ANTITRUST LAW

Unit 20: Exclusive Dealing

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Recent Cases

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

PNY TECHNOLOGIES, INC., Plaintiff, v. SANDISK CORPORATION, Defendant.	Case No. 11-cv-04689-WHO **ORDER GRANTING MOTION TO DISMISS FIFTH AND SIXTH CAUSES OF ACTION IN THIRD AMENDED COMPLAINT** Re: Dkt. No. 237

INTRODUCTION

On April 25, 2014, I granted defendant SanDisk Corporation's motion to dismiss plaintiff PNY Technologies, Inc.'s Fifth and Sixth Causes of Action in the Second Amended Complaint ("SAC") because PNY failed to adequately allege that SanDisk's short-term, easily terminable exclusivity agreements with retailers unlawfully foreclosed competition in, or constituted an illegal attempt to monopolize, the market for Secure Digital cards ("SD cards"). Dkt. No. 218 ("Order"). I also granted PNY leave to amend its pleading. *Id.* On May 5, 2014, PNY filed a Third Amended Complaint ("TAC"). Dkt. Nos. 224, 250.

Because the TAC suffers from the same fundamental deficiency as the SAC, SanDisk's motion to dismiss PNY's Fifth Cause of Action for attempted monopolization and Sixth Cause of Action for exclusive dealing in the TAC is GRANTED.

FACTUAL BACKGROUND

PNY alleges the following new facts in its TAC[1]:

[1] This order incorporates the legal and factual discussions from the April 25, 2014, Order granting SanDisk's motion to dismiss, as well as SanDisk's Request for Judicial Notice which it referenced. Order 4 n.4. I will not repeat facts pleaded in the TAC identical to ones already recited in that Order.

SanDisk has entered into agreements with retailers making it their exclusive supplier of SD cards for sale to consumers. Many retailers enter these agreements because the agreements contain significant incentives in exchange for exclusivity. SanDisk's competitors, including PNY, are thus unable to reach consumers and competition is thereby harmed. SanDisk has attempted to monopolize the SD card market through these exclusive-dealing arrangements.

The United States retail channel is dominated by a limited number of retailers, such as Best Buy, RadioShack, Verizon, CVS, Target, and Costco. TAC ¶ 173. Of 16 major retailers, SanDisk has exclusive arrangements with 11. TAC Table 7. Of the five retailers where PNY is present, SanDisk is the only other competitor. TAC Table 7. "[O]n information and belief SanDisk has never lost an exclusive arrangement once it has been established." TAC ¶ 98. "[O]n information and belief, SanDisk has been known to threaten retaliation in the event [retailers] terminate their arrangements." TAC ¶ 184.

All of SanDisk's contracts with retailers identified in the TAC had terms ranging from one year to three years, with only one contract lasting three years. *See, e.g.*, TAC ¶¶ 204, 220, 225, 235, 246. "SanDisk's exclusive arrangements, in practice and effect, are long-term" because retailers almost always renew those arrangements. *See* TAC ¶ 179. For example, SanDisk has had an exclusive agreement with Costco since 2001. TAC ¶ 179. Costco, however, has previously tested carrying the products of a competing manufacturer, Kingston; it is also currently testing products from Lexar. TAC ¶¶ 214-15.

SanDisk's agreements with retailers have "massive hard dollar incentives, corresponding penalties for non-exclusivity, and economic investments that make no sense for any rational economic action except to create a monopoly." TAC ¶ 168. For example, an internal SanDisk email from September 2012 shows that it was prepared to offer Rite Aid nearly [redacted] dollars in marketing development funds and markdown funding in exchange for exclusivity (though there is no allegation that SanDisk actually presented such an offer). TAC ¶ 168. Similarly, SanDisk has offered up to [redacted] in marketing funds and rebates for a 19-month exclusivity period. TAC ¶¶ 190-96. RadioShack's 2013 agreement included a [redacted] marketing development fund contingent on exclusivity. TAC ¶ 206.

"Some of SanDisk's written exclusive dealing agreements have provisions that make it very difficult or expensive for retailers to terminate the arrangement." TAC ¶ 180. For example, through the use of "co-op funding," a retailer can accrue advertising funds based on its purchases from a manufacturer, but if the funds are not fully used by the end of a contract term, the retailer will be "leaving unused funding on the table" if it does not extend its agreement. TAC ¶ 180. Another "practical" impediment to ending an exclusive agreement is retailers' use of "planograms," i.e., schedules for arranging product displays, which occur on pre-determined cycles that may not coincide with the term of a supply contract. TAC ¶ 181. "To the extent the end of an exclusive dealing agreement and the end of the planogram cycle do not align, it may not be possible for a competing seller of SD cards to persuade a retailer to terminate the exclusive arrangement." TAC ¶ 181. Finally, SanDisk's SD cards are considered a "must-have" product for retailers. TAC ¶ 182.

"SanDisk's exclusive arrangements with retailers are reflected in written agreements but may also be based on oral or informal understandings, not found in the written agreements . . . . Accordingly, the terms and conditions of SanDisk's exclusive arrangements may not be determined solely from SanDisk's written agreements." TAC ¶ 178. Staples's agreement does not have an exclusivity requirement, but it is "economically motivated to maintain the exclusive arrangement." TAC ¶ 248.

"PNY has made numerous attempts to compete with SanDisk at retailers at which SanDisk has established an exclusive arrangement. These attempts have been unavailing." TAC ¶ 185. For example, Costco once rejected PNY's offer of pricing on SD cards "that was below PNY's cost on a special promotion." TAC ¶ 185. Similarly, RadioShack, CVS, and Walgreens have "expressly communicated to PNY that it is precluded from even *entertaining* a proposal from PNY because of its exclusive arrangement with SanDisk." TAC ¶ 157; *see also* TAC ¶¶ 183, 186.

SanDisk's internal documents reflect that it targeted PNY in its drive for exclusivity. TAC ¶ 170. A November 2012 SanDisk email chain shows that while SanDisk was negotiating an exclusive agreement with Best Buy, Best Buy said that "while [SanDisk] sell[s] more, PNY provides more margins." TAC ¶ 188 (original brackets). In response, SanDisk prepared a

spreadsheet showing a benefit of [redacted] to Best Buy premised on replacing PNY's lower-priced products with SanDisk's higher-priced products. TAC ¶ 188. SanDisk and Best Buy also discussed selling SanDisk products under another brand name so that consumers would not know that "one vendor manages the entire category," though there is no allegation that this was done. TAC ¶ 189. Another email from April 2011 shows that SanDisk hoped that PNY would be out at Walgreens. TAC ¶ 234.

In 2007, SanDisk's market share in retail sales of SD cards was 32 percent. TAC ¶ 162. In July 2011, SanDisk's market share was 47 percent; by December 2013, after entering into exclusive agreements with Best Buy, CVS, Walgreens, and BJ's, its market share reached 66.1 percent. TAC ¶ 172. Concurrently, PNY's market share dropped from 22.3 percent to 11 percent. TAC ¶ 172. During the same period, Lexar's share grew from 5.8 to 6.4 percent; Sony's share fell from 4.7 to 3.9 percent, Transcend's share fell from 4.3 to 2.6 percent, and other retailers fell from 15.8 to 10 percent.[2] TAC Table 6. In March 2014, SanDisk accounted for over 60 percent of SD card sales. TAC ¶ 95. SanDisk "recently enticed" Walmart to enter into an exclusive agreement with it—if Walmart accepts, SanDisk will control over 75 percent of the retail distribution channel for SD cards. TAC ¶ 251.

Despite the fact that the price of flash memory (a component of SD cards) has dropped by 45 to 52 percent, SanDisk's prices on SD cards at Best Buy have been "nearly level" and have not been reduced since July 2013, when SanDisk entered an exclusive agreement with Best Buy. TAC ¶¶ 278-80 & Tables 14, 15. Though the components of an SD card and a USB flash drive are very similar and thus their costs are similar (though USB flash drives cost slightly more because they require additional outer housing), Best Buy has been charging over 50 percent more for 16 gigabyte SD cards—for which SanDisk has an exclusive agreement with Best Buy—than it charges for similarly sized USB flash drives—for which PNY competes with SanDisk on Best Buy's shelves. TAC ¶ 282. A similar trend has occurred at Staples, where SanDisk dropped its price for a short time when PNY competed against it, then raised its prices when it reached an

[2] Other manufacturers include Memorex and Kingston. *See* TAC ¶ 177.

exclusive deal. TAC ¶¶ 281 & Tables 16, 17.

Over the course of 2011, "brick and mortar" retailers accounted for approximately 81 to 87 percent of SD card sales while "e-tail" sales—which include direct sales by manufacturers—accounted for approximately 13 to 19 percent. TAC ¶ 105 & Table 5. PNY's own experience with direct sales "confirms that the direct sales channel is not a viable alternative to the retail channel": PNY has invested heavily in promoting its products online, offering better prices than retailers, yet its direct-channel sales in 2013 were less than one percent of its total SD card sales. TAC ¶ 102. SanDisk's internal documents show that it "places an emphasis on driving the retail business." TAC ¶ 161.

"On information and belief, no other major manufacturer of SD cards—including giants like Toshiba, Samsung, and Micron—has had any meaningful success in building a direct sales channel." TAC ¶ 103. One "likely" reason is that SD cards are often purchased at the point of sale along with devices such as cameras and cell phones since consumers would rather not wait for SD cards to be delivered through the mail a few days later. TAC ¶ 103. Because SD cards are often purchased as part of a bundle, "customers are often insensitive to the price of SD cards, do not consider alternative sources for SD cards, and are willing to pay an inflated price at retail for their SD card." TAC ¶ 104. "Because of the need for personalized service and product demonstrations, established brick and mortar retailers have a substantial advantage over internet sales" and online sales have been stagnant, at least from January to December 2011. TAC ¶¶ 103-04 & Table 5.

"On information and belief," it has become considerably more expensive and difficult for a new market entrant to develop the necessary distribution network, relationships, and brand recognition to become a meaningful competitor in the SD card market. TAC ¶ 100. Other constraints prevent expansion by existing firms, including: SanDisk's ability to deprive a firm of its license from SD-3C ("an entity combining certain SanDisk, Panasonic, and Toshiba intellectual property"); the short supply of components needed to produce SD cards; and "the severe constraints on the distribution network." TAC ¶¶ 46, 106.

"SanDisk has not merely used its power in the flash memory technology market to obtain

an advantage in the SD card market. It has used it to maintain a monopoly position in the SD card market, or at a minimum, to create a dangerous probability of obtaining a monopoly position in that market." TAC ¶ 97.

PROCEDURAL HISTORY

On February 28, 2014, SanDisk moved to dismiss PNY's Fifth and Sixth Causes of Action for exclusive dealing and attempted monopolization in the SD card market. Dkt. No. 195. On April 25, 2014, I granted the motion to dismiss but allowed PNY an opportunity to amend its complaint to further support its claims. Dkt. No. 218. On May 5, 2014, PNY filed its TAC. Dkt. Nos. 224, 250. SanDisk again moves to dismiss the Fifth and Sixth Causes of Action for exclusive dealing and attempted monopolization. Dkt. No. 237. A hearing on the motion was held on June 25, 2014.

LEGAL STANDARD

A motion to dismiss is proper under Federal Rule of Civil Procedure 12(b)(6) where the pleadings fail to state a claim upon which relief can be granted. FED. R. CIV. P. 12(b)(6). The court must "accept factual allegations in the complaint as true and construe the pleadings in the light most favorable to the nonmoving party," *Manzarek v. St. Paul Fire & Marine Ins. Co.*, 519 F.3d 1025, 1031 (9th Cir. 2008), drawing all "reasonable inferences" from those facts in the nonmoving party's favor, *Knievel v. ESPN*, 393 F.3d 1068, 1080 (9th Cir. 2005). A complaint may be dismissed if it does not allege "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). "A claim has facial plausibility when the pleaded factual content allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). However, "a complaint [does not] suffice if it tenders naked assertions devoid of further factual enhancement." *Id.* (quotation marks and brackets omitted). "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.*

DISCUSSION

I. EXCLUSIVE DEALING[3]

A. Legal Standard for Exclusive Dealing

"Exclusive dealing involves an agreement between a vendor and a buyer that prevents the buyer from purchasing a given good from any other vendor." *Allied Orthopedic Appliances Inc. v. Tyco Health Care Grp. LP*, 592 F.3d 991, 996 (9th Cir. 2010). "Exclusive dealing agreements are often entered into for entirely procompetitive reasons, and generally pose little threat to competition." *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 270 (3d Cir. 2012). "[A]n exclusive dealing arrangement violates Section 1 [of the Sherman Act] only if its effect is to foreclose competition in a substantial share of the line of commerce affected." *Allied Orthopedic Appliances*, 592 F.3d at 996 (citations and internal punctuation omitted); *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1163 (9th Cir. 1997) ("Only those arrangements whose 'probable' effect is to 'foreclose competition in a substantial share of the line of commerce affected' violate Section 3 [of the Clayton Act]."). Actual exclusivity is not a prerequisite to finding unlawful exclusive dealing under the rule of reason. *See Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.*, 676 F.2d 1291, 1302 (9th Cir. 1982).

"[T]he short duration and easy terminability of [ ] agreements negate substantially their potential to foreclose competition." *Omega Envtl.*, 127 F.3d at 1163. If the contracts at issue are short-term or easily terminated, "a competing manufacturer need only offer a better product or a better deal" to get contracts of its own. *Id.* at 1164.

"[E]xclusive dealing arrangements imposed on distributors rather than end-users are generally less cause for anticompetitive concern." *Id.* at 1162 (quoting with approval *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1235 (8th Cir. 1987) ("Where the exclusive dealing restraint operates at the distributor level, rather than at the consumer level, we require a higher standard of

[3] In the Order, I said that I will disregard PNY's request that I declare that SanDisk's "exclusive dealing arrangements" violate Section 16720 of California's Cartwright Act because there is no cause of action being asserted under that statute. Order 7 n.5. The prayer for relief in the TAC still contains such a request. I will again disregard PNY's request that I declare that SanDisk's "exclusive dealing arrangements" violate the Cartwright Act.

proof of 'substantial foreclosure.'")). "If competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution, it is unclear whether [exclusive dealing arrangements] foreclose from competition *any* part of the relevant market." *Id.* at 1163.

In sum, "The prevailing rule in districts and circuits across the country is that where exclusive or semi-exclusive contracts are short in duration, easily terminable, incentive-based, and leave open alternative channels to competitors, they are not exclusionary." *Church & Dwight Co., Inc. v. Mayer Labs., Inc.*, 868 F. Supp. 2d 876, 903 (N.D. Cal. 2012), *vacated in part on other grounds*, No. 10-cv-4429-EMC, 2012 WL 1745592 (N.D. Cal. May 16, 2012); *see also* AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 1821d3, at 200 (3d ed. 2011) ("even a high foreclosure percentage will not exclude competition if the period covered by the exclusive-dealing arrangement is short *and* there are no other impediments to switching").

B. PNY Fails To Plead That The Contracts Unlawfully Foreclose Competition.

In my earlier Order, I concluded that "PNY fail[ed] to plead adequate facts showing that SanDisk's agreements unlawfully foreclose competition. As SanDisk correctly argue[d], nearly all of its contracts have short terms: more than half are a year long and only two are more than two years long, with the longest one being three years." Order 9. Courts in this circuit have found contracts with terms ranging up to three, and even five, years to be acceptable. Order 9-10. The facts demonstrated that SanDisk's contracts are also easily terminable, none requiring more than 45-days' notice to cancel.[4] Since the "short duration and easy terminability" of SanDisk's agreements "negate substantially their potential to foreclose competition," *Omega Envtl.*, 127 F.3d at 1163, in order for its renewed claim of exclusive dealing to succeed, PNY must plead that, despite their terms, the contracts have the "practical effect" of unreasonably suppressing competition, *see* Order 8-9 (citing *United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 457

[4] PNY points out that SanDisk's agreement with Best Buy "reveals no [ ] 'at will' termination provision. Opp'n 7 n.2 (citing Mot. 5 n.5). However, as the agreement states—and the TAC recognizes—Best Buy may cease carrying SanDisk products exclusively (apparently at any time during the term of the contract), at which point the marketing and markdown funding provided by SanDisk will be pro-rated. RJN Ex. 1 ¶ E; TAC ¶ 194.

(1922)).

PNY argues that "[s]ubstantial foreclosure can coexist with short-term exclusive agreements." Opp'n 4. In addition, PNY asserts that there may be a question about whether supposedly "at will" contracts are truly terminable at will. Opp'n 5. PNY contends that SanDisk's agreements with retailers are not in fact short-term or easily terminable because (1) SanDisk has had exclusive arrangements with Costco and RadioShack for eight to ten years, Opp'n 7 (citing TAC ¶¶ 178, 179, 199-215); (2) it has exclusive arrangements with 11 of 16 major retailers that carry SD cards, Opp'n 7 (citing TAC ¶¶ 173-75 & Table 7); (3) no exclusive arrangement has ever been terminated, Opp'n 7 (citing TAC ¶¶ 98, 198, 208, 215, 213, 231, 241); (4) RadioShack, CVS, and Walgreens have all "refused to even entertain competing offers from PNY," Opp'n 7 (citing TAC ¶¶ 157, 172, 183, 186)[5]; and (5) SanDisk's market share has grown nearly 30 percent in the last seven years despite the fact that its products are higher-priced than competitors, Opp'n 7 (citing TAC ¶¶ 95, 164, 172).

SanDisk rejects PNY's allegations that SanDisk offered retailers various incentives, such as marketing funding and rebates, to wrongfully create a "disincentive" for those retailers to terminate their relationship with SanDisk. Mot. 3 (citing TAC ¶¶ 168, 197, 201, 248).[6] It contends that "[t]he existence of these incentives does not change the fact that SanDisk's retailer agreements are short-term and easily terminable." Mot. 4. In particular, "PNY fails to plead facts that could establish that the incentives that SanDisk offers to retailers could foreclose competition." Mot. 5. Out of 16 named retailers, only three—Best Buy, RadioShack, and Staples—are alleged to have benefits that "disincentivize" them from ending their agreements with SanDisk.[7] Mot. 5 (citing TAC ¶¶ 197, 201, 248). SanDisk points out that the TAC never alleges

[5] PNY's brief asserts that PNY has "made multiple attempts to outbid SanDisk, but retailers refused to even entertain PNY's offers." Opp'n 9. The TAC does not allege that PNY has attempted to outbid SanDisk.

[6] SanDisk points out that "[t]o the extent PNY seeks to allege that SanDisk has offered retailers SD cards at below-cost prices (*see* TAC ¶¶ 168-69), the TAC does not plead any facts to support such a theory." Mot. 3 n.3. PNY does not respond to this point.

[7] SanDisk notes that BJ's, CVS, and Walgreens receive financial incentives from SanDisk, but PNY does not allege that these benefits create any "disincentive" for them. Mot. 5 (citing TAC ¶¶ 221-22, 227-28, 236, 239).

that it has prevented PNY or any other firm from offering more favorable incentives to retailers to draw them away from SanDisk. Mot. 5. Indeed, PNY does not allege that it failed to win a retailer's business despite offering better terms than SanDisk, nor does it allege that any retailer has said that its relationship with SanDisk prevents the retailer from accepting a better deal offered by another SD card supplier. Mot. 5-6. SanDisk says that PNY's allegation that RadioShack, CVS, and Walgreens have told PNY that they "could not even entertain an offer from PNY as a result of its exclusive arrangement with SanDisk" is unsupported by facts and cannot show foreclosure from those three retailers, let alone the other 13. Mot. 6 (citing TAC ¶¶ 207, 230, 240).

SanDisk also rejects PNY's allegation that "SanDisk's exclusive arrangements, in practice and effect, are long-term" because it "has had exclusive arrangements in place with certain retailers for years." Mot. 4 (citing TAC ¶ 179). SanDisk argues that, as a legal matter, agreements are not "long-term" simply because they have never been terminated. In addition, while PNY alleges that SanDisk's exclusive relationship with Costco, which dates to 2001, is evidence that SanDisk's long-standing relationship with certain retailers illustrates foreclosure, that assertion is belied by the TAC's allegation that "Costco is currently testing Lexar product." Mot. 7 (citing TAC ¶¶ 179, 214).[8]

Again, SanDisk's arguments are persuasive: while PNY has added over 100 paragraphs to its complaint, the new allegations in no way plausibly show that SanDisk's agreements unlawfully foreclosed competition in the market for SD cards. None of the new facts PNY offers to illustrate "the practical effect of SanDisk's exclusive dealing arrangements"—such as that SanDisk has exclusive contracts with 11 of 16 retailers or that no such contract has ever been terminated—evince unlawful foreclosure as opposed to the fruits of legitimate competition.

PNY's assertion that SanDisk's agreements constitute exclusive dealing based on the fact

[8] SanDisk also disputes PNY's allegations that SanDisk has coerced retailers into exclusive dealing arrangements, saying that PNY fails to plead any facts to support its allegations. Mot. 8. PNY rightly points out that coercion is not a necessary element of the claim, Opp'n 12 n.7, and SanDisk does not meaningfully respond. *See* Reply 6 n.15. Accordingly, there is no need to address this issue.

that retailers have entered into and continually renew contracts with SanDisk is not plausible because PNY has not pleaded (beyond naked assertions) facts showing that it failed to win contracts despite offering better terms or that SanDisk somehow thwarted its efforts to secure business through conduct other than competition on the merits. That a manufacturer has a long-standing exclusive relationship with a retailer does not mean that their agreement constitutes actionable exclusive dealing. It may be the case that SanDisk has continually offered Costco and RadioShack better terms than PNY has—as an example, the TAC points out, "Although SanDisk competitors have attempted to sell to Costco, SanDisk has responded by temporarily lowering its cost to induce Costco not to go forward with testing of competitors' products." TAC ¶¶ 214. Absent allegations of predatory pricing or some other anticompetitive conduct, that is the essence of competition.[9] Indeed, the TAC acknowledges that despite SanDisk's allegedly exclusive relationship with Costco and the offer of lower prices, Costco has tested two other manufacturers' products. *See* TAC ¶¶ 214-15. Notably, PNY does not explain why it cannot seek its own exclusive contracts with the five major retailers in which it already has a presence or the 13 retailers that did not allegedly tell PNY that they could not entertain offers from it. It is not enough for PNY to simply observe that SanDisk has gained several contracts through the years while PNY has been unable to do so and that SanDisk has maintained existing ones—PNY must plead facts plausibly showing that SanDisk's contracts have the practical effect of wrongfully foreclosing competition. It has not done so.

Other allegations PNY provides are conclusory. For example, PNY has baldly alleged on four separate instances that RadioShack, CVS, and Walgreens have explicitly told PNY that they cannot even entertain competing offers from PNY due to their exclusive agreements. Each of those allegations is bereft of any supporting facts. *See* TAC ¶¶ 157, 172, 183, 186. PNY argues that these allegations are not conclusory because "there is no requirement for PNY to allege the dates or further specifics of these conversations." Opp'n 9 (citing TAC ¶ 157). While PNY need

[9] PNY does not allege that SanDisk engaged in predatory pricing, which may be actionable. *See Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 901 (9th Cir. 2008) ("in the normal case, above-cost pricing will not be considered exclusionary conduct for antitrust purposes").

not plead with specificity, it must still give "some further factual enhancement" for its allegations to be more than bare assertions that cannot support a cognizable claim. *Twombly*, 550 U.S. at 557. Without more detail, it is unclear that the retailers meant that they are actually prevented from considering SanDisk's competitors or that their deal with SanDisk is simply too good to forego, not something more nefarious.[10] PNY does not allege in the TAC that it offered better terms to these retailers than SanDisk (contrary to PNY's assertion in its brief that it "made multiple attempts to outbid SanDisk," Opp'n 9). PNY fails to explain why competition has been substantially foreclosed despite the fact that SanDisk's arrangements with all three of these retailers are both short-term and easily terminable and that 13 other retailers apparently have not expressed this sentiment. Because PNY has not "nudged [its] claims across the line from conceivable to plausible, [its causes of action] must be dismissed." *Twombly*, 550 U.S. at 570.

PNY claims that the TAC "explains, in detail, *why* no retailer has ever terminated its exclusive arrangements with SanDisk," namely, because "termination of an exclusive arrangement with SanDisk is too expensive," six-month "planogram" cycles prevent retailers from terminating their arrangements,[11] and "because SanDisk is the category leader for SD cards, retailers feel compelled to carry its products and are powerless against SanDisk's insistence on exclusivity." Opp'n 7-8 (citing TAC ¶¶ 180-82). Those allegations are conclusory, overly general, and

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[10] For this reason, PNY's argument that "retailers cannot afford to lose the incentives provided for in the agreements" is unpersuasive. Opp'n 8. Any entity engaged in commerce will generally pick a better economic arrangement than a worse economic arrangement. The question is whether competition has been harmed, not just whether a competitor lost out on a deal. Similarly, it is of no moment that "[r]etailers are typically required to return or forego large incentives if they violate [ ] the exclusivity provision" in their contracts. Opp'n 8 n.5. That dynamic reflects the essence of a contractual exchange. *Cf. Church & Dwight Co., Inc. v. Mayer Labs., Inc.*, 868 F. Supp. 2d 876, 903 (N.D. Cal. 2012) ("The only consequence is that retailers may not receive a rebate based on" their decision to not abide by an arrangement.), *vacated in part on other grounds*, No. 10-cv-4429-EMC, 2012 WL 1745592 (N.D. Cal. May 16, 2012). Without adequately pleading facts showing that the contracts unreasonably foreclose competition despite their short term and easy terminability, such contracts are not actionable under the antitrust laws.

[11] PNY alleges that "[t]here are many practical impediments to a retailer terminating an exclusive arrangement for SD cards," identifying as an example "planogram cycles," for which a store determines its store product placement. TAC ¶ 181. PNY claims that "the opportunity to introduce new products to a planogram comes up only at pre-planned intervals" and "[t]o the extent the end of an exclusive dealing agreement and the end of the planogram cycle do not align, it may not be possible for a competing seller of SD cards to persuade a retailer to terminate the exclusive arrangement." *Id.* But PNY has not alleged that this has in fact happened or explained why easily terminable contracts do not mitigate any such "impediment."

speculative. PNY does not identify any particular retailer for which any of its allegations are true, and instead relies on abstract claims about unidentified "retailers." Indeed, these allegations are contradicted by other portions of the TAC. For example, PNY's claim about "SanDisk's insistence on exclusivity" goes against the TAC's recognition that five of 16 named retailers do not have exclusive arrangements with SanDisk and that Costco is considering carrying another manufacturer's products.

The TAC contains allegations suggesting valid reasons for retailers to want exclusive relationships with SanDisk and that its ability to gain and maintain such arrangements was achieved through procompetitive means. For example, PNY alleges that "SanDisk for many years has been the largest seller of SD and MicroSD cards," suggesting an incumbent advantage. TAC ¶ 182. Additionally, SanDisk "has marketed its cards heavily" and "many retailers believe they must stock SanDisk's SD cards" due to the "brand preference for SanDisk." TAC ¶ 182. The TAC lists in great detail the incentives SanDisk offers to many retailers to carry and market its product. For example, SanDisk has lowered its price to a retailer in the face of competition from another manufacturer. TAC ¶¶ 214. On the other hand, PNY identifies only one concrete instance in which PNY offered a retailer SD cards "below PNY's cost on a special promotion." TAC ¶ 185. Notably, PNY does not allege that its price or terms were better than SanDisk's, and the TAC contains no information about any other bidding episodes. In general, the TAC is devoid of any indication that SanDisk engaged in anticompetitive conduct to preclude retailers from considering PNY or other manufacturers or to prevent PNY or other manufacturers from approaching retailers with better offers than SanDisk such that SanDisk's agreements have the practical effect of substantially foreclosing competition.

The cases PNY cites in support of its position are distinguishable. PNY asserts that volume-based incentives which "bar" retailers from terminating an exclusive agreement "have been held to support an exclusive dealing claim," citing *Church & Dwight Co., Inc. v. Mayer Laboratories, Inc.*, No. 10-cv-4429 EMC, 2011 WL 1225912, at *10 (N.D. Cal. Apr. 1, 2011), in support. Opp'n 8. That case is not on point because the counterclaimant there alleged that its products were "better selling, and more profitable on a per unit basis," and that displacement of its

product "was not based on the merits" but attributable to the retailer's arrangement with the counterdefendant. *Id.* at *2. Here, PNY has not alleged that its product is superior, "better selling," or "more profitable" overall—it merely complains that certain retailers have decided not to carry it without plausibly pleading that there is no possible justification for their doing so.[12]

PNY points to *United States v. Dentsply International, Inc.*, No. 99-cv-5, 2001 WL 624807 (D. Del. Mar. 30, 2001), as another case in which a court allowed exclusive dealing claims to go forward despite the defendant's argument that its dealers were free to switch suppliers at any time. Opp'n 5. Citing *Minnesota Mining & Manufacturing Co. v. Appleton Papers, Inc.*, 35 F. Supp. 2d 1138 (D. Minn. 1999), and *Pro Search Plus, LLC v. VFM Leonardo, Inc.*, No. 12-cv-2102, 2013 WL 6229141, at *5-6 (C.D. Cal. Dec. 2, 2013), for the same point, PNY argues that supposedly "at will" agreements may not be terminable at all given the increasing concentration and structure of the markets at issue. Opp'n 5. None of those cases help it.

In *Dentsply*, the defendant manufacturer threatened to stop supplying its other products to dealers if they purchased the product at issue from Dentsply's competitors. *See United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 194 (3d Cir. 2005). There is no allegation of similar conduct here: as the TAC reflects, PNY products share shelf space with SanDisk products in five major retailers. Indeed, SanDisk's agreement with Best Buy contemplates the possibility of Best Buy's rescinding SanDisk's exclusivity with the consequence that any benefits offered to Best Buy would be pro-rated "to reflect the relative period of the exclusive program until such non-SanDisk branded products were added," but SanDisk has not threatened to withdraw its products. RJN Ex. 1 ¶ E.

In *Minnesota Mining*, while the court recognized that "[w]hen ascertaining the characteristics of an exclusive dealing arrangement, courts look to the 'practical effect' of the agreement, not merely to its form," the court found that the agreements "often include[d]

[12] Indeed, Judge Chen reaffirmed that a plaintiff must still adequately plead foreclosure and the length of the agreements at issue to state a claim for exclusive dealing, *id.* at *15, and stated in another order in the same case "that where exclusive or semi-exclusive contracts are short in duration, easily terminable, incentive-based, and leave open alternative channels to competitors, they are not exclusionary," *Church & Dwight Co.*, 868 F. Supp. 2d at 903.

incentives that have the practical effect of tying up the paper sheet inventory of a merchant over a period of several years." 35 F. Supp. 2d at 1144. Furthermore, there were "unique distribution factors, like the high costs a paper merchant must incur to switch completely from one brand to another, that ma[d]e it very difficult for a supplier to dislodge a competitive brand from an exclusively dealing merchant" and "major distributors ha[d] agreed among themselves that they [would] remain loyal to Appleton carbonless sheets regardless of competitors' pricing or product innovations." 35 F. Supp. 2d at 1144. Here, there is no allegation that retailers' inventories were tied up by SanDisk, that the retailers themselves incurred costs to carry other manufacturers' products, or that the retailers would continue being exclusive with SanDisk regardless of competitors' pricing or innovations.[13] In other words, there is no plausibly pleaded allegation that the short-term or easily terminable nature of SanDisk's agreements is illusory.

C. PNY Fails To Plead The Lack Of Alternative Channels Of Distribution.

"Competitors are free to sell directly, to develop alternative distributors, or to compete for the services of the existing distributors. Antitrust laws require no more." *Omega Envtl.*, 127 F.3d at 1163; *see also Pro Search Plus*, 2013 WL 6229141, at *7 ("[T]he fact that an alternative channel could theoretically be used does not mean that it actually is used, and a *de facto* exclusive dealing arrangement could prevent a potential alternative channel of distribution from actually being used.").

In the Order, I concluded that PNY failed to plead the lack of alternative channels of distribution because its allegations that the direct sales channel was insufficient to reach customers were "nothing but bare assertions." Order 14. PNY now pleads that the retail channel is dominated by only 16 retailers, five of which carry PNY's SD cards. TAC ¶ 173 & Table 7. It alleges that because SD cards are often sold as "add-ons" to products such as cameras or cell phones, SD card purchases often occur in retail stores due to "the need for personalized service and product demonstrations," which are a "substantial advantage over internet sales." TAC ¶ 103.

[13] Similarly, the plaintiff in *Pro Search* alleged that despite its superior products, the cost of switching from the defendant's products to another's was prohibitive despite the short duration and easy termination of the defendant's contracts. 2013 WL 6229141, at *6. No similar allegation is present here.

In 2011, brick-and-mortar retail stores comprised 81 to 87 percent of SD card sales. TAC Table 5. PNY claims that it "routinely offers better prices through its direct channel," but "despite significant financial and business investment PNY has had very little success with its direct sales channels." TAC ¶ 102.

PNY again fails to adequately plead that there are no "potential alternative channels of distribution" by which it can reach ultimate consumers. *Omega Envtl.*, 127 F.3d at 1163. As the TAC reflects, in the latest month of data PNY provides, non-retail sales amounted to 19 percent of the SD card market in December 2011. TAC Table 5. (PNY has not provided more recent data from 2012 to the present.) That non-retail channels amounted to nearly a fifth of the market over two and a half years ago does not indicate that PNY is foreclosed from competing in selling SD cards. PNY's own inability to exploit the "e-tail" channel does not indicate harm to competition: as the data show, some manufacturers are succeeding through non-retail means to reach SD card purchasers. While PNY claims that its direct sales have been weak despite the fact that it "routinely offers better prices through its direct channel" compared to "the inflated prices consumers must pay at retailers" for SanDisk products, as the TAC acknowledges, customers have a "need for personalized service and product demonstrations," and PNY's allegation does not account for any discrepancy in retail prices versus its direct-sales price that that need may have caused. Even if the vast majority of customers prefer brick-and-mortar retailers, Opp'n 10, the TAC reflects that there is a substantial number for which the lack of a physical store is not an insurmountable deterrent to purchasing through e-tail. In sum, PNY has not adequately pleaded any significant barriers to entering direct or e-tail sales and that competition through such means has been foreclosed.[14]

D. Direct Evidence Of Harm Alone Is Insufficient To State A Claim.

PNY argues that its allegations about direct evidence of competitive harm are sufficient to sustain a charge of exclusive dealing. Opp'n 2, 4. Specifically, PNY claims that "SanDisk's

[14] PNY again relies on *Dentsply* for the proposition that "direct sales are insufficient" to provide "an effective means of competition." Opp'n 11. I have already rejected PNY's reliance on *Dentsply* on that point in my Order and explained why it is distinguishable from the facts here even as pleaded in the TAC. Order 14.

exclusive dealing in the SD card market violates Section 1 of the Sherman Act and Section 3 of the Clayton Act because it has caused harm to competition in the form of supra-competitive prices," pointing to the allegedly high retail prices of SD cards at Best Buy and Staples relative to the allegedly falling USB drives (which allegedly cost nearly the same to manufacture and has dropped in manufacturing cost by about half).[15] Opp'n 3 (citing TAC ¶¶ 278-82).

PNY cites no authority establishing that it can state a claim for exclusive dealing without pleading substantial foreclosure of competition. The crux of an exclusive-dealing case is the allegation that competitors are shut out of the market. It is not enough to point to supposed "direct evidence of competitive harm" that cannot be attributed to the claimed exclusion.[16] None of the cases PNY cites supports it and, indeed, the cases directly contradict it. *Dentsply*—a Section 2 case—still required a plaintiff to establish that "the challenged practices bar a substantial number of rivals or severely restrict the market's ambit." *Dentsply Int'l*, 399 F.3d at 191. Similarly, *ZF Meritor, LLC v. Eaton Corporation* confirms that "[t]he legality of an exclusive dealing arrangement depends on whether it will foreclose competition in such a substantial share of the relevant market so as to adversely affect competition." 696 F.3d at 271; *see also id.* ("There is no set formula for evaluating the legality of an exclusive dealing agreement, but modern antitrust law generally requires a showing of significant market power by the defendant, substantial foreclosure, contracts of sufficient duration to prevent meaningful competition by rivals, and an analysis of

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[15] SanDisk points out that the TAC shows that the prices for both PNY's and SanDisk's USB drives have actually remained steady at Best Buy. Reply 3 (citing TAC Table 18). SanDisk also persuasively argues that there is no basis for PNY's contention that SD cards and USB drives should be priced similarly simply because of their allegedly similar component costs, rather than based on supply and demand, and cites testimony from another case in which a PNY executive represented that "firms set their prices [for USB drives] according to the market price rather than on their costs." Reply 3 n.8 (quoting *SanDisk Corp. v. Kingston Tech. Co., Inc.*, 863 F. Supp. 2d 815, 831 (W.D. Wis. 2012)). Finally, SanDisk points out that it does not set prices in retailers' stores—the retailers do. Reply 3 n.4, 7 n.18. PNY has not alleged otherwise.

[16] At the hearing, counsel for PNY noted that the alleged foreclosure in the SD card market is well over 30 percent. However, "a high foreclosure rate does not necessarily tell us anything about how competitively a market is performing." AREEDA & HOVENKAMP ¶ 1820b, at 175. Rather, high numbers "only encourage closer scrutiny based on factors" such as contract duration and alternative distribution channels. *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 68 (1st Cir. 2004) (Boudin, J.); AREEDA & HOVENKAMP ¶ 1821d, at 197-209. For the reasons discussed in this order, those other factors do not weigh in PNY's favor.

likely or actual anticompetitive effects considered in light of any procompetitive effects.") (citations omitted). Finally, *Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.* makes clear that finding a Section 1 exclusive-dealing violation involves "assess[ing] whether competition has been foreclosed in a substantial share of the relevant market." 676 F.2d 1291, 1302 (9th Cir. 1982).[17] PNY's argument is unsuccessful.[18]

E. Intent Is Irrelevant Here.

PNY argues that evidence of intent can be relevant to establishing the likely effect of allegedly anticompetitive conduct. Opp'n 11. In making that assertion, PNY cites authority relevant to Section 2 (for which intent is indeed an element), rather than Section 1, and a century-old case that does not appear to have direct applicability to the case at hand. Opp'n 11 (citing *Bd. of Trade of City of Chicago v. United States*, 246 U.S. 231, 238 (1918); *United States v. Microsoft Corp.*, 253 F.3d 34, 59 (D.C. Cir. 2001)). Because intent is not necessary to establish a Section 1 offense and PNY fails to adequately plead substantial foreclosure, and because PNY does not cite relevant authority for the point it asserts, there is no need to further address this issue.

II. ATTEMPTED MONOPOLIZATION

"[E]xclusive dealing arrangements can constitute an improper means of acquiring or maintaining a monopoly." *E.I. du Pont de Nemours & Co. v. Kolon Indus., Inc.*, 637 F.3d 435, 441 (4th Cir. 2011). "To establish a Sherman Act § 2 violation for attempted monopolization, a private plaintiff seeking damages must demonstrate four elements: (1) specific intent to control prices or destroy competition; (2) predatory or anticompetitive conduct directed at accomplishing

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[17] For this reason, PNY's assertion that "SanDisk's exclusive dealing in the SD card market violates Section 1 of the Sherman Act and Section 3 of the Clayton Act because it has caused harm to competition in the form of supra-competitive prices" is unavailing because the existence of supra-competitive prices does not, in itself, suggest foreclosure. There could be any number of reasons to explain why SD card prices at certain retailers may have stayed steady or risen, but needless to say, the mere fact that exclusive arrangements with SanDisk were in place at the time does not indicate causality.

[18] To be clear, as one leading treatise states, "any rule of reason inquiry must focus on the likelihood that the challenged restraint will result in reduced output and higher prices in some relevant market." AREEDA & HOVENKAMP ¶ 1820b, at 178. But "it must also show a foreclosure coverage sufficient to warrant an inference of injury to competition, depending on the existence of other factors that give significance to a given foreclosure percentage, such as contract duration, presence or absence of high entry barriers, or the existence of alternative sources of distribution or resale." *Id.* ¶ 1821, at 179-80.

that purpose; (3) a dangerous probability of achieving 'monopoly power'; and (4) causal antitrust injury." *Rebel Oil Co., Inc. v. Atl. Richfield Co.*, 51 F.3d 1421, 1432-33 (9th Cir. 1995). "[A]ll three elements [of an attempted monopolization claim] may be proved with evidence of conduct that is either: (1) conduct forming the basis for a substantial claim of restraint of trade, or (2) conduct that is clearly threatening to competition or clearly exclusionary." *Twin City Sportservice*, 676 F.2d at 1309.

In my earlier Order, I concluded that "PNY fail[ed] to adequately allege actionable exclusive dealing" and thus "fails to plead anticompetitive conduct sufficiently and therefore cannot sustain a claim for attempted monopolization." Order 16. Because I again conclude that the TAC does not sufficiently plead actionable exclusive dealing, PNY cannot state a claim for attempted monopolization.[19] *See R. J. Reynolds Tobacco Co. v. Philip Morris Inc.*, 199 F. Supp. 2d 362, 395 (M.D.N.C. 2002) ("because Plaintiffs have alleged no other anticompetitive acts, Plaintiffs' [ ] attempted monopolization claims fail as a matter of law").

PNY also asserts that SanDisk is using its power in the flash memory technology market to improperly attempt to obtain a second monopoly in the SD card market.[20] Opp'n 13 (citing TAC ¶ 97). However, the allegations upon which PNY relies are ones already rejected in the previous Order. *See* Order 17; Opp'n 13 (citing TAC ¶¶ 94-96). PNY's sole new paragraph about monopoly leveraging is wholly conclusory. TAC ¶ 97 ("SanDisk has not merely used its power in the flash memory technology market to obtain an advantage in the SD card market. It has used it to maintain a monopoly position in the SD card market, or at a minimum, to create a dangerous probability of obtaining a monopoly position in that market."). Absent new facts pleaded, there is no need to reconsider the Order's analysis.

[19] For this reason, I will not address PNY's arguments concerning intent and barriers to entry. *See* Opp'n 13-15. For the record, I have considered them and do not find them persuasive.

[20] SanDisk points out that PNY does not allege that SanDisk's licensing practices are themselves antitrust violations and does not explain how its licensing of the technology to enter the SD card market is consistent with its alleged intention of excluding firms from that market. Reply 9 n.22.

CONCLUSION

The Supreme Court has said, "it is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, but quite another to forget that proceeding to antitrust discovery can be expensive." *Twombly*, 550 U.S. at 558 (citation omitted). Accordingly, "a district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed." *Id.* (citation omitted).

In dismissing the SAC, I gave PNY another opportunity to state a claim for exclusive dealing and attempted monopolization in the SD card market. Careful review of the TAC shows that PNY has not adequately pleaded that SanDisk's "superior market share was achieved or maintained by means other than the competition on the merits." *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1062 (8th Cir. 2000) (internal punctuation omitted). Even so, at the hearing, PNY's counsel indicated that there is only about a month of discovery left and that I should allow PNY to continue discovery to further support its claims regarding SD cards.

This case was filed in 2011, several of these agreements have been in place for multiple years, discovery *has* been ongoing, motion practice has been robust, and PNY filed its motion for leave to add these causes of action to its complaint in December 2013. PNY—represented by able antitrust counsel—has not pleaded sufficient facts to state a claim despite being given two opportunities to do so. There is no basis to allow PNY to conduct further discovery on this issue.

For the reasons above, SanDisk's motion to dismiss the Fifth and Sixth Causes of Action of the TAC is GRANTED and the causes of action are DISMISSED WITH PREJUDICE. SanDisk shall file its answer within 10 days.

IT IS SO ORDERED.

Dated: July 2, 2014

WILLIAM H. ORRICK
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MAXON HYUNDAI MAZDA, et al.,

Plaintiffs,

–v–

CARFAX, INC.,

Defendant.

No. 13-cv-2680 (AJN)

REDACTED MEMORANDUM & ORDER

ALISON J. NATHAN, District Judge:

Plaintiffs are both franchised and independent car dealerships in the business of selling used cars. With their complaint in this action, they allege that Defendant Carfax, Inc. illegally has entered into exclusive-dealing arrangements for the sale of Vehicle History Reports (VHRs) with both the auto manufacturers who run "Certified Pre-Owned" (CPO) used car programs and with the two largest websites providing classified used car listings, Autotrader.com and Cars.com. According to the Second Amended Complaint (Dkt. No. 56), these agreements violate Section 3 of the Clayton Act (15 U.S.C. § 14) and Sections 1 and 2 of the Sherman Act (15 U.S.C §§ 1 & 2). Defendant has moved to dismiss the Complaint under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim. For the following reasons, Defendant's motion is granted in part and denied in part.

I. Background

For the purpose of evaluating Defendant's motion to dismiss, all allegations in the Complaint are taken as true. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007).

The Plaintiffs are over 450 car and light truck dealerships who have either purchased VHRs from Defendant as a condition of participating in a CPO program, placed classified listings of used cars on one or both of Autotrader.com and Cars.com, or both. Compl. ¶¶ 8-478, 481. A CPO program offers consumers extended warranties on used cars that have passed an extensive inspection in exchange for premium prices. *Id.* ¶ 504. All major auto manufacturers run CPO programs through their franchised dealerships. *Id.* ¶ 505. The Plaintiff franchised dealerships were required to purchase Defendant's VHRs in conjunction with CPO programs they administered. *Id.* ¶ 481.

According to the complaint, VHRs provide information about the title, flood damage, total loss accident history, odometer readings, lemon history, number of owners, accident indicators, state missions inspection results, service records, and vehicle use to customers shopping for used cars. *Id.* ¶ 5. Defendant prepares VHRs electronically in .pdf format, and the reports can be printed for customers, including at computer work stations at car dealerships. *Id.* ¶¶ 5-6.

Basic information about used vehicles must be reported to a centralized database called the National Motor Vehicle Title Information System (NMVTIS), established by the Anti Car Theft Act of 1992, *codified as amended at* 49 U.S.C. §§ 30501-30505. *Id.* ¶ 485. The database contains information of five quality indicators for used cars: (1) the date of the last title and the name of the state titling agency; (2) "brand" history applied by the state titling agency, such as "junk," "salvage," or "flood"; (3) the odometer reading; (4) total loss history; and (5) salvage history. *Id.* The data in the NMVTIS is made available to dealers and individual consumers through private companies. *Id.* ¶ 486; *Research Vehicle History*, National Motor Vehicle Title

Information System, http://vehiclehistory.gov/nmvtis_vehiclehistory.html (last visited Sept. 26, 2014).

There are ten approved vendors of NMTVIS VHRs. *Id.* ¶ 488. Defendant is the oldest, and supplies VHRs to more than 32,000 franchised and independent used-car dealerships. *Id.* ¶ 489-90. The Complaint claims, based on an exhibit attached to the complaint in another case, that Defendant has a 90% market share nationwide in the sale of VHRs. Compl. ¶ 492; Ortmeier Decl. Ex. Q (Dkt. No. 46-17). For comparison, the complaint claims that one of Defendant's largest competitors, AutoCheck (run by the credit reporting agency Experian) supplies VHRs to about 13,000 franchised and independent auto dealers. *Id.* ¶¶ 493-94. AutoCheck, plaintiffs allege, accounts for 10% of the market share in VHRs, with the other eight providers having negligible shares of the market. *Id.* ¶¶ 495-96.

The Complaint claims that Defendant's VHR prices are significantly higher than those of its competitors. *Id.* ¶ 498. It enters into annual subscription agreements with dealerships, and charges them either per vehicle at a typical rate of $16.95 per VHR, or a monthly flat fee for unlimited VHRs that varies between $899 and $1549 per month based on the average inventory of the dealer. *Id.* ¶¶ 499-500. Unlimited monthly subscriptions for AutoCheck VHRs cost "less than half" the price of Defendant's VHRs, but "relatively few" dealerships purchase them because of Defendant's exclusive-dealing arrangements. *Id.* ¶ 501.

Plaintiffs allege that Defendant acquired and maintains its 90% market share by entering into long-term partnerships that effectively force dealers to purchase Defendant's VHRs instead of its rivals'. *Id.* ¶¶ 497, 502. These agreements can be broken down into two categories. The first type is with auto manufacturers sponsoring CPO programs. *Id.* ¶¶ 503-04. Manufacturers of 37 of the 40 vehicle brands that sponsor CPO programs have entered into agreements with

Defendant requiring dealers participating in the program to provide a VHR prepared by Defendant to every consumer shopping for any CPO vehicle. *Id.* ¶ 509. In return, Defendant provides cash or non-cash "marketing support" to manufacturers, at a level no other VHR provider can match. *Id.* ¶ 510. For example, the same document from separate litigation in which Defendants claimed a 90% market share in VHRs also showed that Defendant offered to increase its marketing support to Subaru from $190,000 to at least $215,000 if Subaru agreed to enter into a renewed three-year partnership agreement, rather than entering into an agreement with AutoCheck. *Id.* ¶ 511; Ortmeier Decl. Ex. Q (Dkt. No. 46-17). The upshot of these agreements, Plaintiffs say, is that dealers with CPO programs are required to purchase "overpriced and less reliable Carfax VHRs," even though they would prefer to purchase "competitively-priced and more reliable VHRs from other sources." *Id.* ¶ 512.

CPO programs accounted for over 12% of the total number of used car sales by franchised used car dealers in the United States in 2012. *Id.* ¶ 514. VHRs are provided for approximately 34% of all vehicles sold in the United States. *Id.* Because VHRs are required for all CPO vehicles, Plaintiffs calculate that VHR sales for CPO vehicles account for more than 36% of the VHRs sold in 2012. *Id.*

Even though the partnership contracts permit auto manufacturers to cancel the agreements after "a term of some years," Plaintiffs allege that the agreements are "de facto long term exclusive agreements" because of Defendant's: (1) overwhelming market share; (2) marketing message that is has no trustworthy competitors; (3) cash and non-cash marketing support payments; and (4) [redacted], and because (5) switching to another VHR provider can take years to accomplish. *Id.* ¶ 515.

The second type of agreement underlying Plaintiffs' complaint is between Defendant and the two leading operators of internet sites listing classified ads for used cars, Cars.com and Autotrader.com. Under these agreements, [redacted]. *Id.* ¶ 516.

The Complaint calculates that because inventory for auto dealers ranges from 45 to 60 days, the number of used car listings annually must be six to nine times the number of monthly listings. *Id.* ¶ 523. Using the 'six times' figure, they reason that the average of 1,873,920 monthly listing for used cars on Autotrader.com offered by franchise dealers translates to 11,243,520 such listings annually, which is 75% of the 14,989,431 used vehicles sold by franchised dealers in the United States in 2012. *Id.* Thus, it says, Defendant's agreement has foreclosed the market for VHRs for 75% of used cars sold by franchised dealers in the United States. *Id.* Using similar calculations, the Plaintiffs allege that Defendant's agreement with Autotrader have foreclosed the market for VHRs for 53% of used vehicles sold by independent dealers. *Id.* ¶ 524. Adding in non-dealers, the Complaint alleges that 47% of the used vehicles sold in the United States are listed on Autotrader, and thus that portion of the market is foreclosed to other VHR providers. *Id.* ¶ 525. The Complaint raises similar allegations regarding Cars.com. Based on Cars.com having 78% the number of listings of Autotrader, Plaintiffs find the foreclosed market shares in each category are 78% what they were for Autotrader. *Id.* ¶¶ 532-34.

Even though Autotrader [redacted], Plaintiff alleges that the agreement is a *de facto* long term agreements because of Carfax's market share, its [redacted]

[redacted]. *Id.* ¶ 535. The Plaintiffs contend that other exclusive agreements are likely to be found in discovery. *Id.* ¶ 537.

The Complaint identified the relevant geographic market as the United States, and the relevant product market is the production and sale of VHRs. *Id.* ¶ 539. Publication and sale of VHRs to franchised auto dealers is a relevant product submarket, and publication and sale to independent auto dealers is a second relevant submarket. *Id.* ¶¶ 540-41. Defendant possesses a 90% share in the national market, and in each of the product submarkets. *Id.* ¶ 543.

Plaintiffs say that this market share, combined with consumers' lack of familiarity with any other provider, Defendant's ability to charge double its competitors' prices without losing market share, and the existence of significant barriers to entry for competitors indicate that Defendant has monopoly power in the product market and each submarket. *Id.* ¶ 544. The barriers to entry include federal and state rules requiring minimum content of VHRs, economies of scale in collecting information, and economies of scale in marketing and providing service and support to the entities that need to purchase VHRs. *Id.* ¶ 546.

Carfax's exclusive long-term contracts with 37 of 40 auto manufacturers for CPO programs lead to significant market foreclosure, as CPO vehicles account for 36% of VHRs sold annually. *Id.* ¶ 548.

The contracts with the websites resulted in blocking competitors for selling VHRs for at least 47.3% of used cars sold annually, including 75% of used cars sold by franchised auto dealers and 53% of used cars sold by independent auto deals. *Id.* ¶ 549.

Plaintiffs claim that the anticompetitive effects of Defendant's exclusive dealing arrangements include decreased competition that impairs entry of competitors, a reduction in

choice between VHR providers, decreasing quality of VHRs, increased expenses in Plaintiffs' business operations because of the artificially inflated prices of VHRs, and deprivation of the opportunity to purchase "the best possible VHRs at the lowest possible prices." *Id.* ¶ 550.

II. Motion to Dismiss Legal Standard

When deciding a motion to dismiss for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6), a court must accept as true all well-pleaded facts and draw all reasonable inferences in the light most favorable to Plaintiffs. *See Kassner v. 2nd Ave. Delicatessen Inc.*, 496 F.3d 229, 237 (2d Cir. 2007). Although factual allegations are therefore afforded a presumption of truth, a court is "not bound to accept as true a legal conclusion couched as a factual allegation." *Twombly*, 550 U.S. at 555 (quoting *Papasan v. Allain*, 478 U.S. 265, 286 (1986)). "To survive a motion to dismiss, the plaintiff's pleading must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Twombly*, 550 U.S. at 570).

III. The Defendant's Documents

In conjunction with its motion to dismiss, Defendant submitted a number of documents to the court, including its current contracts with auto manufacturers running CPO programs [redacted]. Plaintiffs dispute whether the court can consider these contracts at the Rule 12(b)(6) stage, or if they are extraneous to the complaint and therefore more appropriately considered at the summary judgment stage. *See Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 47-48 (2d Cir. 1991).

Documents attached to the complaint as exhibits or incorporated by reference are deemed to be part of the complaint for the purpose of resolving a motion to dismiss under Rule 12(b)(6). *Cortec Indus.*, 949 F.2d at 47. "Even where a document is not incorporated by reference, the

court may nevertheless consider it where the complaint 'relies heavily upon its terms and effect,' which renders the document 'integral' to the complaint." *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002) (quoting *Int'l Audiotext Network, Inc. v. Am. Tel. & Tel. Co.*, 62 F.3d 69, 72 (2d Cir. 1995)).

The purpose of the rule against considering extraneous documents is to ensure that plaintiffs have sufficient notice before material is considered by the court. *Chambers*, 282 F.3d at 153. To that end, it is not enough that plaintiffs have notice or possession of the documents that a defendant wants the court to consider; the plaintiffs must have relied on the "terms and effects" of the document in the complaint. *Id.*

There can be no doubt that Plaintiffs rely upon the "terms and effects" of Defendant's many agreements with auto manufacturers and [redacted] in their Complaint. The allegation that Defendant committed an antitrust violation depends first on the existence of these agreements, and second on the agreements containing the pricing, duration, exclusivity, and non-termination terms contained in the Complaint, as explained in greater detail below. Plaintiff's references to the terms of the contracts indicate that they were in possession of at least some subset of the contracts between Defendant and auto manufacturers, and both of the contracts between Defendant and [redacted]. *See, e.g.*, Compl. ¶¶ 503 (details about exclusivity), 509 (arrangements with manufacturers require them to require dealers to provide purchasers with Defendant's VHRs), 510 ([redacted]), 515 ([redacted]), 520 ([redacted]), 521 [redacted]), 526 ([redacted]), 529 ([redacted]), 530 ([redacted]

[redacted]), 535 ([redacted]), 557 ([redacted]).

Defendant has provided both its most recent contract and previous contracts [redacted], as referred to in the Complaint. *See* Ortmeier Decl. Exs. A & S (Dkt. Nos. 46-1 & 46-19). It has also provided its most recent contract with [redacted]. *See id.* Ex. B (Dkt. No. 46-2). Current contracts with [redacted] were provided to the Court, along with [redacted]. *Id.* Exs. C-O, U-W (Dkt. Nos. 46-3 to 46-15, 46-22 to 46-24).

Plaintiffs do not dispute that the agreements Defendant has provided to the Court are authentic. Instead, they claim that they are a cherry-picked subset of Defendant's exclusivity arrangements, both in terms of the number of agreements Defendant currently has with auto manufacturers, and in the failure to include past agreements with the auto manufacturers that were parties to the agreements provided. *Compare* Def't Mot. 12 (Dkt. No. 45) ("Carfax is providing the Court … the most recent written CPO program agreements with each OEM … .") *and* Def't Reply 10 (Dkt. No. 55) ("The materials Carfax has provided to this Court are the precise agreements to which Plaintiffs referred in the Second Amendment Complaint.") *with* Pls.' Resp. to Def't. Mot. 10-11 (Dkt. No. 48) ("Carfax admits that it only produced *some* of its *most recent* confidential agreements … .").

Whether the documents provided are a full and complete set of the exclusivity agreements to which Defendant is currently a party is a disputed issue of fact, and the Court cannot take it as established that these documents represent all such contracts. No representation in the Complaint names the complete universe of documents, and indeed Plaintiffs allege that

Defendant has exclusivity agreements that cover 37 of 40 vehicle brands, while [redacted].[1] *See* Compl. ¶ 509. However, to the extent the terms of the contracts are consistent or inconsistent with the allegations in the Complaint, the Court can take them into account under *Chambers*. The Plaintiffs "heavily rely" on the "terms and effects" of these contracts, and do not dispute that the documents are faithful reproductions of the contracts that Defendant maintains [redacted]. The allegations in the complaint allay any concerns that the Plaintiffs were not aware of the content of these contracts, meaning lack of notice is not a concern.

Ultimately, the outcome of Defendant's 12(b)(6) motion does not depend on whether the additional documents are considered. The Court would come to the same conclusions both with and without the documents. Therefore, the 12(b)(6) analysis that follows will indicate both the sufficiency of the allegations in the Complaint and the effect of the additional documents. But once again, and as the analysis that follows makes clear, the Court's conclusions on the current motion do not turn on those documents.

IV. Clayton Act § 3

In relevant part, Section 3 of the Clayton Act provides:

> It shall be unlawful for any person engaged in commerce … to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities … 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 … condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

[1] Some contracts cover multiple brands, such as Honda and Acura, which may account for some of this gap. *See* Compl. ¶ 513.

15 U.S.C. § 14 (Clayton Act § 3). Exclusive-dealing contracts that foreclose competition in a "substantial share" of the area of commerce affected fall within the proscription of the Act. *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961). However, for section 3 to apply to an exclusive dealing arrangement, two prerequisites must be met: the exclusive dealing arrangement must be one for goods or other commodities, as opposed to services, and the agreement putting in place the arrangement must be a lease, sale, or contract for sale.

On the first score, it is "well settled that section 3 does not apply to sales of services." *Hudson Valley Asbestos Corp. v. Tougher Heating & Plumbing Co., Inc.*, 510 F.2d 1140, 1145 (2d Cir. 1975). Its application is restricted to "tangible products of trade." *Innomed Labs, LLC v. ALZA Corp.*, 368 F.3d 148, 156 (2d Cir. 2004) (quoting *May Dep't Store v. Graphic Process Co.*, 637 F.2d 1211, 1214 (9th Cir. 1980)) (interpreting same word "commodities" in Robinson-Patman Act, 15 U.S.C. § 13(a)). When a product has the properties of both a good and a service, courts look to the "dominant nature" of the activity to determine whether it falls under section 3. *Innomed*, 368 F.3d at 156; *see also First Comics, Inc. v. World Color Press, Inc.*, 884 F.2d 1033, 1035 (7th Cir. 1989); *Tri-State Broad. Co. v. United Press Intern., Inc.*, 369 F.2d 268, 270 (5th Cir. 1966). Examples of items found to be "services" and thus outside the scope of the Clayton Act include newspapers advertisements, *see Ambook Enters. v. Time, Inc.*, 612 F.2d 604, 609-10 (2d Cir. 1979), contracting services, *Hudson Valley Asbestos*, 510 F.2d at 1144-45, mutual fund shares, *see Baum v. Investors Diversified Servs., Inc.*, 409 F.2d 872, 874-75 (7th Cir. 1969), news reporting services, *Tri-State Broad. Co.*, 369 F.2d at 270-71, and patent licenses, *Linzer Prods. Corp. v. Sekar*, 499 F. Supp. 2d 540, 556 (S.D.N.Y. 2007).

Like all of these examples of non-commodities, Vehicle History Reports are not primarily tangible goods for sale and trade. Defendant deals in information; their sale contracts

are for the service of providing data about a vehicle, not for the ultimate physical embodiment of that data. Indeed, Defendant's end-product need not take physical form. It provides the VHRs as electronic .pdf files, which are only reduced to a tangible form if a purchaser makes an independent choice to print them out. A buyer cannot convert a sale of a non-tangible service into one of a tangible good through its own activity that occurs entirely after the sale. *Cf. Nat'l Tire Wholesale v. Wash. Post Co.*, 441 F. Supp. 81, 85 (D.D.C. 1977) (finding printing of newspaper advertisements did not render them a commodity because it was "merely a tangible vehicle for the conveyance" of ideas), *aff'd* 595 F.2d 888 (D.C. Cir. 1979); *Ambook Enters.*, 612 F.2d at 609 (citing *National Tire Wholesale* with approval).

Plaintiffs argue that even the VHRs in .pdf-file form should be considered "commodities" within the meaning of the Clayton Act. They point to a single line from a district court decision in a false advertising case stating that Defendant's VHRs are not published "for the purpose of influencing consumers to buy its goods or services," and instead the "the reports are the goods themselves." *Off Lease Only, Inc. v. Carfax, Inc.*, 2012 U.S. Dist. LEXIS 75234, at *6-7 (S.D. Fla. May 31, 2012). But the court in that false-advertising action was not concerned with the Clayton Act's distinction between commodities and services when it referred to Defendant's product as "goods." It was trying to distinguish between a characterization of the reports as an advertisement and one of the reports as what Defendant was holding out for sale. Similarly, Plaintiffs' reference to *City of Kirkwood v. Union Electric Co.*, 671 F.2d 1173, 1181-82 (8th Cir. 1982), does not undermine the conclusion that VHRs are a service, not a commodity. The *Kirkwood* court held that electricity is a commodity under the Clayton Act; Plaintiff claims that like energy, Defendant's vehicle history data takes up storage space (on servers) and is "collected" and "eventually delivered" by Defendant. But electricity is stored in the same form it

is ultimately delivered and used. The physical manifestation of Defendant's data in digital storage bears no relation to the ultimate service it is offering, and is nothing more than an incidental tangible aspect of that service.

Plaintiffs' analogy between VHRs and newspapers, which the Eighth Circuit stated were commodities in *Morning Pioneer, Inc. v. Bismarck Tribune Co.*, 493 F.2d 383, 389 n.11 (8th Cir. 1974), also misses the mark. Newspapers always took a physical form in 1974 when that case was decided. Although the service of information reporting contributed substantially to the ultimate tangible product, the court noted that it necessarily was reduced to a physical product when published, and had no value to consumers outside of that ultimate state. *Id.* Even if this reasoning were to control a modern-day Clayton Act analysis, it does not accurately describe VHRs, for which the transmission of information is primary, and its reduction to physical form is a mere occasional happenstance.

That VHRs cannot accurately be understood as a commodity would itself be sufficient to dismiss Plaintiffs' Clayton Act § 3 claim, but Plaintiffs also face the additional problem that the alleged exclusive-dealing contracts are not themselves for the sale or lease of goods. As the Second Circuit has explained, "Section 3 … prohibits only specified 'sales' or 'contracts for sale.'" *CDC Techs., Inc. v. IDEXX Labs., Inc.*, 186 F.3d 74, 78 (2d Cir. 1999) (alterations omitted). Accordingly, when the allegedly illegal contract does not involve both a seller and a purchaser, it falls outside of section 3's prohibition. *Id.* For example, the plaintiffs in *CDC Technologies* alleged that their competitor, IDEXX Labs, had entered into exclusive dealing arrangements whereby their distributors agreed not to deal in CDC's products. *Id.* at 76. However, the distributors neither bought nor sold the products produced by the parties, but instead provided only "qualified leads" and in return received a finder's fee from the

manufacturer, who would make the sale directly. *Id.* According to the Court, section 3 could not apply to such arrangements, because the exclusive-dealing arrangement by definition did not involve a "sale"—sales were ultimately obtained because of the arrangements, but none were provided for in the arrangements themselves. *Id.* at 78-79.

Like the arrangements at issue in *CDC Technologies*, the exclusive dealing contracts alleged here do not involve any sales of Defendant's products. According to the Complaint, Defendant has entered into contracts with many of the major auto manufacturers and with the two largest internet sources of classified used car listings. Under the contracts, those entities agree to either require their franchised dealerships to provide Defendant's VHRs, or to give Defendant's VHRs a privileged and exclusive place on classified ads, respectively. Notably, Defendant sells VHRs neither to the auto manufacturers nor to the websites with which it maintains these alleged contracts. Sales follow when third-parties affected by the contracts—the Plaintiffs—ultimately buy VHRs from Defendant to satisfy the terms of their arrangements with the manufacturers and websites, but the contracts containing these conditions are not the ones involving Defendant. In short, the contracts for sales of VHRs are separate from the contracts containing the alleged exclusive dealing requirement.

To be sure, the restriction of the Clayton Act to "sales" is often used to dismiss claims when the contract is one for an agency relationship rather than a sale. *See FTC v. Curtis Publ'g Co.*, 260 U.S. 568, 581 (1923) ("[W]e think this contract is one of agency, not of sale upon condition … . This, of courses, disposes of the charges under the Clayton Act."); *Grand Union Co. v. FTC*, 300 F.2d 92, 97 n.14 (2d Cir. 1962) ("Under the antitrust laws the difference between a sale and an agency relationship is not simply one for form, but may be outcome-determinative.") (internal quotation marks omitted); *C.B.S. Bus. Equip. Corp. v. Underwood*

Corp., 240 F. Supp. 413, 424 (S.D.N.Y. 1964) (agency contract not actionable under section 3). But there is nothing in the Clayton Act to make an agency relationship the only way that a contract can fall outside the "sales" requirement. Defendant's contracts with the manufacturers and websites are not contracts for sales, and thus fall outside of the Clayton Act's scope even though those entities do not become Defendant's agents by the terms of the contracts.

Either the lack of a "commodity" or the lack of a contract for sales would be enough on its own to find that Plaintiffs had failed to state a claim under Clayton Act § 3. Accordingly, Plaintiffs' first claim for relief in the Second Amended Complaint is dismissed.

V. Sherman Act § 1

Unlike the Clayton Act, the Sherman Act is not limited to contracts for sales of commodities. Sherman Act § 1 declares, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1. In general, a plaintiff alleging a violation of § 1 must show "(1) a combination or some form of concerted action between at least two legally distinct economic entities that (2) unreasonably restrains trade." *Geneva Pharm. Tech. Corp. v. Barr Labs. Inc.*, 386 F.3d 485, 506 (2d Cir. 2004) (citing *Tops Mkts., Inc. v. Quality Mkts., Inc.*, 142 F.3d 90, 95-96 (2d Cir. 1998)).

Exclusive dealing arrangements have the potential to violate section 1 by "allowing one supplier of goods or services unreasonably to deprive other suppliers of a market for their goods." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring in the judgment), *abrogated on other grounds by Illinois Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28 (2006). However, such arrangements may also possess procompetitive virtues, such as "ensuring stable markets and encouraging long-term, mutually advantageous

business relationships." *Id.*; *see also E. Food Servs., Inc. v. Pontifical Catholic Univ. Servs. Ass'n, Inc.*, 357 F.3d 1, 8 (1st Cir. 2004) ("[I]t is widely recognized that in many circumstances [exclusive dealing contracts] may be highly efficient—to assure supply, price stability, outlets, investment, best efforts or the like—and pose no competitive threat at all."). As a result, exclusive dealing arrangements are "presumptively legal" and are examined under the rule of reason. *CDC Techs.*, 186 F.3d at 80.

Under the rule of reason, Plaintiffs bear the initial burden to demonstrate that the agreements have an actual adverse effect on competition. *Geneva Pharm.*, 386 F.3d at 509 (citing *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986)). Thus, to survive a motion to dismiss they must plead plausible allegations that, if true, would show such an adverse effect; if Plaintiffs then provide evidence of anticompetitive effects, Defendant will later have the opportunity to show the procompetitive effects of the agreements. *Id.* at 506-07. If Plaintiffs can show direct proof of adverse effects on competition, the Second Circuit has not required a showing of market power in Sherman Act § 1 cases. *See K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 129 (2d Cir. 1995). Alternatively, if Plaintiffs cannot show direct adverse effects, it must at least show that Defendant had market power "and thus the capacity to inhibit competition market-wide." *Id.* (citing *Capital Imaging Assocs., P.C. v. Mohawk Valley Med Assocs., Inc.*, 996 F.2d 537, 546 (2d Cir. 1993)).

A. Existence of Anticompetitive Agreements

Defendant argues that Plaintiffs have not pleaded facts that would show that the exclusive dealing arrangements could actually harm competition. Although the documents they have provided tend to bolster this argument, at this stage they are not enough to undermine Plaintiffs' plausible allegations that competition is harmed by the exclusive-dealing agreements.

In the first instance, Defendant implicitly concedes that agreements within the contemplation of the Sherman Act exist. It does not deny that it has contracts with the auto manufacturers regarding the VHRs used as part of CPO programs, nor that it has arrangements for display of VHRs on Autotrader.com and Cars.com. The existence of these contracts is enough to satisfy section 1's requirements that the harm to competition be the result of a "contract, combination … , or conspiracy." 15 U.S.C. § 1.

Defendant does offer several reasons why its contracts with the manufacturers and websites should be deemed not anticompetitive as a matter of law. It first contends that the agreements with CPO manufacturers cover an insufficiently large portion of the manufacturers offering CPO programs, such that it would be impossible to show that any significant portion of the market for the sale of VHRs is foreclosed. However, Plaintiffs have alleged the manufacturers of 37 of the 40 vehicle brands that sponsor CPO programs have entered into exclusive-dealing agreements with Defendant for their franchisees' VHRs. Compl. ¶ 509. The Complaint does not indicate what portion of the market is controlled by those 37 brands, but a reasonable inference can be drawn that such a high proportion of the brands represents a significant share of the CPO market, as explained in more detail in the discussion of market foreclosure below. While Defendant claims that [redacted], whether these documents actually represent the full extent of agreements is a disputed fact. Moreover, Plaintiffs allege that Defendant's previous arrangements with manufacturers also show an antitrust violation. The Sherman Act has a four-year statute of limitations, *see* 15 U.S.C. § 15b, meaning it is plausible that contracts predating the current ones could establish a Sherman Act violation. Again,

Defendant will have the opportunity to prove that these allegations are false, but that does not mean Plaintiffs' complaint has failed to state a claim.[2]

Defendant next argues that its contracts with the auto manufacturers and websites are for short time periods and easily terminable, and therefore cannot lead to anticompetitive effects. It is true that exclusive dealing contracts that are "short in duration and terminable at will" generally do not pose a threat of foreclosing enough of the market to cause anticompetitive effects. *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d 101, 111 (2d Cir. 2002). Indeed, short-term competition for exclusive contracts is often seen as pro-competitive, insofar as it allows purchasers regularly to select a new supplier, and thus encourages both the incumbent and competitor firms to improve prices and product quality. *See Balaklaw v. Lovell*, 14 F.3d 793, 799 (2d Cir. 1994). There is no bright-line rule about the length of time that makes a contract 'short-term' as opposed to 'long-term,' but contracts terminable within a year tend not to implicate anticompetitive concerns. *See, e.g.*, *Thompson Everett, Inc. v. Nat'l Cable Adver., L.P.*, 57 F.3d 1317, 1326 (4th Cir. 1995).

The Plaintiffs' allegation is that the agreements are long-term, and [redacted], have a non-terminable period of "some years." Compl. ¶ 515. The typical agreement, they say, lasts for three years. *Id.* ¶ 503. For that time period, CPO-participant dealerships are required to provide one of Defendant's reports to "every consumer shopping for any particular CPO vehicle." *Id.* ¶ 509. Exclusive-dealing arrangements that run for three years are not so short that the potential for harm to competition can be wholly disregarded at this stage in the litigation, or

[2] Defendant also explains that [redacted]

that procompetitive outcomes can be presumed. *See Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 237 (1st Cir. 1983) (describing allegation of three-year contracts, "[i]n terms of the case law," as "significant foreclosure"). Defendant replies that it is forced to compete for the contracts with auto manufacturers and the websites, but this is not enough to overcome Plaintiffs' allegations in light of the alleged length of the contracts, and indeed Plaintiffs' example of Defendant's competition for the contract with one manufacturer (Subaru) alleges that the "competition" does not take place over price or product quality, but instead in the form of payments to the manufacturer, who is not itself in the market for VHRs. Compl. ¶ 511.

The documents provided by Defendant tend to undermine Plaintiff's claims about the length of the average exclusive-dealing contract. [redacted]. *See* Ortmeier Decl. Exs. A-O (Dkt. Nos. 46-1 to 46-15). If discovery shows that this set of documents is complete or that [redacted], it may well be the case that Plaintiffs cannot show enough market foreclosure to demonstrate a violation of the Sherman Act. Given the allegations that this set of documents is incomplete, however, and the aforementioned allegations regarding past arrangements, Plaintiffs' allegations that Defendant's contracts were of sufficient length to harm competition remain plausible.

Plaintiffs also allege that even those contracts that are terminable "after an initial term of some years" remain *de facto* exclusive beyond that point. *See* Compl. ¶¶ 515, 535. Plaintiffs' allegations are meant to show that even manufacturers and websites whose contracts allow for termination realistically cannot chose another VHR provider for reasons that have nothing to do with competition between them. The concept of *de facto* exclusivity is based on the premise that some agreements, though they do not require a contracting party not to deal in its counterparty's

competitor's goods in so many words, still have the effect of being exclusive. *See Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 326 (1961) ("practical effect" of agreement is what matters). Simply put, it means courts privilege reality over formality when evaluating the existence of an exclusive dealing arrangement.

The notion that contracts can be *de facto* exclusive is what allows the Plaintiffs to allege an exclusive contract at all here: the contracts between Defendant and the manufacturers and websites do not *prohibit* the Plaintiffs from purchasing and supplying customers with VHRs from other providers. But a dealer that has already purchased a VHR from Defendant under compulsion from a manufacturer is highly unlikely to purchase a second VHR containing the same NMVTIS data. Beyond that, Plaintiffs need not rely on a theory of *de facto* exclusivity to state a claim, because they plausibly allege that sufficiently lengthy exclusive dealing arrangements exist to state a violation of the Sherman Act.

B. Unreasonable Restraint of Trade and Foreclosure of Relevant Market

In addition to these allegations showing the existence of potentially anticompetitive agreements, Plaintiffs must also state allegations showing that these agreements unreasonably restrain trade. That showing, in turn, has two aspects. First, an exclusive-dealing agreement cannot unreasonably restrain trade unless it "freezes out" a significant share of sellers from the relevant market. *Geneva Pharm.*, 386 F.3d at 508 (citing *Jefferson Parish,* 466 U.S. at 45 (O'Connor, J., concurring in the judgment)); *accord Tampa Elec. Co.*, 365 U.S. at 327.[3] Otherwise, the agreements are insufficiently harmful to competition in the market to violate the antitrust laws. Second, the Plaintiff must show that the Defendant has sufficient power in the

[3] *Tampa Electric Co.* was a Clayton Act § 3 case, but the same rule of reason analysis governs exclusive dealing claims under both statutes. *Cf. CDC Techs.*, 186 F.3d at 79 ("The conclusion that a contract does not violate § 3 of the Clayton Act ordinarily implies the conclusion that the contract does not violate the Sherman Act.").

market to raise an inference that the foreclosure threatens a harm to competition, such as reduced output or higher prices. *See CDC Techs.*, 186 F.3d at 81; *Tops Mkts.*, 142 F.3d at 97; Philip E. Areeda & Herbet Hovenkamp, *Antitrust Law* ¶ 1821 (3d ed.).

1. Market Definition

To begin, plaintiffs must allege a relevant market for the sale of VHRs. The "relevant market" has two aspects: the geographic market, and the product market. Plaintiffs allege that the relevant geographic market is the United States. Compl. ¶ 539. Defendant does not contest this geographic market definition, and it is plausible.

The relevant product market, meanwhile, "consists of 'products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered.'" *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d at 105 (quoting *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956)). Other products in the same market provide a substitute that consumers can purchase and thus restrain firms from raising prices on competing goods above competitive levels. *E.I. du Pont de Nemours,* 351 U.S. at 395. "To survive a Rule 12(b)(6) motion to dismiss, an alleged product market must bear a 'rational relation to the methodology courts prescribe to define a market for antitrust purposes—analysis of the interchangeability of use or the cross-elasticity of demand.'" *Todd v. Exxon Corp.*, 275 F.3d 191, 200 (2d Cir. 2001) (quoting *Gianna Enters. v. Miss World (Jersey) Ltd.,* 551 F.Supp. 1348, 1354 (S.D.N.Y.1982)). It must also be "plausible." *Todd*, 275 F.3d at 200.

Plaintiffs' alleged product market is for VHRs generally. Compl. ¶ 539. As Plaintiffs allege, it is rational that a purchaser in this market would find no wholly adequate substitute—for example, an inspection by an auto mechanic might uncover certain damage or other information, but could not provide historical information about the car that a VHR can. *Id.* ¶ 542.

Defendant argues that the market is better understood as used car sales generally—a definition that would radically decrease the market foreclosure and market share percentages plaintiff alleges. At most, this is a question of fact that remains to be answered, because market definition is a "deeply fact-intensive inquiry." *Todd*, 275 F.3d at 199; *see also Found. for Interior Design Educ. Research v. Savannah Coll. of Art & Design,* 244 F.3d 521, 531 (6th Cir. 2001) ("Market definition … generally requires discovery."). At least at first blush, Defendant's position seems somewhat illogical; for various reasons, not every purchaser of used cars can be induced to buy VHRs, much like not every purchaser of slacks can be induced to have them dry cleaned, even though dry cleaning would benefit all owners of slacks.[4] The takeaway is that Plaintiffs have plausibly alleged a relevant market.

Plaintiffs have also alleged two submarkets, one composed of VHR sales to franchised auto dealers and one composed of VHR sales to independent auto dealers. "Defining a submarket requires a fact-intensive inquiry that includes consideration of 'such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.'" *Geneva Pharm.*, 386 F.3d at 496 (quoting *Brown Shoe Co. v. United States,* 370 U.S. 294, 325 (1962)). Defining a submarket is generally another way of showing that certain products are not reasonably interchangeable in that market, and thus should be evaluated differently. *Geneva Pharm.*, 386 F.3d at 496. As Defendant point out, Plaintiffs' only allegation is that these two submarkets have different customers, so if Plaintiffs were depending on these allegations alone they might be closer to the

[4] It may well be that some portion of the used cars not currently sold with VHRs should be included in the relevant market, but that is a matter for factual dispute, not one that defeats Plaintiffs' allegations at the pleading stage.

line. However, on the overall matter of market definition, Plaintiffs have pleaded enough to state a claim that is plausible.

2. Market Foreclosure and Market Power

Plaintiffs must also plead that a substantial share of the market has been foreclosed by the exclusive-dealing arrangement at issue. *See Tampa Elec.*, 365 U.S. at 327. According to the Complaint, VHRs were provided for about 34% of all used vehicles sold in the United States in 2012. Compl. ¶ 514. Since CPO programs accounted for over 12% of the total number of used car sales that year, and VHRs are provided for every car sold through a CPO program, Plaintiffs calculate that VHR sales for CPO vehicles accounted for over 36% of the VHRs sold in 2012. *Id.*

Meanwhile, the Complaint extrapolates from the average number of monthly postings on Autotrader.com and the average turnover rate for inventory at car dealerships that 75% of the used cars sold by franchised dealers in the United States were listed on the website in 2012. Compl. ¶ 523.[5] Similar calculations lead the Complaint to reason that 53% of the cars sold by independent dealers are listed on Autotrader. Adding in non-dealer resellers of cars, the Complaint alleges that 47% of used vehicles are listed on Autotrader, and thus the exclusivity arrangements foreclose that share of the market to other VHR providers. *Id.* ¶ 525. Because Cars.com has 78% the volume of listings as Autotrader, Plaintiffs estimate that Cars.com

[5] Specifically, the Complaint explains that inventory for dealerships turns over every 45-60 days, and thus reasons that the number of used car listings annually must be between six and nine times the monthly figure. With an average of 1,873,920 monthly listings for franchised dealers, the Plaintiffs estimate that there are 11,243,520 listings annually by franchised dealers. This number is 75% of the 14,989,431 used vehicles sold by franchised dealers. Compl. ¶ 523.

forecloses 36.66% of the market, although how much of that overlaps with Autotrader's 47% is unclear. Compl. ¶¶ 532-34.[6]

Plaintiffs' figures are rough, and it stands to reason that there is significant overlap in the three categories of cars sold through CPO programs, listed on Autotrader.com, and listed on Cars.com. Moreover, it is problematic that Plaintiff calculates the foreclosure share caused by the website agreements based on the total number of used cars sold, without reference to what portion of those cars are listed with VHRs—the very definition of the market that Plaintiffs reject in response to Defendant's suggestion that the market should include sales of all used cars.

Nevertheless, even taking Plaintiff's allegation of foreclosure based on the CPO contracts alone—as that 36% figure is based on VHR sales, not overall used car sales—and assuming (unrealistically) that all of the website listings are overlaps, Plaintiffs' claim is on the border of figures that state a claim. As Defendant points out, "foreclosure percentages of less than 30 or 40 percent in a properly defined market would seem to be harmless to competition." Areeda & Hovenkamp, *supra*, at ¶ 1821c. At the pleading stage, the problem for Defendant is that even this artificial restating of the allegations is not "*less* than 30 or 40 percent." Moreover, Plaintiffs' allegations in the Complaint raise an inference that the actual foreclosure share is higher than this conservative figure. At this stage, the Court draws such inferences in favor of Plaintiffs.

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[6] [redacted]. *See* Ortmeier Decl. Ex. A (Dkt. No. 46-1). The contract being terminable on relatively short notice means this portion of the market may not be foreclosed, and to remove [redacted] from the foreclosure analysis would seem to detract significantly from the share of the overall market that is foreclosed. However, it is unclear the extent to which Cars.com listings overlap with Autotrader listings, and if most vehicles are listed on both, [redacted], because it still forces most customers to buy one of Defendant's VHRs and leaves them with little incentive to buy from competitors. Moreover, [redacted]. *See* Ortmeier Decl. Ex. S (Dkt. No. 46-19). To the extent allegations based on [redacted] still fall within the statute of limitations, they can support a Sherman Act claim.

In addition to their direct allegations of market foreclosure, Plaintiffs raise claims that the Defendant is leveraging its superior position in the market to secure exclusive dealing contracts and thus exclude rivals. According to the Complaint, Defendant has a 90% market share in the sale of VHRs, with Autocheck maintaining most of the remaining 10% and the other eight competitors in the market all possessing insubstantial shares. Compl. ¶¶ 492, 492-95, 543. Plaintiffs base this figure on an Exhibit attached to the Complaint in a business libel and defamation suit in the Northern District of Illinois. Compl. at Ex. C., *Experian Info. Solutions, Inc. v. Carfax, Inc.*, No. 11-cv-8927 (N.D. Ill. Dec. 16, 2011). The Court may consider this document because it was directly relied on in drafting the Complaint, and as a litigation document it is subject to judicial notice. *See Chambers*, 282 F.3d at 152. That document, a letter sent by one of Defendant's employees to someone at Subaru of America in light of its apparent decision to drop Defendant as its VHR provider, contains the following representation: "JD Power estimates that Carfax's market share is 90% and therefore the consumer is 9 times more likely to see the Carfax report over any other report." Compl. at Ex. C.

Defendant argues that the Complaint does not explain how this 90% market share figure relates to the foreclosure figures discussed in the preceding section. This argument elides the distinction between market share and market foreclosure. A firm can have a market share that exceeds the amount of the market it has foreclosed with exclusive dealing agreements; such agreements do not limit the firm to selling only to entities with whom it can secure such an arrangement. That Plaintiffs do not link the alleged market foreclosure with the alleged market share does not, on its own, undermine either number.[7]

[7] Defendant also tries to call into question the accuracy of the 90% figure provided by its own employee. It does so in several ways: first, by stating that the figure was limited to individuals who actually bought VHRs rather than all used car purchasers, and second, by claiming (based on evidence outside the Complaint) that it only relates to online sales. The former argument depends on redefining the VHR market to include all used car sales, which has

In sum, the Plaintiffs' allegations depict the exclusive dealing contracts here as neither so small in their effect on the market nor so plainly benign or beneficial to competition that they have failed to state a claim. The motion to dismiss Count II of the Second Amended Complaint is therefore denied.

IV. Sherman Act § 2

Section 2 of the Sherman Act makes it illegal to "monopolize, or attempt to monopolize … any part of the trade or commerce among the several States, or with foreign nations … ." 15 U.S.C. § 2. A claim under Section 2 has two elements: first, "possession of monopoly power in the relevant market," and second, "the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). An attempt to monopolize, meanwhile, involves showing both of intent to monopolize and a "dangerous probability" that monopolization will be completed. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 455 (1993).

A. Monopolization

To state a claim for unlawful monopolization in violation of Sherman Act § 2, Plaintiffs must first plausibly allege that Defendant has monopoly power in the relevant market. Monopoly power is the power to "control prices or exclude competition." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956). A plaintiff can demonstrate monopoly power either by offering direct evidence that the defendant has control over prices or has been able to exclude competition, or it can rely on an inference drawn from the defendant's "large

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already been rejected. The latter does not suffice to make Plaintiffs' argument facially implausible, particularly in light of Defendant's own reliance on the 90% figure.

percentage share of the relevant market." *Tops Mkts., Inc. v. Quality Mkts., Inc.*, 142 F.3d 90, 97-98 (2d Cir. 1998) (citing *K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 129 (2d Cir. 1995)).

The Complaint alleges that Defendant's market share in the nationwide VHR market is 90%, as evidenced by the JD Power reference in the aforementioned exhibit from the *Experian Information Solutions* litigation. *See* Compl. ¶ 492. While determining the existence of monopoly power is a fact-dependent analysis that depends on consideration of the unique features of the market at issue, a market share over 70% is usually "strong evidence" of market power. *Broadway Delivery Corp. v. United Parcel Serv. of Am., Inc.*, 651 F.2d 122, 129 (2d Cir. 1981). Accordingly, the Complaint plausibly states that monopoly power exists.

The existence of monopoly power is half of the analysis. Possession of monopoly power alone is not always harmful, though, and indeed the short-term opportunity for monopoly profits is what attracts participants into new markets in the first place. *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004). A plaintiff must also show that the defendant participated in anticompetitive conduct in order to create or sustain its monopoly. *Id.*

As the Defendant itself explains, the analysis on this point is essentially the same as it was for Section 1 above. The requisite anticompetitive action alleged in the Complaint is the formation of exclusive dealing contracts that foreclose a significant share of the market. For the same reasons as above, the documents provided by Defendant, if they prove complete or substantially similar to the other documents that form part of Plaintiff's allegations, could undermine any finding of an antitrust violation, but they are not enough to render Plaintiff's allegations implausible at this stage.

Defendant's reference to *Corsearch, Inc. v. Thomson & Thomson*, 792 F. Supp. 305 (S.D.N.Y. 1992), does not compel a different outcome. In the relevant portion of that opinion, the court was considering whether the defendant's decision to stop selling access to its database of trademarks could violate the Sherman Act. *Id.* at 328-32. Defendant tries to analogize this cessation of dealings with its rival as "exclusive dealing," but in fact the two are different; keeping one's product to one's self rather than selling it to a rival is not a form of "dealing" at all. The *Corsearch* court reasoned that terminating its competitor's right to resell its database "was a valid act of an owner of a copyright to protect its marketing strategy." *Id.* at 332. Whether much of the core information was otherwise available through a government-sponsored database was not controlling of the outcome of that case; the most important difference is that refusal to resell was not an anticompetitive act in the way that preventing purchasers from dealing in competitors' VHRs is alleged to be here.

Accordingly, Plaintiffs have plausibly stated claims that Defendant has monopoly power and has maintained it through anticompetitive conduct. The motion to dismiss Plaintiffs' monopolization claim is therefore denied.

B. Attempted Monopolization

To state a claim of attempted monopolization, a plaintiff must plausibly allege "(1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." *Spectrum Sports,* 506 U.S. at 456. The allegations of anticompetitive conduct stemming from the exclusive dealing contracts suffices on the first point. On the third point, Defendant's alleged market share is enough to raise an inference that, if it has not already monopolized the VHR market, there is a

dangerous probability that it will do so via its exclusive dealing arrangements, which could make it difficult for its marginal competitors to gain a foothold in the market or challenge its position.

Defendant relies on its previous arguments about its ability to exclude competitors and its purported market share; it does not specifically challenge the existence of specific intent to monopolize. Indeed, proof of anticompetitive conduct can be used to infer a specific intent to monopolize. *Volvo N. Am. Corp. v. Men's Int'l Prof'l Tennis Council*, 857 F.2d 55, 74 (2d Cir. 1988). Accordingly, Plaintiff has raised allegations regarding each of the elements of an attempted monopolization claim. The motion to dismiss this claim is denied.

V. Conclusion

For the foregoing reasons, Defendant's motion to dismiss is GRANTED with respect to Plaintiffs' claim under Clayton Act § 3, and DENIED in all other respects.

This resolves Dkt. No. 29. Docket Nos. 9 and 10 are administratively denied as moot. A separate Order scheduling an Initial Pre-Trial Conference will follow.

SO ORDERED.

Dated: Sept. 29, 2014
New York, New York

ALISON J. NATHAN
United States District Judge

United States v. Dentsply Int'l, Inc.

UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

DENTSPLY INTERNATIONAL, INC., Plaintiff, v. ANTITRUST DIVISION OF THE UNITED STATES DEPARTMENT OF JUSTICE, Defendant.	)	**COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

Plaintiff Dentsply International, Inc. ("Dentsply") brings this complaint against defendant the Antitrust Division of the United States Department of Justice ("Antitrust Division") and complains and alleges as follows:

The Parties

Plaintiff Dentsply International, Inc. is a Delaware corporation with its principal place of business in York, Pennsylvania. Dentsply is engaged in the design, development, manufacture, distribution and sale of dental products and equipment in the United States and throughout the world.

Defendant Antitrust Division is a division of the Department of Justice, an agency of the United States government, with its principal place of business in Washington, D.C.

Jurisdiction And Venue

This Court has jurisdiction of the subject matter of this action under the Declaratory Judgments Act, 28 U.S.C. ? 2201 et seq., and under 28 U.S.C. ?? 1331, 1337(a) and for review of final agency action under 5 U.S.C. ?? 701 et seq.

Venue is proper in this judicial district under 28 U.S.C. ? 1391(e) because it is the district in which Dentsply resides.

Nature Of The Controversy

The Distribution Of Artificial Teeth

This complaint for declaratory relief arises out of the Antitrust Division?s long running investigation of Dentsply?s manufacture, distribution and sale of artificial teeth used in the fabrication of dentures.

Founded in 1899, Dentsply is a leading manufacturer and distributor of products and equipment for the dental market. Through its Trubyte Division, Dentsply manufactures and sells artificial teeth and complementary products such as denture base acrylic, waxes, gypsums and denture curing appliances that are used by dental laboratories in the fabrication of removable or partial dentures. The laboratories fabricate the dentures upon the work order of a dentist, who ultimately provides the denture to the patient.

Dentsply has manufactured artificial teeth at its York facility for almost 100 years, and has been a leading innovator in the technology of artificial teeth. Its Trubyte brand, introduced in 1912 and trademarked in 1930, is the oldest branded artificial tooth product in the United States. Patients and dentists prefer that artificial teeth used in dentures

resemble, as closely as possible, the patient?s original teeth. To serve this demand, Dentsply?s Trubyte Division today offers a broad range of teeth in differing materials, shapes, shades and cutting surfaces that constitute approximately 14,000 SKUs (stock keeping units).

Dentsply does not sell its artificial teeth directly to the dental laboratories that fabricate dentures, or to the dentists who provide them to patients. Rather, Dentsply sells its artificial teeth through a network of 33 authorized dental products dealers throughout the United States, who in turn resell the artificial teeth to dental laboratories. These dental products dealers maintain large inventories of Trubyte teeth, from which they satisfy laboratory orders, and employ trained personnel to service and support the needs of laboratory customers.

Dentsply and its dental product dealers work as partners in the promotion and sale of Trubyte artificial teeth to dental laboratories. Together, Dentsply sales representatives and dealer representatives call on laboratory customers, train them in the purchase and handling of denture teeth, and handle returns and exchanges. In addition, because Dentsply sells many of its dental products other than artificial teeth through the same dealers, these dealers assist Dentsply in maintaining the relationships with laboratories for the purchase of Dentsply products other than artificial teeth.

There are over 375 dental products dealers in the United States, with over 642 outlets. Trubyte authorized dealers maintain 208 outlets, and account for only 32% of total dental dealer locations in the United States. Dentsply does not have a contractual relationship with its authorized dealers, and sells teeth to them on a purchase order basis.

Seventeen of Trubyte?s 33 authorized dealers distribute teeth manufactured by Dentsply?s competitors.

Dentsply?s Distribution Practices

In February 1993, Dentsply?s Trubyte Division formalized a written set of dealer criteria that, in part, provided that dealers recognized as Trubyte authorized dealers could not add competitive tooth lines to their product offerings. These criteria do not preclude Trubyte authorized dealers from continuing to sell competitive tooth lines that they sold prior to publication of the criteria.

Dentsply adopted the dealer criteria to obtain from dealers a maximized level of support for its broad artificial tooth product offerings, and to preclude its competitors from free riding on Dentsply?s investment in both dealer training and in establishing a customer base and credibility for its dealers.

In 1994, to promote these business purposes further, Dentsply instituted the Exclusive Trubyte Dealer Program. This program entitles those dealers that carry Trubyte teeth exclusively to earn volume purchase rebates at a higher percentage than non-exclusive dealers. This program offers a financial incentive only. There is no contract or agreement between Dentsply or any dealer to carry only Trubyte teeth for any period of time.

Occasionally, when Dentsply sales representatives are successful in converting a laboratory to Trubyte teeth from those of a competitor, Dentsply will swap the competitor?s product for its own. In doing so, Dentsply provides a credit to the laboratory against future sales of Trubyte teeth.

This practice facilitates Dentsply?s ability to respond to consignments and other direct sales initiatives of its competitors where laboratories cannot otherwise afford to pursue

their product preferences due to high inventory of competitive products. Dentsply?s marketing practice of swapping its teeth for competitive teeth amounts to a temporary price discount to laboratory dealers, but does not amount to pricing below any measure of Dentsply?s costs.

Distribution Alternatives To Authorized Trubyte Dealers

Manufacturers have several options for distributing artificial teeth to laboratory end-users in the United States. These include utilizing dental dealers to distribute their products, selling products direct to laboratory end-users, or utilizing a hybrid approach employing both methods. Any of the three methods provides commercially viable competitive access to consuming laboratories.

Because there are only 33 Trubyte authorized dealers of the 375 known dental product dealers, the vast majority of dental dealers are not designated as authorized Trubyte dealers. Moreover, direct sales to laboratories allow suppliers to satisfy the laboratories? requirement for prompt service, while eliminating a significant portion of an independent dealer?s margin, thus providing a material pricing advantage over competing brands sold through dealers.

In addition, some suppliers provide teeth to large laboratories on consignment and provide pricing incentives for these laboratories to service the requirements of smaller laboratories. In these instances, the large laboratories essentially act as the suppliers? distributors for the benefit of the smaller laboratories.

In addition to the great number of unaligned dental dealers, one or more alternative distribution channels remains available to Dentsply?s competitors for the sale of artificial teeth. Two of Dentsply?s Trubyte Division?s competitors in the market for artificial teeth products, Vita and Ivoclar, have achieved notable success through the direct distribution of other dental laboratory products?*e.g.*, Vita?s highly successful crown and bridge products, and Ivoclar?s William?s line of acrylic systems products.

Many of these same laboratories that purchase crown, bridge, and acrylic systems products from Vita and Ivoclar, also purchase artificial teeth from them directly.

The Antitrust Division?s Investigation

On June 6, 1995, the Antitrust Division notified Dentsply that a Civil Investigative Demand had issued (CID No. 13009) pursuant to the Antitrust Civil Process Act, 15 U.S.C. ?? 1311-1314, to determine whether Dentsply?s business practices constituted unreasonable restraints of trade, exclusive dealing, and monopolization in connection with the manufacture, distribution and sale of artificial teeth and related products in violation of Sections 1 or 2 of the Sherman Act or Section 3 of the Clayton Act, 15 U.S.C. ?? 1, 2 and 14.

The Antitrust Division?s investigation continued over the course of three-and-a-half-years. Dentsply provided over 75,000 documents to the Division relating to its business practices, provided written interrogatory answers, and provided witnesses for deposition. The Antitrust Division deposed Dentsply dealers, non-Dentsply aligned dealers, Dentsply?s end-user laboratory customers, as well as Dentsply?s competitors. The uncertainty

surrounding the investigation has tainted Dentsply?s reputation in the dental products industry.

The Antitrust Division?s Final Action And Its Adverse Affect On Dentsply

On December 10, 1998, the Antitrust Division notified Dentsply that it had reached a final determination that Dentsply?s distribution practices for its artificial teeth violate the antitrust laws of the United States. According to the Antitrust Division, unless Dentsply alters these policies and practices, Dentsply will be subject to a civil antitrust enforcement action.

The Antitrust Division?s drawn-out investigation and subsequent final determination that Dentsply?s distribution practices violate the antitrust laws has had a substantial, detrimental impact upon Dentsply?s business. If Dentsply abandons its dealer criteria and permits its dealers to distribute competitive teeth, its ability to compete effectively will be substantially damaged. If Dentsply continues its established policies and practices with its dealers, Dentsply faces the ever-present threat of prosecution. Finally, the imminent threat of prosecution has and will continue to negatively impact Dentsply?s ability to recruit additional exclusive dealers to promote, sell, and service its Trubyte product line.

First Claim For Declaratory Relief

The foregoing paragraphs of the Complaint are realleged and incorporated by reference.

Dentsply?s distribution practices do not constitute agreements in restraint of trade.

Therefore, Dentsply is entitled to a declaration that its distribution practices do not violate Section 1 of the Sherman Act, 15 U.S.C. ? 1.

Second Claim For Declaratory Relief

The foregoing paragraphs of the Complaint are realleged and incorporated by reference.

Dentsply?s distribution practices do not constitute the sale of goods upon the condition, agreement or understanding that the purchaser will not deal in the goods of another.

Therefore, Dentsply is entitled to a declaration that its distribution practices do not violate Section 3 of the Clayton Act, 15 U.S.C. ? 14.

Third Claim For Declaratory Relief

The foregoing paragraphs of the Complaint are realleged and incorporated by reference.

Dentsply?s distribution practices do not constitute the willful acquisition or maintenance of monopoly power, or an attempt to monopolize a relevant market.

Therefore, Dentsply is entitled to a declaration that its distribution practices do not violate Section 2 of the Sherman Act, 15 U.S.C. ? 2.

Prayer For Relief

Therefore, Dentsply requests that the Court enter the following relief:

(a) That this Court adjudge and decree that Dentsply?s distribution practices do not violate Section 1 of the Sherman Act, 15 U.S.C. ? 1.

(b) That this Court adjudge and decree that Dentsply?s distribution practices do not violate Section 2 of the Sherman Act, 15 U.S.C. ? 2.

(c) That this Court adjudge and decree that Dentsply?s business practices do not violate Section 3 of the Clayton Act, 15 U.S.C. ? 14.

(d) That this Court enjoin the Antitrust Division of the United States Department of Justice from prosecuting an action against Dentsply for violation of any of the antitrust laws of the United States.

(e) That this Court grant such other and further relief as may be just and proper.

Respectfully submitted,

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By: _____
James P. Hughes, Jr.

Attorneys for
DENTSPLY INTERNATIONAL, INC.

Dated: December 10, 1998

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

UNITED STATES OF AMERICA,	)	
Plaintiff,	)	Civil Action No. 99-005
vs.	)	
DENTSPLY INTERNATIONAL, INC.,	)	
Defendant.	)	

COMPLAINT

The United States of America, acting under the direction of the Attorney General of the United States, brings this action for equitable and other relief against Dentsply International, Inc. ("Defendant") to prevent and enjoin Defendant from continuing to violate the antitrust laws by a variety of actions that unlawfully maintain its monopoly power and deny competing manufacturers of artificial teeth access to independent distributors (known in the industry as "dealers"). These dealers are a valuable and necessary means of effective distribution of artificial teeth in the United States. Specifically, Dentsply has: (1) entered into agreements and taken other actions to induce dealers not to carry certain competing lines of teeth; and (2) explicitly agreed with some dealers that the dealers will not carry certain competing lines of teeth. Among other things, Dentsply has threatened to refuse to sell teeth and other merchandise to dealers if they add certain lines of competing teeth, and on the rare occasions when a dealer has dared to offer the lines in question, has carried out its threat and terminated the dealer. As a result of this conduct, 80% of the dealer outlets in the United States that carry artificial teeth do

not carry brands that compete closely with Dentsply's premium products. For over a decade, Dentsply, the dominant manufacturer of artificial teeth in the United States, through these means has wilfully maintained a monopoly and unreasonably restrained competition in the market for prefabricated artificial teeth in the United States.

Dentsply initiated its efforts to lock up the dealers in 1987, when two competitors whose products compete closely with Dentsply's premium artificial teeth in quality and price were attempting to build a dealer network. In the intervening years, other competitors and potential competitors have been deprived of the opportunity to distribute their products efficiently. As Dentsply intended, its actions have foreclosed these rivals from selling their teeth through the large majority of outlets in the United States that carry artificial teeth, have impaired the ability of other artificial tooth manufacturers to develop or maintain an adequate dealer network, and have deterred new entrants from the market for artificial teeth.

Dentsply's actions have deprived consumers of the benefits of competition among artificial tooth manufacturers and resulted in higher prices, fewer choices, less market information, and lower quality for artificial teeth.

I. JURISDICTION AND VENUE

1. The United States files this Complaint under Section 4 of the Sherman Act, 15 U.S.C. § 4, as amended, and under Section 15 of the Clayton Act, 15 U.S.C. § 25, to prevent and restrain a continuing violation by Defendant of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2, and Section 3 of the Clayton Act, 15 U.S.C. § 14.

2. Defendant transacts business in, and is found within, the District of Delaware, all within the meaning of 15 U.S.C. § 22.

3. Defendant and other artificial tooth manufacturers ship teeth across state lines. Defendant receives substantial payments across state lines from the sale of artificial teeth to dealers. Other artificial tooth manufacturers are attempting to compete with Defendant to make these interstate sales. Defendant's business activities that are the subject of this Complaint are within the flow of, and substantially affect, interstate trade and commerce.

II. DEFENDANT

4. Defendant is a Delaware for-profit corporation and has its corporate headquarters in York, Pennsylvania. Defendant manufactures a range of dental products which are marketed, distributed, and sold world-wide. Through its Trubyte Division, Defendant manufactures and markets products used by dental laboratories to make dentures and other removable dental prosthetics. The sale of artificial teeth generates most of the revenues of the Dentsply Trubyte Division.

III. RELEVANT MARKETS

5. The relevant market for purposes of this action is the sale of prefabricated, artificial teeth in the United States. The relevant product--prefabricated, artificial teeth--is highly differentiated in price and quality and is commonly segmented in the industry by the

terms “premium,” “mid-range,” “economy,” and “subeconomy.” Premium artificial teeth offer more life-like quality, more natural shades, and greater wear resistance than less expensive teeth.

6. Dentsply now holds, and since at least 1987, has held monopoly power in this relevant market.

IV. DENTSPLY’S PRACTICES

A. Sales and Use of Artificial Teeth

7. In 1996, Dentsply sold 70 to 80% of the artificial teeth used in the United States. It has held that approximate market share for at least ten years.

8. Almost all artificial teeth sold in the United States are used by dental laboratories to make dentures. Dental laboratories are engaged in two distinct lines of business: crown and bridge work, and dentures. Crown and bridge work produces a fixed dental prosthetic device that generally does not include pre-fabricated artificial teeth. A denture, in contrast, is a removable prosthetic device comprised of pre-fabricated artificial teeth fixed in an acrylic base material to replace some or all of a person’s natural teeth. Artificial teeth are the single most expensive component of a denture. Dental laboratories generally use pre-fabricated artificial teeth in making dentures.

9. Dental laboratories distinguish among artificial teeth based upon price and quality. For example, dental laboratories pay significantly higher prices for premium teeth.

10. Dentsply manufactures artificial teeth in the premium, mid-range, and economy segments. Dentsply's premium teeth are its most profitable lines and generate most of the Trubyte Division's revenue. The Dentsply Trubyte Division also manufactures other merchandise used by dental laboratories in the fabrication of dentures. Some of the Dentsply Trubyte Division's merchandise is widely used and frequently demanded by dental laboratories.

11. A handful of companies compete with Dentsply in this country and elsewhere in the manufacture and sale of artificial teeth. Two manufacturers of premium artificial teeth, Vita Zahnfabrik ("Vita") and Ivoclar AG ("Ivoclar"), compete successfully outside the United States against Dentsply and have succeeded, in at least one country, in unseating Dentsply as the dominant brand. Vita's and Ivoclar's teeth are comparable in quality and value to Dentsply's premium teeth and, by some measures, are superior to Dentsply's premium teeth.

12. In the 1980s, Vita and Ivoclar began exporting their artificial teeth into the United States market. Ivoclar exports its teeth through a wholly-owned subsidiary. Vita exports its teeth through Vident, a company that it partially owns. Despite their substantially greater success elsewhere in the world, Vita and Ivoclar teeth combined account for less than 10% of the artificial tooth sales by dollar in this country.

13. Domestic artificial tooth manufacturers also compete more successfully with Dentsply outside the United States. For example, Austenal, Inc. manufactures and sells the "Myerson" premium tooth line. While the Myerson line has sold well in countries where it has better access to dealers, it has done significantly less well in the United States, where it is carried

by only a small number of dealers. During the last five years, Austenal has attempted without success to obtain additional dealers for the Myerson line.

B. Dentsply's Restrictive Dealing Arrangements

14. Dental laboratory dealers have been, and continue to be, the primary channel of distribution of artificial teeth to dental laboratories. These dental laboratory dealers stock the full array of products needed to make dentures, not just artificial teeth. Most dental laboratory dealers employ skilled sales and service people and provide a variety of services to their dental laboratory customers, including regular ordering and restocking of inventory, new product demonstrations, tooth returns and exchanges, technical know-how, and delivery services. Dental laboratory dealers generally are able to satisfy dental laboratories' need for same or next day delivery through their own sales people, a delivery service, or by maintaining walk-up tooth counters, staffed by dedicated tooth counter personnel, at the dealers' warehouses.

15. Although some artificial tooth manufacturers sell directly to dental laboratories, both artificial tooth manufacturers and most dental laboratories prefer to work through established dental laboratory dealers located near laboratories. As a result, manufacturers of artificial teeth need to distribute through local dental laboratory dealers throughout the country in order to compete effectively.

16. Dentsply's Trubyte Division distributes its teeth through a network of 33 independent dental laboratory dealers with over 168 outlets throughout the United States,

constituting approximately 80% of the outlets distributing artificial teeth and other dental laboratory products. Dentsply does not sell its Trubyte products directly to dental laboratories.

17. The independent dealers through which Dentsply distributes its artificial teeth are the most significant and successful of the firms that distribute supplies to dental laboratories in the United States. They sell dental laboratory products other than artificial teeth made by a variety of dental product manufacturers. While manufacturers of dental products commonly engage in joint selling with the dealers and provide training in, and technical information regarding, the use of their specific products, the dealers market themselves under their own names and establish independent relationships with their laboratory customers based on their own service and price. Before Dentsply imposed its restrictive dealing arrangements in 1987, Dentsply did not restrain these independent dealers' ability to sell the artificial teeth of other manufacturers, and the dealers commonly carried at least two competing lines of artificial teeth.

18. A number of distributors sell dental products to customers other than dental laboratories. For example, some distributors sell dental products exclusively to dentists (known as "operatory dealers") and do not compete for the business of dental laboratories. Dentists purchase a wide range of products that dental laboratories do not need or purchase, and dental laboratories for their part purchase a wide range of products that dentists generally do not need or purchase. An operatory distributor, that does not also already sell to dental laboratories, cannot quickly or easily expand into the business of distributing the broad range of products used by dental laboratories.

19. Starting at least as early as 1987 and continuing through today, first Ivoclar and then Vita attempted to establish a network of dental laboratory dealers to sell and distribute their artificial teeth to dental laboratories in the United States. More recently, Austenal and other manufacturers have sought to increase their dealer networks as well.

20. In 1987, two independent dental laboratory dealers agreed to carry Ivoclar's line. Those dealers already carried other brands of artificial teeth, including Dentsply's Trubyte brand. Dentsply reacted by threatening to terminate the dealers. One of the dealers abandoned its plans to distribute Ivoclar teeth. The other dealer, Frink Dental, located in Elk Grove, Illinois, attempted to go forward with its plans. Dentsply's highest level officials, including its Chief Executive Officer and the General Manager of its Trubyte Division, flew to Illinois to tell Frink that they would not permit Ivoclar to obtain distribution in the United States. Dentsply then cut off Frink's supply of Trubyte artificial teeth and other Trubyte merchandise. Frink continued to sell Ivoclar teeth for a time but eventually agreed to stop distributing Ivoclar teeth in return for reinstatement as a dealer of Trubyte products. Dentsply did not require Frink to drop its other, preexisting lines of competing teeth.

21. In the 1980s, Vita placed its teeth with The Tooth Counter, an independent dealer in the Chicago area that did not carry Dentsply's teeth but did carry a number of other brands of artificial teeth. Dentsply at first rejected requests from The Tooth Counter to carry its teeth. In 1992, after Dentsply learned that The Tooth Counter was selling Vita teeth, Dentsply offered The Tooth Counter the opportunity to sell Trubyte teeth. Dentsply required The Tooth Counter

to agree not to carry the Vita line but permitted it to continue selling its other lines of teeth. The Tooth Counter agreed to these terms.

22. In 1993, Dentsply imposed written "Dealer Criteria" for its Trubyte Division. These Dealer Criteria set forth various conditions for continuing as or becoming an independent dealer of Trubyte products. "Dealer Criterion Number 6" states that dealers “may not add further tooth lines to their product offering.” Dentsply has actively monitored compliance with its criteria, enforced the criteria by warning dealers not to add new lines of teeth and terminating dealers that did add new lines, and entered into express agreements with some dealers to assure their partial or complete compliance with the criteria.

23. When terminating a dealer for adding a new competing line of teeth, Dentsply refuses to sell the dealer not only its artificial teeth but also other Trubyte merchandise, some of which is frequently sought by dental laboratories from their dealers.

24. Dentsply’s dominant position in the United States necessarily means that many dental laboratories currently use Dentsply Trubyte teeth and expect their dealers to have the Trubyte line available. Thus, a dealer that is currently selling Trubyte teeth may lose a significant volume of business if it is suddenly unable to supply its laboratory customers with Trubyte teeth. Moreover, because a laboratory buys many products from its dealer, the dealer’s loss of a laboratory account due to not having Trubyte teeth will likely lead it to lose significant other sales as well.

25. The detrimental impact on dealers of losing Dentsply Trubyte teeth is aggravated by Dentsply’s refusal to sell non-tooth Trubyte merchandise to dealers that add competing lines

of teeth. The loss of this Trubyte merchandise by itself may cause some laboratories to switch their accounts in whole or in part from the terminated dealer to another dealer.

26. Dealers' exchange accounts with Dentsply further increase dealers' economic disincentive to add competing tooth lines. These accounts reflect credit that Dentsply owes dealers against future purchases of teeth. Laboratories buy artificial teeth on cards containing 6 or 8 teeth. The laboratories frequently do not use all the teeth on a card in making a particular denture. Dealers collect these unused teeth from the laboratories and credit the value of the returned teeth against the laboratories' future purchases. The dealers then return the teeth to Dentsply, which in turn gives the dealers credit against future purchases. The dealers' understanding with Dentsply is that a terminated dealer cannot apply its exchange account against future purchases, since it is not permitted to make additional purchases. Dentsply will not settle the exchange account of a terminated dealer for cash, but it may provide Trubyte teeth to the terminated dealer to close out the account. The cash value of that account significantly exceeds the value to the terminated dealer of any Trubyte teeth Dentsply might then give the dealer. Essentially, the terminated dealer forfeits most of the cash value of the exchange account to Dentsply.

27. Dentsply's practices have deterred dealers from adding competing lines of teeth, and no existing dealer of Dentsply's artificial teeth has added a new tooth line since Dentsply first terminated Frink in 1987.

28. Dentsply also has blocked its competitors' access to dealers that did not previously carry Dentsply's teeth. Just as it did with The Tooth Counter, Dentsply has induced

dealers to drop or not add Vita's and Ivoclar's teeth by recruiting them as new dealers of Trubyte teeth on the condition that they not sell Vita and Ivoclar teeth. Dentsply has on occasion signed a new dealer it had previously rejected to prevent the dealer from beginning to sell a competitor's teeth. Given Dentsply's dominant market position, these non-Trubyte dealers face economic incentives to drop or not add competing lines of teeth and deal exclusively with Dentsply, whenever given an opportunity to do so. Faced with the dilemma of accepting a slice of Dentsply's dominant share of the artificial tooth market but then having to drop or refuse Vita and Ivoclar teeth, most dealers are compelled by economic realities to add the Trubyte line and no longer offer their customers the competing brands.

29. For example, Dentsply's addition of Darby Dental Supply, Inc., deprived Vita of a potential dealer. Dentsply had previously terminated Darby because Darby sold a private-label brand of artificial teeth. After Darby filed an antitrust lawsuit, Dentsply agreed to allow Kent, a subsidiary of Darby, to sell Trubyte teeth. Darby continued to sell its private-label brand of teeth but Dentsply did not permit it to sell Trubyte teeth through its Darby operations. In 1994, Dentsply learned that Darby was considering adding the Vita line. In response, Dentsply's Senior Vice President for North America specifically approved an "action plan" intended to block Vita from gaining "a major distribution point." The "key issue" in Dentsply's adopting that plan was "Vita's potential distribution system." Dentsply recognized that Vita was "having a tough time getting teeth out to customers. One of their key weaknesses is their distribution system." Accordingly, Dentsply decided to "threaten to cut-off Kent unless Darby agree[d]" not

to add the Vita line and to drop some lines, but not all, of its house brand. Darby agreed to these restrictive conditions.

C. Exclusion of Dentsply's Competitors

30. Dentsply's refusals to deal and restrictive agreements, as well as other similar and related acts, were designed to and have thwarted Vita's and Ivoclar's attempts to build a dealer network and thus their ability to compete effectively in the United States.

31. Dentsply's conduct has also undermined the efforts of small domestic competitors of Dentsply in the United States to maintain or recruit dental laboratory dealers. Dentsply has successfully induced some dealers to stop distributing these small manufacturers' teeth. Once a dealer drops a preexisting competing tooth line, Dealer Criterion Number 6 prevents the dealer from renewing its distribution of that line.

32. Dentsply's lock on distribution has delayed the possible entry of a substantial foreign competitor into the domestic market and has contributed to the decision of one major United States company not to begin manufacturing and selling artificial teeth in this country.

33. Rival manufacturers have no reasonable or effective means of combating Dentsply's lock on the national independent laboratory dealer network. Nor are rival manufacturers able to obtain effective, alternative channels of distribution. Direct sales to dental laboratories are not a reasonable or adequate substitute for the established dealers because laboratories want and need the various services dealers provide and have strong existing relationships with dealers. Nor can rival manufacturers reasonably or effectively employ larger

laboratories to serve as distributors to smaller, competing laboratories. Also, the existing dental laboratory dealers not subject to retaliation from Dentsply for adding a new line of teeth are too few and too small to serve adequately as an effective distribution network. These dealers are not likely to expand their operations, and operatory dealers that do not currently serve laboratories cannot readily expand into that multi-product laboratory business simply to take advantage of the opportunity to carry Vita's, Ivoclar's, and other manufacturers' teeth. Finally, rival manufacturers cannot profitably integrate into the distribution of artificial teeth and other dental laboratory products.

34. Dentsply's foreclosure of its rivals' access to adequate distribution has been successful in restricting competition in the market for pre-fabricated artificial teeth for over ten years and, absent court order, is likely to continue to foreclose competition.

35. Dentsply has refused to deal, imposed and enforced its restrictive dealing arrangements, and taken other anticompetitive actions for the purpose and with the effect of reducing or eliminating competition in the sale of artificial teeth in the United States and maintaining a monopoly in that market. Indeed, Dentsply maintains more dealers than it believes are needed to distribute its products and has added new dealers despite its overly broad distribution network in order to deprive its rivals of effective distribution. Dentsply documents reflect its intent to block its rivals' access to dealers. For example, a document captioned, "Sales/Distribution Principles of Cash Cow Business," sets out the following goals:

* BLOCK COMPETITIVE DISTRIBUTION POINTS. DO NOT ALLOW COMPETITION TO ACHIEVE TOEHOLDS IN DEALERS.

-- TIE-UP DEALERS
-- DO NOT "FREE-UP" KEY PLAYERS

V. ANTICOMPETITIVE EFFECTS

36. Dentsply's refusals to deal, restrictive dealing arrangements, and other anticompetitive acts as alleged in this Complaint have effectively deprived rival tooth manufacturers of access to the vast majority of, and the most important, sales outlets for artificial teeth in the United States and, therefore, of the ability to compete effectively in the United States market for prefabricated, artificial teeth.

37. Dentsply's exclusion of its rivals has resulted in higher prices, loss of choice, less market information, and lower quality for artificial teeth. But for Dentsply's acts, additional dental laboratory dealers would distribute Ivoclar's, Vita's, and other manufacturers' artificial teeth. But for Dentsply's acts, additional artificial tooth manufacturers would have attempted to enter the United States market. But for Dentsply's acts, prices for teeth would be lower. Moreover, laboratories would have a greater choice of teeth and more market information about competing teeth. Ultimately, but for Dentsply's acts, dentists and dental patients would have received lower-priced, higher-quality, and more-desirable dentures.

38. The lack of a substantial dealer network has frustrated other tooth manufacturers' efforts to encourage dental laboratories to use their brands of teeth and has led them to curtail their promotional efforts, because doing so would be futile without an adequate dealer network.

39. Dentsply intends to refuse to deal with, and to enforce its restrictive dealing arrangements against, dealers who, in the future, add, or attempt to add, competitive lines of artificial teeth. Dentsply's exclusionary conduct will continue to prevent rival tooth manufacturers from access to the primary distribution channels of artificial teeth, thus continuing to restrain price and quality competition for artificial teeth and to reduce consumer information and choice. Dentsply's conduct is not justified by efficiencies or legitimate business considerations.

VI. FIRST CAUSE OF ACTION

(Violation of § 2 of the Sherman Act)

40. The allegations of ¶¶ 1-39 of this Complaint are re-alleged and incorporated by reference here with the same force and effect as though said paragraphs were set forth here in full.

41. From at least as early as 1987 and continuing at least through the filing of this Complaint, Dentsply has wilfully maintained a monopoly in the United States market for pre-fabricated artificial teeth, and abused its monopoly power in the relevant market, by explicitly agreeing with some dealers that the dealers will not carry certain lines of teeth and inducing other dealers not to carry those competing lines of teeth, in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

VII. SECOND CAUSE OF ACTION

(Violations of § 3 of the Clayton Act
and § 1 of the Sherman Act)

42. The allegations of ¶¶ 1-41 of this Complaint are re-alleged and incorporated by reference here with the same force and effect as though said paragraphs were set forth here in full.

43. From at least as early as 1987 and continuing at least through the filing of this Complaint, Dentsply has entered into restrictive dealing agreements with dental laboratory dealers, maintained and enforced these agreements, otherwise acted in concert with those dealers, and sold artificial teeth on the condition that those dealers not deal with rival manufacturers, thereby causing a substantial lessening of competition in the market for pre-fabricated artificial teeth sold in the United States, in violation of Section 3 of the Clayton Act, 15 U.S.C. § 14, and unreasonably restraining trade in that market in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

44. Dentsply has market power in the market for pre-fabricated artificial teeth sold in the United States. Dentsply has exercised and maintained that market power through its agreements with dental laboratory dealers.

VIII. REQUEST FOR RELIEF

WHEREFORE, the Plaintiff requests:

1. That the Court adjudge and decree that Dentsply acted unlawfully to maintain a monopoly in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

2. That the Court adjudge and decree that Dentsply (a) entered into unlawful restrictive dealing agreements that substantially lessen competition in violation of Section 3 of the Clayton Act, 15 U.S.C. § 14, and (b) entered into unlawful agreements in unreasonable restraint of interstate trade and commerce in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

3. That Dentsply, its members, officers, directors, agents, employees, and successors, and all other persons acting or claiming to act on its behalf, be enjoined, restrained, and prohibited from, in any manner, directly or indirectly, continuing, maintaining, or renewing these agreements, or from engaging in any other combination, conspiracy, agreement, understanding, plan, program, or arrangement having the same effect as the alleged violations.

4. That the United States recover the costs of this action.

5. That the United States have such other relief as the nature of the case may require and the Court may deem just and proper.

January 5, 1999

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PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 03-4097

UNITED STATES OF AMERICA,
Appellant
v.

DENTSPLY INTERNATIONAL, INC.,

APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF DELAWARE
(D.C. Civ. No. 99-00005)
District Judge: Honorable Sue L. Robinson, Chief Judge

Argued September 21, 2004
Before: McKEE, ROSENN and WEIS, Circuit Judges.

(Filed February 24, 2005)

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OPINION

WEIS, Circuit Judge.

In this antitrust case we conclude that an exclusivity policy imposed by a manufacturer on its dealers violates Section 2 of the Sherman Act. We come to that position because of the nature of the relevant market and the established effectiveness of the restraint despite the lack of long term contracts between the manufacturer and its dealers. Accordingly, we will reverse the judgment of the District Court in favor of the defendant and remand with directions to grant the Government's request for injunctive relief.

The Government alleged that Defendant, Dentsply International, Inc., acted unlawfully to maintain a monopoly in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2; entered into illegal restrictive dealing agreements prohibited by Section 3 of the Clayton Act, 15 U.S.C. § 14; and used unlawful

agreements in restraint of interstate trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. After a bench trial, the District Court denied the injunctive relief sought by the Government and entered judgment for defendant.

In its comprehensive opinion, the District Court found the following facts. Dentsply International, Inc. is a Delaware Corporation with its principal place of business in York Pennsylvania. It manufactures artificial teeth for use in dentures and other restorative appliances and sells them to dental products dealers. The dealers, in turn, supply the teeth and various other materials to dental laboratories, which fabricate dentures for sale to dentists.

The relevant market is the sale of prefabricated artificial teeth in the United States.

Because of advances in dental medicine, artificial tooth manufacturing is marked by a low or no-growth potential. Dentsply has long dominated the industry consisting of 12-13 manufacturers and enjoys a 75% - 80% market share on a revenue basis, 67% on a unit basis, and is about 15 times larger than its next closest competitor. The other significant manufacturers and their market shares are:

Ivoclar Vivadent, Inc.	5%	
Vita Zahnfabrik	3%	
*Myerson LLC	3%	
*American Tooth Industries		2%
*Universal Dental Company		1% - 2%
Heraeus Kulzer GmbH	1%	
Davis, Schottlander & Davis, Ltd.	<1%	

* These companies sell directly to dental laboratories as well as to dealers.

Dealers sell to dental laboratories a full range of metals, porcelains, acrylics, waxes, and other materials required to fabricate fixed or removal restorations. Dealers maintain large inventories of artificial teeth and carry thousands of products, other than teeth, made by hundreds of different manufacturers. Dentsply supplies $400 million of products other than teeth to its network of 23 dealers.

There are hundreds of dealers who compete on the basis of price and service among themselves, as well as with manufacturers who sell directly to laboratories. The dealer field has experienced significant consolidation with several large national and regional firms emerging.

For more than fifteen years, Dentsply has operated under a policy that discouraged its dealers from adding competitors' teeth to their lines of products. In 1993, Dentsply adopted

"Dealer Criterion 6." It provides that in order to effectively promote Dentsply-York products, authorized dealers "may not add further tooth lines to their product offering." Dentsply operates on a purchase order basis with its distributors and, therefore, the relationship is essentially terminable at will. Dealer Criterion 6 was enforced against dealers with the exception of those who had carried competing products before 1993 and were "grandfathered" for sales of those products. Dentsply rebuffed attempts by those particular distributors to expand their lines of competing products beyond the grandfathered ones.

Dentsply's five top dealers sell competing grandfathered brands of teeth. In 2001, their share of Dentsply's overall sales were

Zahn	39%	
Patterson	28%	
Darby	8%	
Benco		4%
DLDS	<4%	
TOTAL	83%	

16,000 dental laboratories fabricate restorations and a subset of 7,000 provide dentures. The laboratories compete with each other on the basis of price and service. Patients and dentists value fast service, particularly in the case of lost or damaged dentures. When laboratories' inventories cannot

supply the necessary teeth, dealers may fill orders for walk-ins or use over-night express mail as does Dentsply, which dropped-shipped some 60% of orders from dealers.

Dealers have been dissatisfied with Dealer Criterion 6, but, at least in the recent past, none of them have given up the popular Dentsply teeth to take on a competitive line. Dentsply at one time considered selling directly to the laboratories, but abandoned the concept because of fear that dealers would retaliate by refusing to buy its other dental products.

In the 1990's Dentsply implemented aggressive sales campaigns, including efforts to promote its teeth in dental schools, providing rebates for laboratories' increased usage, and deploying a sales force dedicated to teeth, rather than the entire product mix. Its chief competitors did not as actively promote their products. Foreign manufacturers were slow to alter their designs to cope with American preferences, and, in at least one instance, pursued sales of porcelain products rather than plastic teeth.

Dentsply has had a reputation for aggressive price increases in the market and has created a high price umbrella. Its artificial tooth business is characterized as a "cash cow" whose profits are diverted to other operations of the company. A report in 1996 stated its profits from teeth since 1990 had increased 32% from $16.8 million to $22.2 million.

The District Court found that Dentsply's business justification for Dealer Criterion 6 was pretextual and designed expressly to exclude its rivals from access to dealers. The Court

however concluded that other dealers were available and direct sales to laboratories was a viable method of doing business. Moreover, it concluded that Dentsply had not created a market with supra competitive pricing, dealers were free to leave the network at any time, and the Government failed to prove that Dentsply's actions "have been or could be successful in preventing 'new or potential competitors from gaining a foothold in the market.'" United States v. Dentsply Int'l, Inc., 277 F. Supp. 2d 387, 453 (D. Del. 2003) (quoting LePage's, Inc. v. 3M, 324 F.3d 141, 159 (3d Cir. 2003)). Accordingly, the Court concluded that the Government had failed to establish violations of Section 3 of the Clayton Act and Sections 1 or 2 of the Sherman Act.

The Government appealed, contending that a monopolist that prevents rivals from distributing through established dealers has maintained its monopoly by acting with predatory intent and violates Section 2. Additionally, the Government asserts that the maintenance of a 75% - 80% market share, establishment of a price umbrella, repeated aggressive price increases and exclusion of competitors from a major source of distribution, show that Dentsply possesses monopoly power, despite the fact that rivals are not entirely excluded from the market and some of their prices are higher. The Government did not appeal the rulings under Section 1 of the Sherman Act or Section 3 of the Clayton Act.

Dentsply argues that rivals had obtained a share of the relevant market, that there are no artificially high prices and that competitors have access to all laboratories through existing or readily convertible systems. In addition, Dentsply asserts that its

success is due to its leadership in promotion and marketing and not the imposition of Dealer Criterion 6.

I. STANDARD OF REVIEW

We exercise *de novo* review over the District Court's conclusions of law. See Allen-Myland, Inc. v. IBM Corp., 33 F.3d 194, 201 (3d Cir. 1994). See also United States v. Microsoft, 253 F.3d 34, 50 (D.C. Cir. 2001). However, we will not disturb its findings of fact unless they are clearly erroneous. See Smith-Kline Corp. v. Eli Lilly and Co., 575 F.2d 1056, 1062 (3d Cir. 1978).

II. APPLICABLE LEGAL PRINCIPLES

Section 2 of the Sherman Act, 15 U.S.C. § 2, provides that "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person . . . to monopolize any part of the trade" is guilty of an offense and subject to penalties. In addition, the Government may seek injunctive relief. 15 U.S.C. § 4.

A violation of Section 2 consists of two elements: (1) possession of monopoly power and (2) ". . . maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." Eastman Kodak Co. v Image Technical Servs., Inc., 504 U.S. 451, 480 (1992) (citing United States v. Grinnell Corp., 384 U.S. 563, 571 (1966)). "Monopoly power under § 2 requires . . . something greater than market power under § 1." Eastman Kodak Co., 504 U.S. at 481.

To run afoul of Section 2, a defendant must be guilty of illegal conduct "to foreclose competition, gain a competitive advantage, or to destroy a competitor." Id. at 482-83 (quoting United States v. Griffith, 334 U.S. 100, 107 (1948)). See generally Lorain Journal Co. v. United States, 342 U.S. 143 (1951). Behavior that otherwise might comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist. As we said in LePage's, Inc. v. 3M, 324 F.3d 141, 151-52 (3d Cir. 2003), "a monopolist is not free to take certain actions that a company in a competitive (or even oligopolistic) market may take, because there is no market constraint on a monopolist's behavior." 3 Areeda & Turner, Antitrust Law ¶ 813, at 300-02 (1978).

Although not illegal in themselves, exclusive dealing arrangements can be an improper means of maintaining a monopoly. United States v. Grinnell Corp., 384 U.S. 563 (1966); LePage's, 324 F.3d at 157. A prerequisite for such a violation is a finding that monopoly power exists. See, e.g., LePage's, 324 F.3d at 146. In addition, the exclusionary conduct must have an anti-competitive effect. See id. at 152, 159-63. If those elements are established, the monopolist still retains a defense of business justification. See id. at 152.

Unlawful maintenance of a monopoly is demonstrated by proof that a defendant has engaged in anti-competitive conduct that reasonably appears to be a significant contribution to maintaining monopoly power. United States v. Microsoft, 253 F.3d 34, 79 (D.C. Cir. 2001); 3 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law, ¶ 651c at 78 (1996). Predatory or exclusionary practices in themselves are not sufficient. There

must be proof that competition, not merely competitors, has been harmed. LePage's, 324 F.3d at 162.

III. MONOPOLY POWER

The concept of monopoly is distinct from monopoly power, which has been defined as the ability "to control prices or exclude competition." Grinnell, 384 U.S. at 571; see also United States v. E.I. du Pont de Nemours and Co., 351 U.S. 377 (1956). However, because such evidence is "only rarely available, courts more typically examine market structure in search of circumstantial evidence of monopoly power." Microsoft, 253 F.3d at 51. Thus, the existence of monopoly power may be inferred from a predominant share of the market, Grinnell, 384 U.S. at 571, and the size of that portion is a primary factor in determining whether power exists. Pennsylvania Dental Ass'n v. Med. Serv. Ass'n of Pa, 745 F.2d 248, 260 (3d Cir. 1984).

A less than predominant share of the market combined with other relevant factors may suffice to demonstrate monopoly power. Fineman v. Armstrong World Indus., 980 F.2d 171, 201 (3d Cir. 1992). Absent other pertinent factors, a share significantly larger than 55% has been required to established prima facie market power. Id. at 201. Other germane factors include the size and strength of competing firms, freedom of entry, pricing trends and practices in the industry, ability of consumers to substitute comparable goods, and consumer demand. See Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961); Barr Labs. v. Abbott Labs., 978 F.2d 98 (3d Cir.

1992); Weiss v. York Hosp., 745 F.2d 786, 827 n.72 (3d Cir. 1984).

A. The Relevant Market

Defining the relevant market is an important part of the analysis. The District Court found the market to be "the sale of prefabricated artificial teeth in the United States." United States v. Dentsply Int'l Inc., 277 F. Supp 2d. 387, 396 (D. Del. 2003). Further, the Court found that "[t]he manufacturers participating in the United States artificial tooth market historically have distributed their teeth into the market in one of three ways: (1) directly to dental labs; (2) through dental dealers; or (3) through a hybrid system combining manufacturer direct sales and dental dealers." Finding of Fact 13.[1] The Court also found that the "labs are the relevant consumers for prefabricated artificial teeth." FF61.

There is no dispute that the laboratories are the ultimate consumers because they buy the teeth at the point in the process where they are incorporated into another product. Dentsply points out that its representatives concentrate their efforts at the laboratories as well as at dental schools and dentists. See Dentsply Int'l Inc., 277 F. Supp 2d. at 429-34.

During oral argument, Dentsply's counsel said, "the dealers are not the market...[t]he market is the dental labs that

[1] The District Court's Findings of Fact will be referred to as "FF" hereafter.

consume the product." Transcript of Oral Argument at 47. Emphasizing the importance of end users, Dentsply argues that the District Court understood the relevant market to be the sales of artificial teeth to dental laboratories in the United States. Although the Court used the word "market" in a number of differing contexts, the findings demonstrate that the relevant market is not as narrow as Dentsply would have it. In FF238, the Court said that Dentsply "has had a persistently high market share between 75% and 80% on a revenue basis, in the artificial tooth market." Dentsply sells only to dealers and the narrow definition of market that it urges upon us would be completely inconsistent with that finding of the District Court.

The Court went on to find that Ivoclar "has the second-highest share of the market, at approximately 5%." FF239. Ivoclar sells directly to the laboratories. Therefore, these two findings establish that the relevant market in this case includes sales to dealers and direct sales to the laboratories. Other findings on Dentsply's "market share" are consistent with this understanding. FF240-243.

These findings are persuasive that the District Court understood, as do we, the relevant market to be the total sales of artificial teeth to the laboratories and the dealers combined.

Dentsply's apparent belief that a relevant market cannot include sales both to the final consumer and a middleman is refuted in the closely analogous case of Allen-Myland, Inc. v. IBM Corp., 33 F.3d 194 (3d Cir. 1994). In that case, IBM sold mainframe computers directly to the ultimate consumers and also sold to companies that leased computers to ultimate users.

We concluded that the relevant market encompassed the sales directly to consumers as well as those to leasing companies. "...to the extent that leasing companies deal in used, non-IBM mainframes that have not already been counted in the sales market, these machines belong in the relevant market for large-scale mainframe computers." Id. at 203.

To resolve any doubt, therefore, we hold that the relevant market here is the sale of artificial teeth in the United States both to laboratories and to the dental dealers.

B. Power to Exclude

Dentsply's share of the market is more than adequate to establish a prima facie case of power. In addition, Dentsply has held its dominant share for more than ten years and has fought aggressively to maintain that imbalance. One court has commented that, "[i]n evaluating monopoly power, it is not market share that counts, but the ability to *maintain* market share." United States v. Syufy Enters., 903 F.2d 659, 665-66 (9th Cir. 1990).

The District Court found that it could infer monopoly power because of the predominant market share, but despite that factor, concluded that Dentsply's tactics did not preclude competition from marketing their products directly to the dental laboratories. "Dentsply does not have the power to exclude competitors from the ultimate consumer." United States v. Dentsply Int'l, Inc., 277 F. Supp. 2d 387, 452 (D. Del. 2003).

Moreover, the Court determined that failure of Dentsply's two main rivals, Vident and Ivoclar, to obtain significant market shares resulted from their own business decisions to concentrate on other product lines, rather than implement active sales efforts for teeth.

The District Court's evaluation of Ivoclar and Vident business practices as a cause of their failure to secure more of the market is not persuasive. The reality is that over a period of years, because of Dentsply's domination of dealers, direct sales have not been a practical alternative for most manufacturers. It has not been so much the competitors' less than enthusiastic efforts at competition that produced paltry results, as it is the blocking of access to the key dealers. This is the part of the real market that is denied to the rivals.

The apparent lack of aggressiveness by competitors is not a matter of apathy, but a reflection of the effectiveness of Dentsply's exclusionary policy. Although its rivals could theoretically convince a dealer to buy their products and drop Dentsply's line, that has not occurred. In United States v. Visa U.S.A., 344 F.3d at 229, 240 (2d Cir. 2003), the Court of Appeals held that similar evidence indicated that defendants had excluded their rivals from the marketplace and thus demonstrated monopoly power.

The Supreme Court on more than one occasion has emphasized that economic realities rather than a formalistic approach must govern review of antitrust activity. "Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law

. . . in determining the existence of market power . . . this Court has examined closely the economic reality of the market at issue." Eastern Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 457, 466-67 (1992). "If we look at substance rather than form, there is little room for debate." United States v. Sealy, Inc., 388 U.S. 350, 352 (1967). We echoed that standard in Weiss v. York Hosp., 745 F.2d 786, 815 (3d Cir. 1984). "Antitrust policy requires the courts to seek the economic substance of an arrangement, not merely its form." Id.

The realities of the artificial tooth market were candidly expressed by two former managerial employees of Dentsply when they explained their rules of engagement. One testified that Dealer Criterion 6 was designed to "block competitive distribution points." He continued, "Do not allow competition to achieve toeholds in dealers; tie up dealers; do not 'free up' key players."

Another former manager said:

> You don't want your competition with your distributors, you don't want to give the distributors an opportunity to sell a competitive product. And you don't want to give your end user, the customer, meaning a laboratory and/or a dentist, a choice. He has to buy Dentsply teeth. That's the only thing that's available. The only place you can get it is through the distributor and the only one that the distributor is selling is Dentsply teeth. That's your objective.

These are clear expressions of a plan to maintain monopolistic power.

The District Court detailed some ten separate incidents in which Dentsply required agreement by new as well as long-standing dealers not to handle competitors' teeth. For example, when the DLDS firm considered adding two other tooth lines because of customers' demand, Dentsply threatened to sever access not only to its teeth, but to other dental products as well. DLDS yielded to that pressure. The termination of Trinity Dental, which had previously sold Dentsply products other than teeth, was a similar instance. When Trinity wanted to add teeth to its line for the first time and chose a competitor, Dentsply refused to supply other dental products.

Dentsply also pressured Atlanta Dental, Marcus Dental, Thompson Dental, Patterson Dental and Pearson Dental Supply when they carried or considered adding competitive lines. In another incident, Dentsply recognized DTS as a dealer so as to "fully eliminate the competitive threat that [DTS locations] pose by representing Vita and Ivoclar in three of four regions."

The evidence demonstrated conclusively that Dentsply had supremacy over the dealer network and it was at that crucial point in the distribution chain that monopoly power over the market for artificial teeth was established. The reality in this case is that the firm that ties up the key dealers rules the market.

In concluding that Dentsply lacked the power to exclude competitors from the laboratories, "the ultimate consumers," the District Court overlooked the point that the relevant market was

the "sale" of artificial teeth to both dealers and laboratories. Although some sales were made by manufacturers to the laboratories, overwhelming numbers were made to dealers. Thus, the Court's scrutiny should have been applied not to the "ultimate consumers" who used the teeth, but to the "customers" who purchased the teeth, the relevant category which included dealers as well as laboratories. This mis-focus led the District Court into clear error.

The factual pattern here is quite similar to that in LePage's, Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003). There, a manufacturer of transparent tape locked up high volume distribution channels by means of substantial discounts on a range of its other products. LePage's, 324 F.3d at 144, 160-62. We concluded that the use of exclusive dealing and bundled rebates to the detriment of the rival manufacturer violated Section 2. See LePage's, 324 F.3d at 159. Similarly, in Microsoft, the Court of Appeals for the D. C. Circuit concluded that, through the use of exclusive contracts with key dealers, a manufacturer foreclosed competitors from a substantial percentage of the available opportunities for product distribution. See Microsoft, 253 F.3d at 70-71.

The evidence in this case demonstrates that for a considerable time, through the use of Dealer Criterion 6 Dentsply has been able to exclude competitors from the dealers' network, a narrow, but heavily traveled channel to the dental laboratories.

C. Pricing

An increase in pricing is another factor used in evaluating existence of market power. Although in this case the evidence of exclusion is stronger than that of Dentsply's control of prices, testimony about suspect pricing is also found in this record.

The District Court found that Dentsply had a reputation for aggressive price increases in the market. It is noteworthy that experts for both parties testified that were Dealer Criterion 6 abolished, prices would fall. A former sales manager for Dentsply agreed that the company's share of the market would diminish should Dealer Criterion 6 no longer be in effect. In 1993, Dentsply's regional sales manager complained, "[w]e need to moderate our increases – twice a year for the last few years was not good." Large scale distributors observed that Dentsply's policy created a high price umbrella.

Although Dentsply's prices fall between those of Ivoclar and Vita's premium tooth lines, Dentsply did not reduce its prices when competitors elected not to follow its increases. Dentsply's profit margins have been growing over the years. The picture is one of a manufacturer that sets prices with little concern for its competitors, "something a firm without a monopoly would have been unable to do." Microsoft, 253 F.3d at 58. The results have been favorable to Dentsply, but of no benefit to consumers.

Moreover, even "if monopoly power has been acquired or maintained through improper means, the fact that the power has not been used to extract [a monopoly price] provides no

succor to the monopolist." Microsoft, 253 F.3d at 57 (quoting Berkey Photo, Inc. v. Eastman Kodak, Co., 603 F.2d 263, 274 (2d Cir. 1979)). The record of long duration of the exclusionary tactics and anecdotal evidence of their efficacy make it clear that power existed and was used effectively. The District Court erred in concluding that Dentsply lacked market power.

IV. ANTI-COMPETITIVE EFFECTS

Having demonstrated that Dentsply possessed market power, the Government must also establish the second element of a Section 2 claim, that the power was used "to foreclose competition." United States v. Griffith, 334 U.S. 100, 107 (1948). Assessing anti-competitive effect is important in evaluating a challenge to a violation of Section 2. Under that Section of the Sherman Act, it is not necessary that all competition be removed from the market. The test is not total foreclosure, but whether the challenged practices bar a substantial number of rivals or severely restrict the market's ambit. LePage's, 324 F.3d at 159-60; Microsoft, 253 F.3d at 69.

A leading treatise explains,

> A set of strategically planned exclusive dealing contracts may slow the rival's expansion by requiring it to develop alternative outlets for its products or rely at least temporarily on inferior or more expensive outlets. Consumer injury results from the delay that the dominant firm imposes on the smaller rival's growth. Herbert Hovenkamp, Antitrust Law ¶ 1802c, at 64 (2d ed. 2002).

By ensuring that the key dealers offer Dentsply teeth either as the only or dominant choice, Dealer Criterion 6 has a significant effect in preserving Dentsply's monopoly. It helps keep sales of competing teeth below the critical level necessary for any rival to pose a real threat to Dentsply's market share. As such, Dealer Criterion 6 is a solid pillar of harm to competition. See LePage's, 324 F.3d 141, 159 (3d Cir. 2001) ("When a monopolist's actions are designed to prevent one or more new or potential competitors from gaining a foothold in the market by exclusionary, i.e. predatory, conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general.").

A. Benefits of Dealers

Dentsply has always sold its teeth through dealers. Vita sells through Vident, its exclusive distributor and domestic affiliate, but has a mere 3% of the market. Ivoclar had some relationship with dealers in the past, but its direct relationship with laboratories yields only a 5% share.

A number of factors are at work here. For a great number of dental laboratories, the dealer is the preferred source for artificial teeth. Although the District Court observed that "labs prefer to buy direct because of potential cost savings attributable to the elimination of the dealer middleman[,]" FF81, in fact, laboratories are driven by the realities of the marketplace to buy far more heavily from dealers than manufacturers. This may be largely attributed to the beneficial services, credit function, economies of scale and convenience that dealers provide to

laboratories, benefits which are otherwise unavailable to them when they buy direct. FF71, 81, 84.

The record is replete with evidence of benefits provided by dealers. For example, they provide laboratories the benefit of "one stop-shopping" and extensive credit services. Because dealers typically carry the products of multiple manufacturers, a laboratory can order, with a single phone call to a dealer, products from multiple sources. Without dealers, in most instances laboratories would have to place individual calls to each manufacturer, expend the time, and pay multiple shipping charges to fill the same orders.

The dealer-provided reduction in transaction costs and time represents a substantial benefit, one that the District Court minimized when it characterized "one stop shopping" as merely the ability to order from a single manufacturer all the materials necessary for crown, bridge and denture construction. FF84. Although a laboratory can call a manufacturer directly and purchase any product made by it, FF84, the laboratory is unable to procure from that source products made by its competitors. Thus, purchasing through dealers, which as a class traditionally carries the products of multiple vendors, surmounts this shortcoming, as well as offers other advantages.

Buying through dealers also enables laboratories to take advantage of obtaining discounts. Because they engage in price competition to gain laboratories' business, dealers often discount manufacturers' suggested laboratory price for artificial teeth. FF69, 70. There is no finding on this record that manufacturers offer similar discounts.

Another service dealers perform is taking back tooth returns. Artificial teeth and denture returns are quite common in dentistry. Approximately 30% of all laboratory tooth purchases are returned for exchange or credit. FF97. The District Court disregarded this benefit on the ground that all manufacturers except Vita accept tooth returns. FF97. However, in equating dealer and manufacturer returns, the District Court overlooked the fact that using dealers, rather than manufacturers, enables laboratories to consolidate their returns. In a single shipment to a dealer, a laboratory can return the products of a number of manufacturers, and so economize on shipping, time, and transaction costs.

Conversely, when returning products directly to manufacturers, a laboratory must ship each vendor's product separately and must track each exchange individually. Consolidating returns yields savings of time, effort, and costs.

Dealers also provide benefits to manufacturers, perhaps the most obvious of which is efficiency of scale. Using select high-volume dealers, as opposed to directly selling to hundreds if not thousands of laboratories, greatly reduces the manufacturer's distribution costs and credit risks. Dentsply, for example, currently sells to twenty three dealers. If it were instead to sell directly to individual laboratories, Dentsply would incur significantly higher transaction costs, extension of credit burdens, and credit risks.

Although a laboratory that buys directly from a manufacturer may be able to avoid the marginal costs associated

with "middleman" dealers, any savings must be weighed against the benefits, savings, and convenience offered by dealers.

In addition, dealers provide manufacturers more marketplace exposure and sales representative coverage than manufacturers are able to generate on their own. Increased exposure and sales coverage traditionally lead to greater sales.

B. "Viability" of Direct Sales

The benefits that dealers provide manufacturers help make dealers the preferred distribution channels – in effect, the "gateways" – to the artificial teeth market. Nonetheless, the District Court found that selling direct is a "viable" method of distributing artificial teeth. FF71, 73, 74-81, CL26. But we are convinced that it is "viable" only in the sense that it is "possible," not that it is practical or feasible in the market as it exists and functions. The District Court's conclusion of "viability" runs counter to the facts and is clearly erroneous. On the entire evidence, we are "left with the definite and firm conviction that a mistake has been committed." United States v. Igbonwa, 120 F.3d 437, 440 (3d Cir. 1997) (citations and internal quotations omitted).

It is true that Dentsply's competitors can sell directly to the dental laboratories and an insignificant number do. The undeniable reality, however, is that dealers have a controlling degree of access to the laboratories. The long-entrenched Dentsply dealer network with its ties to the laboratories makes it impracticable for a manufacturer to rely on direct distribution

to the laboratories in any significant amount. See United States v. Visa U.S.A., 344 F.3d 229, 240 (2d Cir. 2003).

That some manufacturers resort to direct sales and are even able to stay in business by selling directly is insufficient proof that direct selling is an effective means of competition. 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. See Microsoft, 253 F.3d at 71. The minuscule 5% and 3% market shares eked out by direct-selling manufacturers Ivoclar and Vita, Dentsply's "primary competitors," FF26, 36, 239, reveal that direct selling poses little threat to Dentsply.

C. Efficacy of Dealer Criterion 6

Although the parties to the sales transactions consider the exclusionary arrangements to be agreements, they are technically only a series of independent sales. Dentsply sells teeth to the dealers on an individual transaction basis and essentially the arrangement is "at-will." Nevertheless, the economic elements involved – the large share of the market held by Dentsply and its conduct excluding competing manufacturers – realistically make the arrangements here as effective as those in written contracts. See Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 n.9 (1984).

Given the circumstances present in this case, there is no ground to doubt the effectiveness of the exclusive dealing arrangement. In LePage's, 324 F.3d at 162, we concluded that 3M's aggressive rebate program damaged LePage's ability to

compete and thereby harmed competition itself. LePage's simply could not match the discounts that 3M provided. LePage's, 324 F.3d at 161. Similarly, in this case, in spite of the legal ease with which the relationship can be terminated, the dealers have a strong economic incentive to continue carrying Dentsply's teeth. Dealer Criterion 6 is not edentulous.[2]

D. Limitation of Choice

An additional anti-competitive effect is seen in the exclusionary practice here that limits the choices of products open to dental laboratories, the ultimate users. A dealer locked into the Dentsply line is unable to heed a request for a different manufacturers' product and, from the standpoint of convenience, that inability to some extent impairs the laboratory's choice in the marketplace.

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[2] In some cases which we find distinguishable, courts have indicated that exclusive dealing contracts of short duration are not violations of the antitrust laws. See, e.g., CDC Techs., Inc. v. IDEXX Labs., Inc., 186 F.3d 74, 81 (2d Cir. 1999) ("distributors" only provided sales leads and sales increased after competitor imposed exclusive dealing arrangements); Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1163 (9th Cir. 1997) (manufacturer with 55% market share sold both to consumers and distributors, market showed decreasing prices and fluctuating shares); Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215 (8th Cir. 1987) (manufacturer sold its products through both direct sales and distributors); Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380 (7th Cir. 1984) (contract between dealer and manufacturer did not contain exclusive dealing provision).

As an example, current and potential customers requested Atlanta Dental to carry Vita teeth. Although these customers could have ordered the Vita teeth from Vident in California, Atlanta Dental's tooth department manager believed that they were interested in a local source. Atlanta Dental chose not to add the Vita line after being advised that doing so would cut off access to Dentsply teeth, which constituted over 90% of its tooth sales revenue.

Similarly, DLDS added Universal and Vita teeth to meet customers' requests, but dropped them after Dentsply threatened to stop supplying its product. Marcus Dental began selling another brand of teeth at one point because of customer demand in response to supply problems with Dentsply. After Dentsply threatened to enforce Dealer Criterion 6, Marcus dropped the other line.

E. Barriers to Entry

Entrants into the marketplace must confront Dentsply's power over the dealers. The District Court's theory that any new or existing manufacturer may "steal" a Dentsply dealer by offering a superior product at a lower price, see Omega Environmental, Inc. v. Gilbarco, 127 F.3d 1157 (9th Cir. 1997), simply has not proved to be realistic. To the contrary, purloining efforts have been thwarted by Dentsply's longtime, vigorous and successful enforcement actions. The paltry penetration in the market by competitors over the years has been a refutation of theory by tangible and measurable results in the real world.

The levels of sales that competitors could project in wooing dealers were minuscule compared to Dentsply's, whose long-standing relationships with these dealers included sales of other dental products. For example, Dentsply threatened Zahn with termination if it started selling Ivoclar teeth. At the time, Ivoclar's projected $1.2 million in sales were 85% lower than Zahn's $8 million in Dentsply's sales.

When approached by Leach & Dillon and Heraeus Kulzer, Zahn's sales of Dentsply teeth had increased to $22-$23 million per year. In comparison, the president of Zahn expected that Leach & Dillon would add up to $200,000 (or less than 1% of its Dentsply's sales) and Heraeus Kulzer would contribute "maybe hundreds of thousands." Similarly, Vident's $1 million in projected sales amounted to 5.5% of its $18 million in annual Dentsply's sales.

The dominant position of Dentsply dealers as a gateway to the laboratories was confirmed by potential entrants to the market. The president of Ivoclar testified that his company was unsuccessful in its approach to the two large national dealers and other regional dealers. He pointed out that it is more efficient to sell through dealers and, in addition, they offered an entre to future customers by promotions in the dental schools.

Further evidence was provided by a Vident executive, who testified about failed attempts to distribute teeth through ten identified dealers. He attributed the lack of success to their fear of losing the right to sell Dentsply teeth.

Another witness, the president of Dillon Company, advised Davis, Schottlander & Davis, a tooth manufacturer, "to go through the dealer network because anything else is futile...[D]ealers control the tooth industry. If you don't have distribution with the dealer network, you don't have distribution." Some idea of the comparative size of the dealer network was illustrated by the Dillon testimony: "Zahn does $2 billion, I do a million-seven. Patterson does over a billion dollars, I do a million-seven. I have ten employees, they have 6,000."

Dealer Criterion 6 created a strong economic incentive for dealers to reject competing lines in favor of Dentsply's teeth. As in LePage's, the rivals simply could not provide dealers with a comparable economic incentive to switch. Moreover, the record demonstrates that Dentsply added Darby as a dealer "to block Vita from a key competitive distribution point." According to a Dentsply executive, the "key issue" was "Vita's potential distribution system." He explained that Vita was "having a tough time getting teeth out to customers. One of their key weaknesses is their distribution system."

Teeth are an important part of a denture, but they are but one component. The dealers are dependent on serving all of the laboratories' needs and must carry as many components as practicable. The artificial teeth business cannot realistically be evaluated in isolation from the rest of the dental fabrication industry.

A leading treatise provides a helpful analogy to this situation:

> [S]uppose that mens's bow ties cannot efficiently be sold in stores that deal exclusively in bow ties* or even ties generally; rather, they must be sold in department stores where clerks can spread their efforts over numerous products and the ties can be sold in conjunction with shirts and suits. Suppose further that a dominant bow tie manufacturer should impose exclusive dealing on a town's only three department stores. In this case the rival bow tie maker cannot easily enter. Setting up another department store is an unneeded and a very large investment in proportion to its own production, which we assume is only bow ties, but any store that offers less will be an inefficient and costly seller of bow ties. As a result, such exclusive dealing could either exclude the nondominant bow tie maker or else raise its costs in comparison to the costs of the dominant firm. While the department stores might prefer to sell the ties of multiple manufacturers, if faced with an "all-or-nothing" choice they may accede to the dominant firm's wish for exclusive dealing. Herbert Hovenkamp, Antitrust Law ¶ 1802e3, at 78-79 (2d ed. 2002).

* The authors do not disclose whether the bow ties are blue polka-dot patterns or other designs.

Criterion 6 imposes an "all-or-nothing" choice on the dealers. The fact that dealers have chosen not to drop Dentsply

teeth in favor of a rival's brand demonstrates that they have acceded to heavy economic pressure.

This case does not involve a dynamic, volatile market like that in Microsoft, 253 F.3d at 70, or a proven alternative distribution channel. The mere existence of other avenues of distribution is insufficient without an assessment of their overall significance to the market. The economic impact of an exclusive dealing arrangement is amplified in the stagnant, no growth context of the artificial tooth field.

Dentsply's authorized dealers are analogous to the high volume retailers at issue in LePage's. Although the dealers are distributors and the stores in LePage's, such as K-Mart and Staples, are retailers, this is a distinction in name without a substantive difference. LePage's, 324 F.3d at 144. Selling to a few prominent retailers provided "substantially reduced distribution costs" and "cheap, high volume supply lines." Id. at 160 n.14. The manufacturer sold to a few high volume businesses and benefitted from the widespread locations and strong customer goodwill that prominent retailers provided as opposed to selling directly to end-user consumers or to a multitude of smaller retailers. There are other ways across the "river" to consumers, but high volume retailers provided the most effective bridge.

The same is true here. The dealers provide the same advantages to Dentsply, widespread locations and long-standing relationships with dental labs, that the high volume retailers provided to 3M. Even orders that are drop-shipped directly from Dentsply to a dental lab originate through the dealers. This

underscores that Dentsply's dealers provide a critical link to end-users.

Although the District Court attributed some of the lack of competition to Ivoclar's and Vident's bad business decisions, that weakness was not ascribed to other manufacturers. Logically, Dealer Criterion 6 cannot be both a cause of the competitors' lower promotional expenditures which hurt their market positions, and at the same time, be unrelated to their exclusion from the marketplace. Moreover, in Microsoft, in spite of the competitors' self-imposed problems, the Court of Appeals held that Microsoft possessed monopoly power because it benefitted from a significant barrier to entry. Microsoft, 253 F.3d at 55.

Dentsply's grip on its 23 authorized dealers effectively choked off the market for artificial teeth, leaving only a small sliver for competitors. The District Court erred when it minimized that situation and focused on a theoretical feasibility of success through direct access to the dental labs. While we may assume that Dentsply won its preeminent position by fair competition, that fact does not permit maintenance of its monopoly by unfair practices. We conclude that on this record, the Government established that Dentsply's exclusionary policies and particularly Dealer Criterion 6 violated Section 2.

V. BUSINESS JUSTIFICATION

As noted earlier, even if a company exerts monopoly power, it may defend its practices by establishing a business justification. The Government, having demonstrated harm to

competition, the burden shifts to Dentsply to show that Dealer Criterion 6 promotes a sufficiently pro-competitive objective. United States v. Brown Univ., 5 F.3d 658, 669 (3d Cir. 1993). Significantly, Dentsply has not done so. The District Court found that "Dentsply's asserted justifications for its exclusionary policies are inconsistent with its announced reason for the exclusionary policies, its conduct enforcing the policy, its rival suppliers' actions, and dealers' behavior in the marketplace." FF356.

Some of the dealers opposed Dentsply's policy as exerting too much control over the products they may sell, but the grandfathered dealers were no less efficient than the exclusive ones, nor was there any difference in promotional support. Nor was there any evidence of existence of any substantial variation in the level of service provided by exclusive and grandfathered dealers to the laboratories.

The record amply supports the District Court's conclusion that Dentsply's alleged justification was pretextual and did not excuse its exclusionary practices.

VI. AVAILABILITY OF SHERMAN ACT SECTION 2 RELIEF

One point remains. Relying on *dicta* in Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961), the District Court said that because it had found no liability under the stricter standards of Section 3 of the Clayton Act, it followed that there was no violation of Section 2 of the Sherman Act. However, as we explained in LePage's v. 3M, 324 F.3d at 157

n.10, a finding in favor of the defendant under Section 1 of the Sherman Act and Section 3 of the Clayton Act, did not "preclude the application of evidence of . . . exclusive dealing to support the [Section] 2 claim." All of the evidence in the record here applies to the Section 2 claim and, as in LePage's, a finding of liability under Section 2 supports a judgment against defendant.

We pointed out in Allegheny County Sanitary Authority v. EPA, 732 F.2d 1167, 1172-73 (3d Cir. 1984), that different theories may be presented to establish a cause of action. A court's refusal to accept one theory rather than another neither undermines the claim as a whole, nor the judgment applying one of the theories. Here, the Government can obtain all the relief to which it is entitled under Section 2 and has chosen to follow that path without reference to Section 1 of the Sherman Act or Section 3 of the Clayton Act. We find no obstacle to that procedure.

Accordingly, for the reasons set forth above, we will reverse the judgment in favor of Dentsply and remand the case to the District Court with directions to grant injunctive relief requested by the Government and for such other proceedings as are consistent with this opinion.

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DOJ Section 2 Report

U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act (issued by the Bush administration on Sept. 11, 2008) (withdrawn by the Obama administration on May 11, 2009).

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 area[25]—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

[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.

[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.").

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]

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

[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.

[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, 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]

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[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 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 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

[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).

[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 investments[89] 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 quality[90] 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

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[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).