under certain circumstances, buyers may agree to inefficient exclusive-dealing arrangements because each buyer believes that, no matter what it does, other buyers will agree. Thus, buyers will not necessarily resist exclusive dealing that harms them collectively. And if those entering into exclusive-dealing arrangements are distributors, the manufacturer may be able to obtain their acquiescence by sharing with them some of its expected monopoly profits.⁶⁷ Thus,

⁶⁵ See, e.g., ROBERT H. BORK, *THE ANTITRUST PARADOX* 304–09 (1978).

⁶⁶ Eric B. Rasmusen et al., *Naked Exclusion: Reply*, 90 AM. ECON. REV. 310, 310 (2000); see also, e.g., Nov. 15 Hr’g Tr., *supra* note 2, at 49 (Marvel); *id.* at 114 (Calkins); Joseph Farrell, *Deconstructing Chicago on Exclusive Dealing*, 50 ANTITRUST BULL. 465, 476 (2005); Jonathan M. Jacobson & Scott A. Sher, “No Economic Sense” Makes No Sense for Exclusive Dealing, 73 ANTITRUST L.J. 779, 791 (2006) (“[I]t is now common ground that, in many contexts, exclusive dealing can be deployed in a way that . . . allows the defendant to reap gains from the arrangement that far exceed the associated costs.”); Eric B. Rasmusen et al., *Naked Exclusion*, 81 AM. ECON. REV. 1137, 1140 (1991); Ilya R. Segal & Michael D. Whinston, *Naked Exclusion: Comment*, 90 AM. ECON. REV. 296, 307 (2000) (stating that when many buyers already have agreed to exclusivity arrangements, a monopolist “will not have to pay much” to induce other buyers to agree as well).

⁶⁷ See, e.g., A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct – Are There Unifying Principles?*, 73 ANTITRUST L.J. 375, 404 (2006) (“If the manufacturer expects to gain or preserve market power by excluding its rivals, it could induce

exclusive dealing can be anticompetitive in some instances, notwithstanding the seeming anomaly of buyers agreeing to arrangements allowing a seller to acquire or maintain a monopoly.

In particular, exclusive dealing may be harmful when it deprives rivals “of the necessary scale to achieve efficiencies, even though, absent the exclusivity,” more than one firm “would . . . be large enough to achieve efficiency.”⁶⁸ In other words, exclusive dealing can be a way that a firm acquires or maintains monopoly power by impairing the ability of rivals to grow into effective competitors that erode the firm’s position. As one panelist put it, “the exclusive dealing case that you ought to worry about” is where exclusivity deprives rivals of the ability to obtain economies of scale.⁶⁹

the distributors to go along with the exclusionary scheme by sharing with them a portion of the anticipated supracompetitive profits.”).

⁶⁸ Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal – Why Aspen and Kodak Are Misguided*, 68 ANTITRUST L.J. 659, 663 (2001); see also Nov. 15 Hr’g Tr., *supra* note 2, at 8 (Steuer) (assessing exclusionary arrangements requires “looking more at foreclosure of competitors than anything else”); *id.* at 54 (Jacobson) (noting that exclusive dealing can harm consumers by “deny[ing] the rivals access to customers or supplies and hav[ing] the effect of driving their costs up and rendering them less effective competitors”); *id.* at 83 (Wright) (characterizing most modern theories of competitive harm from exclusive dealing as dependent upon preventing rivals from obtaining “minimum efficient scale”); MICHAEL D. WHINSTON, *LECTURES ON ANTITRUST ECONOMICS* 133–97 (2006); Eric B. Rasmusen et al., *Naked Exclusion*, 81 AM. ECON. REV. 1137, 1144 (1991).

⁶⁹ Nov. 15 Hr’g Tr., *supra* note 2, at 94 (Jacobson); see also, e.g., RICHARD A. POSNER, *ANTITRUST LAW* 229 (2d ed. 2001) (noting that exclusive dealing may “increase the scale necessary for new entry, and . . . increase the time required for entry and hence the opportunity for monopoly pricing”); Carlton, *supra* note 68, at 665 n.15 (asserting that the “key issue” is that exclusive dealing can “impair[] the competitive effectiveness of the rival with a resulting harm to competition”).

Exclusive dealing can be a way that a firm acquires or maintains monopoly power by impairing the ability of rivals to grow into effective competitors that erode the firm's position.

Panelists noted many issues relevant to the question of when exclusive dealing potentially could be harmful.⁷⁰ In the context of exclusive dealing between a manufacturer and retailers, for example, exclusive dealing is likely to harm consumers only when it affects a significant portion of effective distribution methods. As one panelist explained, “I think everybody would agree that below some percent, no agency should worry about it, and no court should find illegality”⁷¹ Thus, exclusive dealing is more likely to harm consumers when rivals do not have other effective ways to distribute their products. As one panelist put it, if “access to the customers . . . is very easy . . . then exclusive dealing will not present any problems.”⁷² A number of panelists noted that exclusive dealing between a manufacturer and retailers is more likely to pose a threat to consumers when rivals cannot “establish their own distribution networks.”⁷³ Accordingly, the adequacy of other potential alternatives can be a crucial issue in assessing exclusive dealing’s potential to foreclose a competitor and thereby harm consumers.⁷⁴

Panelists also asserted that “the level of distribution really matters”⁷⁵ and that the

⁷⁰ See, e.g., Nov. 15 Hr’g Tr., *supra* note 2, at 8–10 (Steuer); *id.* at 83, 89–90 (Wright); *id.* at 86 (Sullivan); *id.* at 136–37 (Farrell).

⁷¹ *Id.* at 174 (Calkins).

⁷² *Id.* at 183 (Calkins).

⁷³ *Id.* at 10 (Steuer); *cf. id.* at 84 (Wright) (questioning the likelihood of anticompetitive exclusive dealing “if you have free entry at the retail level”).

⁷⁴ See SECTION OF ANTITRUST LAW, *supra* note 1, at 218 & nn.1269–70; see also *United States v. Denstply Int’l, Inc.*, 399 F.3d 181, 193 (3d Cir. 2005) (“The proper inquiry is not whether direct sales enable a competitor to ‘survive’ but rather whether direct selling ‘poses a real threat’ to defendant’s monopoly.” (quoting *United States v. Microsoft*, 253 F.3d 34, 71 (D.C. Cir. 2001) (en banc) (per curiam))).

⁷⁵ Nov. 15 Hr’g Tr., *supra* note 2, at 8 (Steuer).

competitive effects of exclusive dealing with wholesalers may differ from those with retailers or end users.⁷⁶ At least one observed that the potential for anticompetitive harm may depend on the product involved, claiming that if the product is one for which customers are likely to shop around, then exclusive dealing may be less likely to harm rivals because consumers “are more likely to . . . look[] at other . . . dealers” if a “dealer only has one brand.”⁷⁷

B. Potential Procompetitive Effects

Exclusive dealing can help consumers in many ways.⁷⁸ For instance, several panelists noted that (1) a distributor selling the product of only one manufacturer is likely to promote that product more effectively than it would if it sold multiple manufacturers’ products, and (2) increased interbrand competition benefits consumers. One panelist stated that exclusive

⁷⁶ See *id.* at 8–9 (Steuer); *id.* at 136–37 (Farrell) (discussing potentially different effects of exclusivity arrangements with retailers as opposed to consumers); see also, e.g., Kenneth L. Glazer & Abbott B. Lipsky, Jr., *Unilateral Refusals to Deal Under Section 2 of the Sherman Act*, 63 ANTITRUST L.J. 749, 790 (1995) (“Cooperation between a supplier and downstream intermediaries in promoting the product may stimulate interbrand competition. By contrast, consumers or end-users rarely play any role in activities that promote successful distribution of the product—their only role in the process is that of customer.”); Steuer, *supra* note 2, at 118.

⁷⁷ Nov. 15 Hr’g Tr., *supra* note 2, at 9 (Steuer).

⁷⁸ See, e.g., POSNER, *supra* note 69, at 230 (“Exclusive dealing can promote efficiency by increasing the likelihood that a distributor will use his best efforts to promote the manufacturer’s brand rather than try to substitute a cheap knock-off, and (a related point) it can help a seller of intellectual property to prevent piracy, a serious concern in intellectual-property markets.” (footnote omitted)); Jacobson, *supra* note 28, at 312 (“Exclusive dealing arrangements generally promote more effective distribution by increasing dedication and loyalty; and they can minimize free-riding, improve product quality, and ensure customers and suppliers of a reliable source of supply.”); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 288 (1988) (When used in conjunction with exclusive territories or resale price maintenance, exclusive-dealing arrangements “prevent[] free riding on the manufacturer’s payment scheme for dealer services.”).

dealing can “stimulate distributors” because “[i]f the distributor only has one brand of a product, it is going to devote all of its efforts to that brand.”⁷⁹ Another observed that “undivided dealer loyalty . . . increases the dealer’s incentives to supply . . . desired services and to more actively promote the manufacturer’s products.”⁸⁰

Panelists also agreed that exclusive dealing can align distributor and manufacturer incentives and thereby prevent free-rider problems. As Judge Posner has noted,

Exclusive dealing may also enable a manufacturer to prevent dealers from taking a free ride on his efforts (for example, efforts in the form of national advertising) to promote his brand. The dealer who carried competing brands as well might switch customers to a lower-priced substitute on which he got a higher margin, thus defeating the manufacturer’s effort to recover the costs of his promotional expenditures by charging the dealer a higher price.⁸¹

Exclusive dealing can align distributor and manufacturer incentives and thereby prevent free-rider problems.

Put another way, exclusive dealing “encourages the *supplier itself* to give the distributors more support by eliminating what may be called the ‘interbrand free rider effect’; suppliers will strengthen their distributors because other *brands* cannot take a ‘free ride’ on the supplier’s investment by selling through the same distributors.”⁸²

Panelists generally agreed that this sort of free riding is one of the basic theories of exclusive dealing’s procompetitive effects: “the manufacturer invests in a product or a reputation that brings in customers,” thereby enticing customers to patronize a dealer, but “then the dealer says, by the way, I have got a better deal for you,” to patrons drawn by the manufacturer’s investment.⁸³ As one panelist explained, exclusive dealing can “stimulate[] suppliers to put more time and effort and money behind their channels of distribution, because . . . they do not have to worry about divided loyalties where they are wasting their effort.”⁸⁴ In effect, exclusive dealing can help consumers by “encourag[ing] people to make specific investments in the relationship.”⁸⁵ Panelists identified manufacturer advertising,⁸⁶ training of dealer staff,⁸⁷ sharing of trade secrets with retailers,⁸⁸ and promotional investments⁸⁹ as examples of services that ultimately benefit consumers yet might not be provided but for exclusive dealing.

Panelists suggested a host of other potential benefits from exclusive dealing, including allowing manufacturers to better assess and improve dealer quality⁹⁰ and lowering the cost of monitoring certain kinds of contracts.⁹¹ Likewise, exclusive dealing may help assure supply, afford protection against price increases, and allow long-term cost planning. For instance, requirements contracts where a buyer promises to purchase all its needs for an input from a specified seller “allow suppliers to anticipate demand while providing customers

⁷⁹ Nov. 15 Hr’g Tr., *supra* note 2, at 11 (Steuer).

⁸⁰ *Id.* at 150 (Klein); *see also* Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984) (Posner, J.) (“If . . . exclusive dealing leads dealers to promote each manufacturer’s brand more vigorously than would be the case under nonexclusive dealing, the quality-adjusted price to the consumer (where quality includes the information and other services that dealers render to their customers) may be lower with exclusive dealing than without, even though a collateral effect of exclusive dealing is to slow the pace at which new brands . . . are introduced.”).

⁸¹ *Roland Mach.*, 749 F.2d at 395.

⁸² *Steuer, supra* note 2, at 115 (emphasis in original).

⁸³ Nov. 15 Hr’g Tr., *supra* note 2, at 44–45 (Marvel); *see also id.* at 53–54 (Jacobson) (noting that exclusive dealing can allow a manufacturer to obtain “more effective distribut[ion]” by providing services to its dealers “without concern of free riding by competing suppliers”).

⁸⁴ *Id.* at 11–12 (Steuer).

⁸⁵ *Id.* at 185 (Klein).

⁸⁶ *Id.* at 167 (Calkins).

⁸⁷ *Id.* at 147 (Klein).

⁸⁸ *Id.* at 12 (Steuer).

⁸⁹ *Id.* at 148 (Klein).

⁹⁰ *Id.* at 12 (Steuer).

⁹¹ *Id.* at 38 (Wright).

with protection against shortages of needed inputs.”⁹² Another commentator noted that competition among manufacturers to become the exclusive supplier to a retailer can result in significant savings for the ultimate consumer.⁹³ The limited empirical literature available is consistent with these theories of procompetitive benefits.⁹⁴

In summary, although exclusive dealing can harm consumers in some circumstances, it can also generate efficiencies, and there is no simple way of determining—even where harm is possible—whether a particular exclusive-dealing arrangement should be condemned as anticompetitive.⁹⁵ As one panelist noted, current economic theory regarding exclusivity provides “‘possibility results’ in simple settings,” demonstrating that harm could occur under certain circumstances, not that it will.⁹⁶ Similarly, while all panelists recognized that exclusive dealing can benefit consumers, demonstrating the existence of those benefits, much less estimating their magnitude, is

difficult.⁹⁷

IV. Conclusion

Courts currently consider the possibility of both anticompetitive and procompetitive effects when assessing the legality of exclusive dealing. The first step in that analysis is to determine whether the arrangement has the potential to harm competition and consumers. In situations where competitive harm is implausible—for instance, where other efficient distribution methods are available in sufficient size and number to rivals—courts appropriately uphold the arrangement.

When actual or probable harm to competition is shown, the Department believes that exclusive dealing should be illegal only when (1) it has no procompetitive benefits, or (2) if there are procompetitive benefits, the exclusivity arrangement produces harms substantially disproportionate to those benefits.⁹⁸ Where exclusive dealing has both anticompetitive and procompetitive effects, this standard requires plaintiffs to show that the anticompetitive effects substantially outweigh its procompetitive benefits. For example, a trivial benefit should not save an arrangement that has substantial anticompetitive effects. The Department believes this approach is prudent in view of the uncertainty that can surround exclusive dealing’s competitive effects and the costs of inadvertently imposing antitrust liability on conduct that, while potentially hampering a rival’s ability to compete, often lowers costs and benefits consumers.

Further, the Department believes that, although exclusivity arrangements of short duration are less likely to harm competition than those of long duration, even arrangements that are terminable at will can at times be anticompetitive. The Third Circuit endorsed this view in *Dentsply*, explaining that the economic effect of a policy of terminating

⁹² Richard M. Steuer, *Customer-Instigated Exclusive Dealing*, 68 ANTITRUST L.J. 239, 242 (2000); see also Nov. 15 Hr’g Tr., *supra* note 2, at 16 (Steuer) (noting that requirements contracts ensure “dependable supply”).

⁹³ Nov. 15 Hr’g Tr., *supra* note 2, at 38–39 (Wright); see also Benjamin Klein, *Exclusive Dealing as Competition for Distribution “On the Merits,”* 12 GEO. MASON L. REV. 119, 120 (2003) (“[C]ompetition for distribution is . . . an important part of the normal competitive process that benefits consumers.”).

⁹⁴ See, e.g., James Cooper et al., *Vertical Restrictions and Antitrust Policy: What About the Evidence?*, COMPETITION POL’Y INT’L, Autumn 2005, at 45, 63; cf. Francine Lafontaine & Margaret E. Slade, *Retail Contracting: Theory and Practice*, 45 J. INDUS. ECON. 1, 13–14 (1997); Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the U.S. Beer Industry*, 23 INT’L J. INDUS. ORG. 203, 222 (2005).

⁹⁵ See, e.g., Nov. 15 Hr’g Tr., *supra* note 2, at 49 (Marvel) (questioning how frequently, if ever, exclusive dealing harms consumers, although acknowledging that consumer harm “is possible, in principle”). See generally Cooper et al., *supra* note 94, at 55.

⁹⁶ Nov. 15 Hr’g Tr., *supra* note 2, at 50 (Marvel).

⁹⁷ See *id.* at 50 (noting that the procompetitive benefits of exclusive dealing can be “really hard to prove”); cf. *id.* at 143–44 (Farrell).

⁹⁸ See 3 AREEDA & HOVENKAMP, *supra* note 31, ¶ 651a, at 72.

customers that deal with a rival can “realistically make the arrangements . . . as effective as those in written contracts.”⁹⁹ Panelists differed with one another on this point,¹⁰⁰ but the Department believes that the legality of exclusive dealing should not depend solely on its length.

The legality of exclusive dealing should not depend solely on its length.

Finally, in cases where the firm engaging in exclusive dealing already has legally acquired monopoly power, the Department will examine whether the exclusivity contributed significantly to maintaining that power and whether alternative distribution channels allow competitors to “pose a real threat” to its continued existence.¹⁰¹ A significant factor in making this assessment is the portion of customers or dealers with which a monopolist’s rival cannot deal as a result of the exclusivity arrangement. As discussed above, a treatise notes that “single-firm foreclosure percentages of less than 30 percent would seem to be harmless,”¹⁰² and several panelists agreed that courts typically recognize a safe harbor for exclusive dealing affecting less than a thirty-percent market share.¹⁰³ The Department

likewise believes that exclusive-dealing arrangements that foreclose less than thirty percent of existing customers or effective distribution should not be illegal, but emphasizes that exclusive dealing affecting more than thirty percent should be neither automatically nor presumptively illegal.

The Department believes that exclusive-dealing arrangements that foreclose less than thirty percent of existing customers or effective distribution should not be illegal.

⁹⁹ *United States v. Dentsply Int’l, Inc.*, 399 F.3d 181, 193 (3d Cir. 2005).

¹⁰⁰ Compare Nov. 15 Hr’g Tr., *supra* note 2, at 51 (Marvel) (advocating a rule that exclusivity arrangements should be legal if they do not involve a contract), *with id.* at 117 (Calkins) (stating that “a short-term contract or contract that is cancellable” can harm consumers).

¹⁰¹ *United States v. Microsoft Corp.*, 253 F.3d 34, 71, 79 (D.C. Cir. 2001) (en banc) (per curiam); *see also Dentsply*, 399 F.3d at 193.

¹⁰² HOVENKAMP, *supra* note 63, ¶ 1821c, at 176; *see also Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 68 (1st Cir. 2004) (Boudin, C.J.) (stating that “foreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent”); *Minn. Mining & Mfg. Co. v. Appleton Papers Inc.*, 35 F. Supp. 2d 1138, 1143 (D. Minn. 1999) (“Generally speaking, a foreclosure rate of at least 30 percent to 40 percent must be found to support a violation of the antitrust laws.”).

¹⁰³ *See, e.g., Nov. 15 Hr’g Tr.*, *supra* note 2, at 75–76 (Steuer); *id.* at 96 (Jacobson).