Exclusive Dealing and Competition: A US FTC View

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Introduction: Exclusive Dealing Basics

- "An exclusive dealing contract is a contract under which a buyer promises to buy its requirements of one or more products exclusively from a particular seller." Hovenkamp, Federal Antitrust Policy (2016)

- Variations on "full scale" exclusive dealing (partial, de facto)
  - **Loyalty discounts**, discounts tied to percentage of purchases from a seller
  - **Slotting allowances**, supplier pays fee for preferred or exclusive shelf space
  - **Requirements contracts,** agreements to buy all needed units from one seller, also de facto agreements under which firms won't buy from other sellers

- Exclusive dealing may confer substantial procompetitive benefits but also may pose significant anticompetitive risks
  - case-specific analysis is key
  - Exclusive dealing assessed by most authorities under antitrust "rule of reason"

Evaluating Exclusive Dealing – ICN Review

- 2013 ICN Unilateral Conduct Workbook, Chapter 5 – Exclusive Dealing
  - Outlines elements for flexible rule of reason analysis, focus on evidence
  - Potential exclusive dealing efficiencies include:
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Evaluating Exclusive Dealing – U.S. Approach

- In Re Beltone (FTC, 1982). FTC, assessing case law, says "a proper analysis of exclusive dealing arrangements should take into account
  - market definition,
  - the amount of foreclosure in the relevant markets,
  - the duration of the contracts,
  - the extent to which entry is deterred,
  - and the reasonable justifications, if any, for the exclusivity"

- Roland Machinery (7th

Evaluating Exclusive Dealing in U.S., cont.

- Categories of indirect evidence include:
  - estimate of the significance of market foreclosure caused by exclusive dealing agreement ("significant degree of market foreclosure" required, **Microsoft**, 2001)
  - duration
  - terminability of contract (**Omega Envtl**, 1997)

- Many courts have held contracts of one year or less are presumptively legal (e.g., **Concord Boat** (2000), **Omega**), but others have noted that short duration and early terminability do not prohibit liability in all cases (e.g., **Dentsply** (2005), large market share of Dentsply and its conduct excluding competing manufacturers were the key factors)

- Other relevant factors include whether distributors are a significant gateway to end users and evidence of ease of entry (e.g, **Omega**)

Issues Raised by Foreclosure

- Before anticompetitive foreclosure can occur a firm with a relatively large percentage of upstream market must foreclose a significant percentage of access to downstream market (Hovenkamp, 2016)

- Also, important to look at entire range of distribution channels through which efficient distribution can occur – exclusive dealing that shuts off only one distribution channel might permit ample competition through others

- Also, always important to remember that vertically related markets do not necessarily have same geographic boundaries

Exclusives as Efficient "Relational" Contracts (Draws on Hovenkamp (2016))

- Exclusive dealing a classic example of "relational" contracting – contracting that permits parties to make long term arrangements that reduce their risk and account for the fact that knowledge about the future is limited (Hovenkamp, citing Williamson, Carlton, MacNeil)
- Long-term, flexible contracts can minimize costs and risks to both parties of dealing with future uncertainties
    - E.g., gasoline retailer uncertain about future sales and suppliers, while refiner, by contrast, wants steady outlet for its product (customers benefit by knowing they can buy a particular brand at a particular location)
    - Exclusives give both refiners and ultimate consumers benefits of outright station ownership, but avoids high capital costs of investing in stations
    - Exclusives also give incentives for independent retailers to maximize sales – retailers are not mere employees, but businesspersons interested in profit maximization

Efficient Relational Contracts, cont.

- Exclusives may also prevent **interbrand free riding**, which occurs when a dealer with an ongoing supply relationship with one supplier sells a second brand at same location and takes advantage of facilities or goodwill contributed by supplier of the first brand (gasoline example)
  - If gasoline dealer pumps the second brand, neither the supplier of the first brand nor the dealer could segregate all the facilities or amenities provided by the first brand supplier (e.g., help in financing and maintaining equipment, trademark brand value)
  - The first brand supplier's solution is to require that its gas be sold exclusively
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Efficiencies of Exclusive Dealing, cont.
(draws on Abbott & Wright (2008))

- Other free riding stories – because manufacturers often compensate dealers for provision of promotional services such as premium shelf space, dealers have incentive to use these additional promotional efforts to switch consumers to other products upon which dealer earns a higher profit – exclusives prevent this

- Exclusive dealing also mitigates incentive of dealers not to provide agreed upon promotional inputs (see Roland Machinery case (1984))

- An exclusive allows a retailer to intensify manufacturers′ competition for its business and improve purchase terms by committing a substantial fraction of its customers′ purchases to favored supplier

References

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- Derek W. Moore and Joshua D. Wright, Conditional Discounts and the Law of Exclusive Dealing, 22 George Mason Law Review 1205 (2015)

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