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CHAPTER 5 EXCLUSIVE DEALING

In many ways, the distinction between exclusive dealing and tying may be difficult to draw, since a tying agreement is merely a special kind of exclusive dealing agreement. Both the exclusive dealing and the tying arrangement, ties the purchase of some of the units to the purchase of others. But the tying arrangement can usually be distinguished as involving a tied product or products, and a different product or products to which they are tied.¹

On the other hand, conventional usage has it that when a buyer agrees to take a product exclusively from one seller without regard for a second or tying product, it is referred to as exclusive dealing. The exclusive dealing agreement, is a "refrain from" kind of thing, whereas a tying agreement requires that one product be bought with the other. What the seller is saying in an exclusive dealing agreement is that if you want my product, you can't purchase someone else's too.² At issue is whether this is a distinction without a difference.

The need to make this distinction between exclusive dealing and tying, to the extent there is a distinction, is not an idle exercise. Tying arrangements are treated harshly by the courts as per se violations, so unless exclusive dealing arrangements are distinguished, they would automatically be given the same treatment.

The problem is that both arrangements make it a condition of the transaction that the purchaser shall not use or deal in the goods of a competitor of the lessor or seller. As a consequence, both invoke Clayton 3 and its concern with the coercion of buyers and the foreclosure of rivals' market opportunity. Moreover, the Clayton Act does not explicitly distinguish between exclusive dealing and tying arrangements. This is a distinction that has been developed by the courts. Specifically, the Clayton Act says:

§3. It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods...or other commodities ... on the condition, agreement, or understanding that the lessee or purchaser shall not use or deal in the goods..of a competitor or competitors of the lessor or seller...where the effect may be substantially to lessen competition or tend to create a monopoly in any line of commerce.³

¹ p. 153-154, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

² 158. Hammond

³ 15 U.S.C.A. §§ 12-27 (1980).

Given such language, even partial requirements contracts and contracts promising to supply a stated amount of product when the amount approximates the buyer's requirements seem to be covered by this section, since they too condition the sale of the goods on an agreement to take all or most of the buyer's remaining requirements exclusively from one seller.

Exclusive dealing and requirements contracts can also fall under §1 of the Sherman Act and §5 of the FTC Act, since either can be seen as sewing up the market so tightly as to be an unfair method of competition and/or a restraint of trade.⁴

This Sherman Act and FTC Act coverage is very important for the regulation of exclusive dealing and requirements contracts in franchise systems since §3 of the Clayton Act covers only goods or commodities and exclusive arrangements involving services are not otherwise covered.

Also, unlike other Sherman Act situations where "agreement" must often be inferred, exclusive dealing arrangements and requirements contracts typically present no great problems of identification, since they usually involve express agreements which show their character on their face.⁵ Perhaps the one exception is where an exclusionary effect has to be inferred from various cumulative quantity discount and continuity patronage and sales incentive programs.⁶

The law of exclusive dealing and requirements contracts, whether applied through Sherman 1, Clayton 3 or FTC 5, operates on the assumption that the effect and often the objective of exclusive arrangements is to preempt outlets or end-users, and thereby to foreclose the market opportunity of rivals, or potential rivals. Moreover, the courts assume that competition is automatically injured merely through the foreclosure of rivals from a substantial line of commerce.⁷ This is especially true where the buyer is not a dealer, but an OEM or end-user.

The feeling is that when a long-term contract is used to gain exclusive access to a processor, an outlet, or a source of supply, subsequent business dealings are not based solely on the merits of competing products. And a market in which rivals are fenced out is not a free market in any meaningful sense of the word.⁸

⁴69. Areeda

⁵ p. 154, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

⁶ Compare SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056 (3rd Cir.) cert denied, 439 U.S. 838 (1978) where exclusion was inferred from a cumulative quantity discount and Sulmeyer v. Coca-Cola Co., 515 F.2d 835 (5th Cir. 1975), cert. denied, 424 U.S. 934 (1976) where an effort to infer quasi exclusive dealing failed in a case involving a promise by Coke to its bottlers that it would purchase additional advertising once its lemon-lime product Sprite was available to 80% of customers in an area. Since it would be impractical for a bottler to handle two lemon-lime products, the plaintiff sought to equate the arrangement with an agreement by the bottlers that they would not handle competing products.

⁷ 38. Bork p. 303

⁸ 289. Blake & Jones 389.

Beyond their exclusionary effects, requirements contracts and exclusive dealing agreements may also have undesirable effects on entry and pricing. The extent of these anticompetitive effects depends on such factors as the term of the contract, the price mechanism it involves, the extent to which buyers and sellers in the market use similar contracts, and the structure of the market on both the buying and selling sides.⁹

On the other hand, many pro-competitive justifications can be given for the use of exclusive arrangements, a fact which argues against their automatic condemnation.

More often than not, exclusive arrangements may contribute to the creation and effectiveness of distribution outlets. For example, exclusive dealing may merely be used to satisfy the seller's legitimate desire to have the exclusive benefit of the dealer's energies. Obviously, when a dealer's fortune depends entirely on the success of a single product or a single brand, he will be more inclined to promote that product or brand intensively. And of course, in some cases, enhanced dealer loyalty to a particular seller's product may actually increase the vigor of competition—but only provided that the exclusive arrangements do not impede competitors' access to the consuming market.¹⁰

Exclusive dealing can also be used to lock-in markets for the seller and to stabilize sales and demand. Exclusive dealing contracts may also eliminate or reduce selling expense since sales people need to visit resellers less frequently and transactions may be fewer and larger in volume. Fully negotiated transactions are converted into more efficient routine transactions. This is all to the good, but if this enhanced stability and efficiency tends to focus the residual instability on other competitors and increase their costs, the savings will not necessarily be social savings.¹¹

Exclusive dealing is also seen as essential for the effective workings of modern vertical marketing systems which many regard as the core of modern channel competition. In a typical vertical marketing system, the seller may finance, train, advise and otherwise assist member dealers in ways that are quite different from the normal arms-length buy-sell relationship. Without exclusive representation, the "free rider" problem would make this support less attractive, and largely undermine these marketing systems.

In other instances, the supplier is also the dealer's landlord, having specifically developed prime retail sites for the marketing of his brand or service. In addition, sellers often provide free or subsidized display racks and dispensing equipment for the retailer's use. In such instances the seller would obviously resent having these investments benefit his competitors. To prevent this, he might insist that the dealer agree to give him exclusive representation. Without an exclusive, these investments would probably not be made.

Moreover, requirements contracts often arise from the buyer's desire for stable supply or firm prices in order to better plan production and sales in his own market. While this obviously forecloses the

⁹ p. 159, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

¹⁰ p. 160, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

¹¹ Areeda, p. 810.

seller's competitors, it also introduces efficiencies in distribution which are socially desirable. Again, the key is to distinguish contracts which do not significantly impair competitive opportunities and those which do; not an easy task.

While foreclosure is one obvious result of exclusive agreements, these other results that increase efficiency or promote marketing effort and investment make exclusive arrangements obvious candidates for rule of reason treatment.

The present legal attitude toward exclusive dealing agreements and requirements contracts originates in Justice Frankfurter's 1949 Standard Stations opinion.¹² While the Court had previously passed on the applicability of §3 in five cases, three involved contracts tying to the use of a patented article all purchases of an unpatented product used in connection with the patented article.¹³ 258 U.S. 451; International Business Machines Corp. v. United States, 298 U.S. 131; International Salt Co. v. United States, 332 U.S. 392. Only two involved requirements contracts.¹⁴

In the Standard Stations decision Justice Frankfurter noted the basic similarity of exclusive supply and tying contracts, but he raised the key question of whether the standards of proof laid down for Clayton Act tying agreements in International Salt should also be applied to requirements contracts.

The issue before us, therefore, is whether the requirement of showing that the effect of the agreements "may be substantially to lessen competition" may be met simply by proof that a substantial proportion of commerce is affected (which was the Salt decision), or whether it must be demonstrated that competitive activity has actually diminished or probably will diminish.¹⁵

In the Salt decision, at least with respect to contracts tying the sale of a nonpatented to a patented product, the Court had rejected the necessity of demonstrating economic consequences once it has been established that "the volume of business affected" is not "insignificant or insubstantial" and that the effect of the contracts is to foreclose competitors from a substantial market."¹⁶ This amounts to a per se rule.

...Not only is price-fixing unreasonable per se...but also it is unreasonable, per se, to foreclose competitors from any substantial market...¹⁷

¹² Standard Oil of California (Standard Stations) v. United States, 357 U.S. 293 (1949).

¹³ See United Shoe Machinery Corp. v. United States,

¹⁴ Standard Fashion Co. v. Magrane-Houston Co. 258 U.S. 346; Fashion Originator's Guild v. Federal Trade Comm'n, 312 U.S. 457

¹⁵ 337 U.S. 293 at 299.

¹⁶ International Salt co. v. United States, 332 U.S. 392 at page 396.

¹⁷ 332 U.S. 392 (1947) Areeda p. 749.

Justice Frankfurter's initial inclination was to treat requirements contracts differently from tying arrangements even though the qualifying clause of §3 was appended without distinction of terms equally to the prohibition of tying clauses and of requirements contracts.

In favor of confining the standard laid down by the International Salt case to tying agreements, important economic differences may be noted. Tying agreements serve hardly any purpose beyond the suppression of competition...

Requirements contracts, on the other hand, may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public. In the case of the buyer, they may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand. From the seller's point of view, requirements contracts may make possible the substantial reduction in selling expenses, give protection against price fluctuations, and--of particular to a newcomer to the field to whom it is important to know what capital expenditures are justified--offer the possibility of a predictable market...They may be useful moreover, to a seller trying to establish a foothold against the counterattacks of entrenched competitors...Since these advantages of requirements contracts may often be sufficient to account for their use, the coverage by such contracts of a substantial amount of business affords a weaker basis for the inference that competition may be lessened than would similar coverage by tying clauses, especially where use of the latter is combined with market control of the tying device....And so we could not dispose of this case merely by citing International Salt Co. v. United States, 332 U.S. 392.¹⁸

And yet, in spite of his initial inclination to treat exclusive dealing agreements differently from tying agreements, and in spite of his cogent justifications for doing so, Justice Frankfurter rejected the case for applying varying standards of proof on the grounds that if the distinction were accepted, various tests of "economic usefulness or restrictive effect of requirements" would become relevant and that serious difficulties would attend the attempt to apply these tests.¹⁹

...If this distinction [between tying clauses and requirements contracts] were accepted, various tests of the economic usefulness or restrictive effect of requirements contracts would become relevant. Among them would be evidence that competition has flourished despite use of the contracts...Likewise bearing on whether or not the contracts were being used to suppress competition, would be the conformity of the length of their term to the reasonable requirements of the field of commerce in which they were used...

¹⁸ Standard Oil of California (Standard Stations) v. United States, 357 U.S. 293 (1949).

¹⁹ 337 U.S. 293 at 308.

Yet serious difficulties would attend the attempt to apply these tests.....

...to demand that bare inference be supported by evidence as to what would have happened but for the adoption of the practice...would be a standard of proof if not virtually impossible to meet, at least ill-suited for ascertainment by courts.....

We are dealing here with a particular form of agreement specified by §3 and not with different arrangements, by way of integration or otherwise, that may tend to lessen competition. To interpret that section as requiring proof that competition has actually diminished would make its very explicitness a means of conferring immunity upon the practice which it singles out.

This is a curious outcome, since it amounts to the application of the International Salt per se result to requirements contracts, a result which Justice Frankfurter had earlier rejected.²⁰

We conclude, therefore, that the qualifying clause of §3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected. It cannot be gainsaid that observance by a dealer of his requirements contract with Standard does effectively foreclose whatever opportunity there might be for competing suppliers to attract his patronage, and it is clear that the affected proportion of retail sales of petroleum products is substantial. In view of the widespread adoption of such contracts by Standard's competitors and the availability of alternative ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive. Standard's use of the contracts creates just such a clog on competition as it was the purpose of §3 to remove wherever, were it to become actual, it would impede a substantial amount of competitive activity.²¹

Compare this language with that of International Salt!

...it is unreasonable, per se, to foreclose competitors from any substantial market. Fashion Originators' Guild of America v. Federal Trade Commission, 114 F.2d 80, affirmed, 312 U.S. 457. The volume of business affected from these contracts cannot be said to be insignificant or insubstantial and the tendency of the arrangement to accomplishment of monopoly seems obvious...²²

It would be hard to decide which language applies to which case without seeing the citation.

²⁰ p.147, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

²¹ Standard Oil of California (Standard Stations) v. United States, 357 U.S. 293 (1949). 337 U.S. 293 (1949)

²² 332 U.S. 392 (1947) Handler p. 581.

This per se treatment of exclusive dealing and requirements contracts rests not not so much on the opinion that per se treatment is appropriate, as on the asserted inability of the Court to deal with a rule of reason analysis. The result has been that the statutory requirement that a contract be shown likely to injure competition before it be declared illegal has been read out of the act.²³

And even though the court has sought to simplify the application of the law to exclusive arrangements under the rubric of a quasi per se "quantitative substantially" test, the "law" of Standard Stations remains obscure on two important issues of interpretation; and even subsequent decisions continue to leave some doubt that this "substantial foreclosure" test of illegality will ever be a simple matter.²⁴

The obscurities concern the meaning of substantial foreclosure and the extent to which, if any, it is possible to argue in any particular case that a "requirements" contract for a short term is simply the normal economic unit of sale for the market involved.²⁵

For example, in Standard Stations, Standard's foreclosure of dealers was actually foreclosure of competitors only to the extent that competitors could not, by securing other or new dealers, obtain comparable access to the consuming market.²⁶

Even after Standard Stations, the rules governing the legality of exclusive dealing and requirements contracts remain unclear. Not until Tampa Electric in 1961, when the Court seem to apply the law of vertical mergers to exclusive arrangements, has there been any clarification; and even that was minor.²⁷

In the Tampa case, the court ruled that:

An exclusive arrangement...does not violate the section unless the court believes it probable that performance of the contract will foreclose competition in a substantial share of the line of commerce affected. Following the guidelines of earlier decisions, certain considerations must be taken. First, the line of commerce...must be determined...Second, the area of effective competition in the known line of commerce must be charted...

Third, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market. That is to

²³ Robert Bork, The Antitrust Paradox: A Policy at War with Itself, (New York: Basic Books, Inc., 1978) p. 301.

²⁴ Bork again

²⁵ p.147, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

²⁶ p. 147, Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

²⁷ Bork, op. cit. p. 301

say, the opportunities for traders to enter into or remain in that market must be significantly limited...To weigh 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. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence...²⁸

In spite of this list of factors that are to be considered, note that the causal connection between foreclosure and harm to competition is still assumed. In fact, it is not at all clear that Tampa Electric does anything more than declare that relatively small foreclosures are not substantial. Even though the absolute dollar volume and tonnage might be large, they need to be judged in terms of the total relevant market. In Tampa Electric, the challenged contract pre-empted less than 1% of the relevant market, and thus did not foreclose a substantial volume of competition, even though some 2,250,000 tons of coal worth \$128,000,000 was pre-empted.

How much foreclosure is substantial? Tampa Electric merely indicates less than 1% is not substantial. But in the 1966 Brown Shoe case²⁹ brought by the FTC under §5 of the FTC Act, as well as §3, the foreclosure of a trivial share of the retail shoe business was again found to be illegal. In Brown, 650 "franchised" retail shoe stores agreed to concentrate on Brown shoes in return for Brown's provision of architectural plans, merchandising records, services of a Brown field representative and group insurance at a lower rate than the retailer could individually obtain. Even though Brown was the second largest producer of shoes in terms of dollar volume it had no special advantage over competitors in providing these services. Moreover, there were 70,000 to 100,000 retail shoe outlets in the nation at the time. Thus, something less than 1% of the shoe requirements of the nation's retail shoe stores was pre-empted. Nevertheless a foreclosure of this minuscule magnitude was found by a unanimous court to be in violation of §5 of the Federal Trade Commission Act on the grounds that the FTC has broad powers to declare trade practices unfair, particularly those which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws.

...the Commission has power under §5 to arrest trade restraints in their incipiency without proof that they amount to an outright violation of §3 of the Clayton Act or other provisions of the antitrust laws.³⁰

The Supreme Court has elsewhere held that practices "posing no threat to competition within the precepts of the antitrust laws" may still be proscribed under §5 if they are determined to be unfair methods of competition or otherwise unfair or deceptive.³¹ In part, this difference in treatment is related

²⁸ Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, Areeda 824 (1961)

²⁹ Federal Trade Commission v. Brown Shoe Co., 384 U.S. 316 (1966)

³⁰ Areeda, p. 832. (FTC v. Brown Shoe)

³¹ Federal Trade Commission v. Sperry & Hutchinson Co., 405 U.S. 233, 244-245 (1972).

to the functional peculiarities of FTC proceedings. Still most would argue that just to say that §5 is broader is no excuse for failing to show how §5 proceedings call for a divergence from Sherman and Clayton Act analysis of antitrust policies and their application to a particular case.³² The fact remains, however, §5 treatment of exclusive dealing is different from the Clayton Act treatment. Thus it is still possible for very small relative volumes to be held illegal.

To the extent that the courts seem to be applying the same standards appropriate to vertical mergers, one place to look for clarification about exclusive dealing is to the government's 1968 guidelines for vertical mergers.³³ In the guidelines that the Justice Department uses to determine whether to challenge a vertical merger on the ground that it may significantly lessen existing or potential competition in the supplying firm's market, they attach primary significance to (1) the market share of the supplying firm, (2) the market share of the purchasing firm or firms, and (3) the conditions of entry in the purchasing firm's market. Accordingly the Department will ordinarily challenge a merger or series of mergers between a supplying firm, accounting for approximately 10% or more of the sales in its market, and one or more purchasing firms, accounting in toto for approximately 6% or more of the total purchases in that market, unless it clearly appears that there are no significant barriers to entry into the business of the purchasing firm or firms.³⁴

Thus by any standards that are being used by the Courts or the Justice Department, exclusive dealing agreements involving fairly small market shares will be regarded as harming competition and hence will provoke a challenge. Is this desirable? To decide this, we need to look more closely at the way exclusive dealing is alleged to harm competition.

Professor Areeda gives one example:

...If all food canners...agree to buy exclusively from giant can maker Alpha, there would be no customers left for Alpha's rivals. This example invites two further points. First, while all buyers might conceivably choose to make each purchase from Alpha in any event, that possibility does not dissolve our concern with the contractual limitation on their future freedom of choice. Second, if only a portion of the buyers were covered, it would not have the same obvious impact on Alpha's rivals, but it might limit their opportunities to some degree. Whether the resultant "clog on competition" is socially serious is another question. It certainly would be when Alpha's arrangements deprive rivals of the business that would otherwise permit them to operate at an efficient scale and in sufficient numbers to guarantee workable competition.³⁵

Note that his special concern seems to be with the contractual limitation on the customer's future freedom of choice.

³² Areeda, p. 834.

³³ 1 Trade Reg. Rep. ¶4510 (1980), cited in Areeda, p. 914.

³⁴ op. cit. Areeda, p. 912.

³⁵ Areeda, Antitrust Analysis, p. 810.

Harlan Blake and William Jones use the facts of Standard Fashions where Standard, a manufacturer of dress patterns contracted with a dry goods store not to sell lines as another example of the harm done by exclusive dealing.

The most desirable sites for pattern agencies--dry goods and department stores--were limited in number, and the major companies, by reason of their popularity and long lines of styles, could preempt the best outlets, relegating to inferior locations newer and smaller manufacturers with shorter and less well known lines. In communities where suitable outlets were scarce, all but one or a few pattern manufacturers would have been excluded. While the Standard Fashion decision may not have been necessary to ward off monopoly, it was clearly helpful in facilitating entry into a concentrated industry and making possible the wider distribution of competing lines.³⁶

Robert Bork points out the problem with both of these examples. In the case of the can manufacturer, he notes that the only reason that Alpha was able to get all food canners to buy exclusively from him was because he makes a better can or offers extra inducements such as lower price. This has nothing to do with the requirements contract. Rather, this is the essence of competition. Alpha's rivals have the same opportunity to seek this business; they are not foreclosed from offering the same terms as Alpha.³⁷

In the case of Standard Fashion, Bork notes that the argument that the uniqueness of Standard's line of patterns gives it market power that it can use to injure rivals is based on the error of double counting.

Standard can [apart from exclusive contracts] extract in the prices it charges retailers all that the uniqueness of the line is worth. It cannot charge the retailer that full worth in money and then charge it again in exclusivity the retailer does not wish to grant....If Standard must forgo the higher prices it could have demanded in order to get exclusivity, then exclusivity is not an imposition, it is a purchase.³⁸

Obviously, the causal relationship between foreclosure and harm to competition is not as simple as it first looks. True, whenever any rival is excluded from a market segment, competition is automatically reduced. But, surely, the law doesn't mean to oppose every foreclosure, since in one way or the other, the end result of all competition is foreclosure. By definition, every completed transaction excludes all others not party to that transaction. Foreclosure is incidental to

³⁶ Harlan Blake and William Jones, "Toward a Three-Dimensional Antitrust Policy," 65 Colum L. Rev. 442 (1965).

³⁷ Bork, Antitrust Paradox, p. 304

³⁸ Bork, Antitrust Paradox, p. 306-307.

commerce. It can't be avoided. Thus one must assume that the law intends to distinguish between proper foreclosure, which is the normal byproduct of buying and selling, and improper foreclosure which harms the competitive process.

One possibility for distinguishing proper from improper foreclosure might be found in the comparison of a single transaction with an exclusive dealing contract. The single transaction is a one-time exclusion, while the exclusive dealing contract forecloses competitive offers on a stream of future transactions over the term of the contract. This was the point in Professor Areeda's can manufacturer example noted above. This is of course a difference, but is it a difference significant for the competitive process? Is the foreclosure of \$1 million worth of business in a single transaction less harmful to competition than a requirements contract of \$ 100,000 per year for ten years? If so, the reason is not clear. The relevant difference must lie elsewhere.

Perhaps the key to distinguishing an improper foreclosure lies in the relative magnitude of the foreclosure. Suppose that after an intensely competitive bidding process, a seller makes a deal with a buyer who controls 50% of a market to sell that customer 100,000 units of a product and that this is equal to roughly 50% of the expected sales in that market. Is this improper? Again, the answer would seem to be no. There is no reason why a large buyer, for reasons sufficient unto itself, should not be able to confine its purchases to a single supplier, if all suppliers are free to bid for this business.

Maybe the distinction lies in the size of the business that was competitively won relative to the total business locked-in over the term of the contract. Suppose that the seller bid aggressively for an ten-year exclusive dealing contract that involves an estimated 100,000 units per year over the life of the contract, but that the bidding was only on the first 100,000 units. Certainly, there was no harm to the rivals who were also free to bid for this business in the first year, even though 1 million units of business was ultimately locked-in as a result of the bidding for 100,000 units. They were excluded only as a result of their unwillingness to meet the winner's terms. On the other hand, later entrants are in fact foreclosed from this business, since they never had the chance to bid for the original business. When markets are locked up as a result of such contracts, entry is harmed.

But, if as is typical, the contract can be terminated on short notice by either party, the arrangement is in a sense continually up for review, and it would be hard to see how the contract, as such, unduly excludes new entrants. They are free to approach the dealer with a new offer, and subject to the normal inertia accompanying a changeover, capture the business. Competition is not harmed.

The duration of exclusive contracts and the effect of this on entry was an issue in the Motion Picture Advertising case.³⁹ In that case, the

³⁹ Federal Trade Commission v. Motion Picture Advertising Service Co. 344 U.S. 392 (1953)

court upheld the FTC which had entered a cease and desist order prohibiting respondents from entering into any contract that grants an exclusive privilege for more than a year or from continuing in effect any provision of an existing contract longer than a year.

The Commission found in the present case that respondent's exclusive contracts unreasonably restrain competition and tend to monopoly. These findings are supported by substantial evidence. This is not a situation where by the nature of the market there is room for newcomers, irrespective of existing restrictive practices...

The Commission...concluded that, although the exclusive contracts were beneficial to the distributor and preferred by the theatre owners, their use should be restricted in the public interest. The Commission found that the term of one year had become standard practice and that continuance of exclusive contracts so limited would not be an undue restraint upon competition, in view of the compelling business reasons for some exclusive arrangements.⁴⁰

Blake and Jones cite this case as an example in opposition to Bork's proposition that entry can always be effected by seeking a collaborator to enter at the blocked level breaks down where the size of the entrant is small by comparison to the vertical channel which is blocked.

One can hardly be expected to bring into existence numerous motion picture theatres to provide outlets for advertising films.⁴¹

But most would agree with Bork when he asserts that Blake and Jones have the argument backwards in this particular case.

...Under what theory can small firms take a monopoly profit and actually use the difficulty of entry at the large firm's [customer's] level as a factor that preserves their ability to exploit the large firms? The large firms, here the theatres, would not stand for such nonsense for a moment. They would support new entrants in the production and distribution of advertising films or enter the activity themselves. They would certainly not use their own market strength to give a monopoly to their suppliers. That is true whether the monopoly returns are taken directly from the theatres or indirectly from the advertisers...⁴²

Even in a case where market power exists on the supply side, the entry barrier is not so much due to the exclusive contract as it is the market power itself. Still there does seem to be a legitimate public interest in regulating unreasonably long exclusive contracts which needless exclude potential new entrants from bidding for the business from important customers.

⁴⁰ Motion Picture Advertising Services op.cit. Areeda, p. 821-822.

⁴¹ Harlan Blake and William Jones, "Toward a Three-Dimensional Antitrust Policy," 65 Colum L. Rev. 442 (1965). Quoted in Bork, Antitrust Paradox, p. 308.

⁴² Bork, Antitrust Paradox, p. 308.

Because of this difficulty in showing how foreclosure specifically harms competition, there is a growing body of opinion that disputes that there is any connection at all between automatic foreclosure and harm to competition.⁴³ They see this assumed linkage to be part of a misguided theory that holds that aggressive competition can somehow injure competition by injuring one's rivals.⁴⁴ They hold this is the same theory that underlies other areas of antitrust such as price discrimination, tying, reciprocity, vertical and conglomerate mergers, and boycotts as well as requirements contracts and exclusive dealing. In their opinion, all mistakenly assume "foreclosure" harms competition.

As they see it, most of these condemned practices can also be means of competing, and of operating more efficiently. Therefore, they feel that if they are suppressed indiscriminately this will frustrate the very objectives the law is designed to achieve.⁴⁵

Specifically, in the case of exclusive dealing they would argue that, being a form of vertical integration by contract, exclusive dealing creates efficiencies and does not create restrictions of output. Consequently, they hold that such arrangements generally should be held to be lawful.

Robert Bork would even go so far as to assert that there has never been a case in which exclusive dealing or requirements contracts were shown to injure competition. A seller who wants exclusivity must give the buyer something for it. If he gives a lower price, the reason must be that the seller expects the arrangement to create efficiencies that justify the lower price.⁴⁶

Obviously, not all commentators agree with this extreme position, though most, if not all analysts would now agree that a strict per se rule of illegality cannot be justified in the case of requirements contracts and other exclusive dealing arrangements. The opinion in Standard Stations explains the reasons why.

Kaysen and Turner⁴⁷ argue that effective enforcement of Clayton §3 would best be accommodated by applying the Standard Stations test, "foreclosure of a substantial share of the line of commerce affected," with two provisos. The two provisos concern the meaning of "foreclosure." First, the term of the requirements contract may be sufficiently short that it may fairly be called the appropriate unit of sale for the industry concerned.⁴⁸ This was the situation in Motion Picture Advertising.

Second, Kaysen and Turner feel that exclusive arrangements with dealers, as opposed to ultimate consumers, constitute foreclosure only if competing producers cannot obtain other dealers with

⁴³ Cite Bork here

⁴⁴ Bork 65 Colum. L.R. 402

⁴⁵ Ibid.

⁴⁶ Bork, Antitrust Paradox, p. 309

⁴⁷ Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965.

⁴⁸ Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965, p. 160.

comparable access to the consuming market, or can do so only at relatively great expense.⁴⁹

...we think Standard Stations is a reasonable disposition of the problem; on balance the adverse effects significant foreclosure are likely to outweigh by a considerable margin the benefits to the economy of exclusive arrangements which have a foreclosure effect.⁵⁰

Actually, I would favor a more extensive rule of reason analysis which would seem to be a better approach than the quasi per se approach adopted in Standard Stations. One needs to balance the pro competitive with the anticompetitive effects of these arrangements. This involves more than a simple substantiality test. At the very least, one needs to compare the terms of the contracts with what is needed to obtain the advantages sought. One must look at the circumstances which give rise to the contract and to its effect.⁵¹

I would even subscribe to the view that we should consider the intent of the parties as one of the principal criteria for judging violations of the law of exclusive dealing. I am not proposing that we look at personal motives, but rather at conduct, since intent is always an inference drawn from conduct. It is the pattern of conduct in a specific set of circumstances that reveals the intent.⁵²

I am not suggesting that intent alone is enough to signal violation, but when intent, inferred from conduct by an actor shown to have the power or capability to make his conduct effective is present, then one should be reasonably confident in drawing inferences about the effect of the practice on the competitive process.⁵³

In other words, I am proposing that the legal significance of exclusive dealing should be judged largely with respect to the way the market power of the actor has been used or will be used, rather than by

⁴⁹ Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965. p. 160.

⁵⁰ Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965. p. 160.

⁵¹ Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965. p. 159.

⁵² Myron W. Watkins review of "Economic Concentration and the Monopoly Problem" by Edward S. Mason, American Economic Review, (September, 1957), pp 747-753.

⁵³ See Edward S. Mason in the preface to Carl Kaysen & Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, Cambridge: Harvard University Press, 1965, p. xiv-xv, for a discussion of the problems of this approach.

the amount of business effected. The significance of exclusive dealing for the competitive process depends on BOTH the intent and market position of the supplier. This is the reason that we must define the relevant market and assess the position of the actors on that market. This is in line with the reasoning proposed in Tampa Electric. To quote the court:

...one should 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."⁵⁴

One should also inquire into the intent of the arrangement. Is its intent to protect the buyer from price increases and to assure supply and facilitate long-term planning on the basis of known costs? Is the arrangement designed to make possible a substantial reduction of selling expenses, or to give protection against price fluctuations and otherwise to offer the advantages to a newcomer of a predictable market? Are they designed to assist a seller trying to establish a foothold against the counterattacks of entrenched competitors? These are the factors suggested, but not used, by Justice Frankfurter in Standard Stations. This is the part of Standard Stations that should be applied; not the section proposed by Kaysen and Turner.

The fact that these criteria will be hard to apply is not sufficient to justify the per se treatment of exclusive dealing and requirements contracts. To do so is on a par with the vaudeville skit which has the clown searching for the lost ring under the streetlight where he can see, even though he lost it where it is dark. Exclusive dealing is a rule of reason offense. It should be treated as such!

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ENDNOTES

⁵⁴ 365 U.S. 320 at p. ?, (1961) Areeda p. 825.