Adding Bite to Exclusive Dealing?:
An Analysis of the Third Circuit's *Dentsply* Decision

Scott A. Sher and Scott D. Russell

The recent decision of the Court of Appeals for the Third Circuit in *United States v. Dentsply International, Inc.*[1] provides new guidance regarding the legality of exclusive dealing and insight into what constitutes sufficient evidence of "exclusionary conduct" to demonstrate a violation of Section 2 of the Sherman Act. The *Dentsply* decision, along with other prominent cases that recently condemned dominant firm conduct, including *United States v. Microsoft Corp.*,[2] *LePage's v. 3M*,[3] *Conwood v. United States Tobacco Corp.*,[4] and *United States v. Visa U.S.A., Inc.*,[5] reveals a common theme. Dominant firms that restrict access to a significant portion of a relevant market, efficient distribution channels, or scarce retail space, likely will be sanctioned if plaintiffs can support their claims with evidence of stable market shares and the defendant's subjective bad intent. *Dentsply* is also important because it takes a markedly different approach from past exclusive dealing cases both to defining the relevant market where a dominant firm restricts access to distribution channels and analyzing the potential harm to competition resulting from such conduct.

Exclusive dealing arrangements are vertical nonprice restraints that require a buyer to purchase products or services for a period of time exclusively from one supplier. By its nature, exclusive dealing "forecloses" rival suppliers and/or new entrants from marketing their goods to a particular buyer. This does not, however, automatically mean that such practices are inherently suspect. After all, sufficient alternatives may exist, and there are many well-recognized economic benefits that flow from exclusive dealing arrangements, including the enhancement of interbrand competition. Thus, from an antitrust perspective, the concern with exclusive dealing is that the degree of market foreclosure can rise to a level where new entry is discouraged and existing sellers are left without sufficient alternatives to secure low-cost resources or compete for sales on the merits, thus injuring the competitive process and increasing the probability that prices will rise.

Exclusionary conduct raises additional concerns when the exclusive supplier has a substantial market position in the upstream market. Indeed, several recent decisions have found antitrust liability under Section 2 where defendants used their monopoly power to exclude rivals from accessing end-users or a significant fraction of the available distribution chain, usually through contractual or quasi-contractual (e.g., discount incentives) means. For example, in *Microsoft*, the

***Scott A. Sher** is a partner at Wilson Sonsini Goodrich & Rosati, PC in Reston, Virginia. **Scott D. Russell** is an associate at the same firm.*

[1] 399 F.3d 181 (3d Cir. 2005) (Dentsply's recent petition for rehearing *en banc* is pending).

[2] 253 F.3d 34 (D.C. Cir. 2001) (en banc).

[3] 324 F.3d 141 (3d Cir. 2003) (en banc), *cert. denied*, 124 S. Ct. 2932 (2004).

[4] 290 F.3d 768 (6th Cir. 2002), *cert. denied*, 537 U.S. 1148 (2003).

[5] 344 F.3d 229 (2d Cir. 2003), *cert. denied*, 125 S. Ct. 45 (2004).

defendant company used its monopoly power in the operating system market to tie up OEMs, IAPs, and ISPs—the distributors—via exclusive dealing contracts, requiring these distributors to carry only Microsoft's Internet Explorer product (to the exclusion of Netscape Navigator).[6] In *Conwood*, United States Tobacco Corporation used its position as category manager over moist snuff racks in retail stores to restrict point-of-sale advertising and shelf space of competitive moist snuff products (including those offered by Conwood).[7] *LePage's* illustrates how 3M leveraged its position as a market leader in a variety of office supply products to provide incentives to retailers through significant bundled discounts to carry 3M's nonbranded transparent tape to the exclusion of LePage's competitive product.[8]

In decades past, courts analyzed nonprice related exclusionary conduct simply by inferring competitive harm where a substantial percentage of the market was foreclosed to rivals.[9] Today, courts take the analysis one step further. Rather than simply calculating the percentage of the market foreclosed, courts also examine how the exclusionary conduct affects competition and whether any competitive harm results from the exercise of market power, rather than from unrelated factors (e.g., consumer choice, inefficiency of competitors). Similarly, when market foreclosure occurs at the distribution level, courts assess whether competitors can simply circumvent the foreclosed distribution channels and reach end-users through alternative means (i.e., whether entry into the distribution of the product is easy).

This trend toward a more probing analysis of competitive effects is not surprising with the advent of more sophisticated economic analyses.

This trend toward a more probing analysis of competitive effects is not surprising with the advent of more sophisticated economic analyses. As noted by Jonathan Jacobson, the focus of the antitrust inquiry has moved from considering whether the conduct foreclosed competition, to whether "the foreclosure or other aspect of exclusion was imposed in a way designed to lead to an increase in prices or restriction of output in the market as a whole."[10]

This article synthesizes some of the significant issues raised by recent cases addressing dominant firm conduct, focusing on the *Dentsply* decision, and highlights areas of concern for parties contemplating exclusive dealing and other forms of exclusionary conduct.

The *Dentsply* Decision—Facts and Procedural History

Dentsply was the leading manufacturer of prefabricated artificial teeth, accounting for 75–80 percent of sales of such teeth.[11] Dentsply sold its artificial teeth to twenty-three independent dental dealers. Dentsply's distribution network consisted of two large national dealers that together accounted for 67 percent of Dentsply's sales, as well as twenty-one smaller regional dealers, twenty of which accounted for no more than 4 percent of Dentsply's sales individually. The dealers in turn distributed the teeth to dental laboratories for use in the creation of dentures. Notwithstanding the absence of written contracts requiring dealers to purchase Dentsply teeth exclusively, Dentsply prohibited its dealers from carrying the teeth of competitors. Dentsply's dealers were at liberty, however, to end their relationship with Dentsply at any time, for any reason, and without

[6] *Microsoft*, 253 F.3d at 60–74.

[7] *Conwood*, 290 F.3d at 783–85.

[8] *LePage's*, 324 F.3d at 155–58.

[9] *See*, *e.g.*, Standard Oil Co. v. United States, 337 U.S. 293, 298 (1949).

[10] Jonathan Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311, 327 (2002).

[11] 399 F.3d at 185.

penalty. Since adopting exclusive dealing criteria in 1993, no dealer dropped the Dentsply product line in favor of competing brands of artificial teeth.

The Department of Justice filed suit against Dentsply in 1998, contending that Dentsply's dealer program amounted to illegal exclusive dealing. The district court denied Dentsply's motion for summary judgment, and conducted a five-week bench trial. At trial, the DOJ attempted to prove that Dentsply's exclusive dealing practices were anticompetitive and precluded entry given that (1) its dealers were unlikely to drop the popular Dentsply tooth line in favor of carrying the products of competitors, and (2) Dentsply's competitors were unable to compete effectively without access to Dentsply's distributors, which the DOJ maintained were relatively more efficient and better received by dental laboratories than other dealers, and certainly were more effective than direct dealing.[12]

In a 168-page fact-intensive opinion, the district court rejected each of the Division's antitrust claims, concluding that the facts undermined the general presumption that the foreclosure of 75 percent of a market causes anticompetitive harm. Importantly, the district court found that Dentsply's competitors had sufficient access to end-users, given the availability of direct dealing (which, according to the court, could be more efficient than selling through distribution) and access to a number of other distributors who were not locked up by Dentsply.[13]

In addition, the court concluded that Dentsply could not be held accountable for its competitors' failure to offer a better product that could entice the dealers to switch brands. The fact that the dealers could leave at any time without penalty—*and chose not to*—is a theme discussed often in the district court's analysis. Finally, when focusing on price—the touchstone of antitrust analysis—the district court found no evidence of supracompetitive pricing that might indicate the exercise of exclusion, tacit collusion, or monopoly pricing.[14] Interestingly, the court determined that Dentsply's proffered business justifications were pretextual and that Dentsply intended to exclude its rivals through its exclusivity arrangements. However, given the absence of anticompetitive effects, termination penalties, or fixed exclusivity durations, the district court discounted Dentsply's failure to provide a valid justification for its practices.[15]

On February 24, 2005, the Court of Appeals for the Third Circuit issued its decision reversing the judgment of the district court.[16] Specifically, the Third Circuit held that Dentsply's exclusivity arrangements with its twenty-three distributors ("dealers"), in light of Dentsply's ability to exercise market power, qualified as an illegal monopoly maintenance scheme in violation of Section 2 of the Sherman Act.

The Third Circuit's decision is premised on a straightforward application of a Section 2 monopolization analysis, focusing entirely on whether (1) Dentsply wielded monopoly power in the relevant market and (2) Dentsply's exclusive dealing harmed competition. While noting that a dominant firm may engage in exclusive dealing when the conduct is justified by legitimate business concerns, the Third Circuit also cautioned that "[b]ehavior that otherwise might comply with antitrust law may be impermissibly exclusionary when practiced by a monopolist."[17]

---

[12] United States v. Dentsply Int'l, Inc., 277 F. Supp. 2d 387, 450–52 (D. Del. 2003).

[13] *Id.* at 450, 452–53.

[14] *Id.* at 452.

[15] *Id.* at 453.

[16] *Dentsply*, 399 F.3d at 184.

[17] *Id.* at 187.

Issues Raised by *Dentsply* and Their Relation to Section 2 Juriprudence

Market Definition. The first element of a monopoly maintenance claim is the existence of market power, which is defined as the ability to control prices or exclude competitors. In the absence of direct evidence, courts typically infer market power from market structure. As a general rule, a market share of at least 55 percent is required to demonstrate market power, though this threshold can vary significantly depending on the size and strength of competitors, entry conditions, pricing, elasticity of demand, and substitutability limitations.[18]

Rather than define the relevant market in terms of aggregate sales to end-use customers (i.e., dental laboratories) as the district court seemed to do, the Third Circuit included distributors in the relevant market.

The *Dentsply* Decisions: The Third Circuit confirmed the heart of the district court's market structure findings, namely, that Dentsply had a 75–80 percent share of the relevant market on a revenue basis (67 percent on a unit basis); none of the remaining competitors accounted for more than 5 percent of the market; and dental laboratories constituted the end-use consumers of prefabricated teeth. Nevertheless, the Third Circuit reversed one aspect of the district court's findings that arguably played a significant role in the outcome of the case.[19]

Rather than define the relevant market in terms of aggregate sales to end-use customers (i.e., dental laboratories) as the district court seemed to do, the Third Circuit included distributors in the relevant market.[20] Specifically, the Third Circuit defined the relevant market as "total sales of artificial teeth to the laboratories and the dealers combined," thus attributing 75 percent market share to Dentsply's dealers.[21] By defining the market to include distributors and end-users, the Third Circuit expressly adopted the view that Dentsply's exclusive dealing did more than simply foreclose a primary means of distribution; it also precluded rivals from accessing 75 percent of the customers in the relevant market, thus implying harm to competition. According to the Third Circuit, the district court's failure to recognize that the relevant market necessarily included sales to dealers led the court into clear error in its analysis of monopoly power and competitive harm.

This is a significant point and cannot be over-emphasized: the Third Circuit assumed that the only way to reach 75 percent of false teeth customers was by using Dentsply's distributors. By placing the distributors in the relevant market, the court presumed that direct dealing or alternative means of distribution were not available as alternatives to reach these customers, thus leaving to rival manufacturers only a small portion of the total market.

Other Recent Section 2 Case Law: The Third Circuit's perspective on defining relevant markets departs from other decisions in both the exclusive dealing context and in Section 2 cases more generally. In two other exclusive dealing cases, *United States v. Microsoft Corporation*,[22] and *CDC Technologies, Inc. v. Idexx Laboratories, Inc.*,[23] courts defined the relevant market to include end-users only. This is a subtle, but critical, difference. When the market is defined to include only end-users, courts can more freely analyze the viability of alternative methods of distribution to end-

---

[18] *Id.*

[19] *Id.* at 188.

[20] *Id.* The parties continue to dispute whether the Third Circuit reversed or simply clarified the district court's market findings. As explained in the government's response to Dentsply's petition to the Third Circuit for rehearing en banc, "in rejecting Dentsply's apparent attempt to narrow the market to include only direct sales to laboratories, the panel made clear its agreement with the district court that the market includes all U.S. sales by tooth manufacturers, regardless of the method of distribution." *See* Response of the United States to Petition for Rehearing and Rehearing En Banc (May 3, 2005), *available at* http://www.usdoj.gov/atr/cases/f208800/208818.htm.

[21] *Dentsply*, 399 F.3d at 188.

[22] 253 F.3d 34 (D.C. Cir. 2001) (en banc).

[23] 186 F.3d 74 (2d Cir. 1999).

users, and the increased costs to rival manufacturers, if any, of being foreclosed from preferred distribution channels.

Perhaps this issue was not an overly important factor in the Third Circuit's analysis in *Dentsply*—regardless of what level of commerce market shares were calculated, Dentsply still had a market share of end-users sufficient to infer monopoly status. However, the decision to include distributors in the market is a significant departure from recent case law and presupposes lasting market power where such market power may not actually exist. Important questions were left unanswered by the Third Circuit's decision, including a determination of whether distributors unaffiliated with Dentsply could have reached the end-user dental laboratories. For example, when comparing the efficacy of direct dealing to distribution, the Third Circuit focused almost exclusively on the capabilities of Dentsply's two national dealers, making little mention of Dentsply's twenty-one smaller regional dealers and completely ignoring the many other distributors that were not "exclusively" tied to Dentsply. As will be discussed below, market definition becomes critical in determining the extent to which an exclusionary practice is anticompetitive.

Market Power. As mentioned above, market share is only a rough proxy for a determination of market power. In addition to examining market share, courts look at other evidence of market structure that tends to demonstrate market power, including stability of market shares over time, duration of exclusivity provisions, and the ease of entry into the market. On this issue, the *Dentsply* court's analysis of market power failed to consider several important factors articulated by other courts and in the government's own guidelines to determine market power.

THE *DENTSPLY* DECISIONS: Both the district court and the Third Circuit concluded that Dentsply's 75 percent market share was sufficiently high to support a prima facie claim of market power. Far more compelling to the Third Circuit's analysis, however, was Dentsply's ability to maintain such a commanding market share for over ten years, a fact the court treated as near-definitive proof that Dentsply possessed the power to exclude competitors. Indeed, without evaluating the comparative quality or price of competing products, the Third Circuit concluded that Dentsply possessed the requisite monopoly power based solely on (1) the "paltry level" of rival competition, (2) the failure of any dealer to drop the Dentsply product-line in favor of a rival's pre-fabricated teeth, and (3) Dentsply's clear intent to keep competition from gaining a "toehold" with the dealers.[24] Interestingly, the Third Circuit did not challenge the district court's findings that rival manufacturers failed to prosper due to their failure to adapt the texture, shading, or mold of their products to the preferences of American consumers (even though the DOJ's briefing on this issue was quite extensive).

Continuing with the same line of reasoning, the Third Circuit acknowledged that such "evidence of exclusion is stronger than that of Dentsply's control of prices," but even without evidence of monopoly pricing, "[t]he record of long duration of the exclusionary tactics and anecdotal evidence of their efficacy make it clear that power existed and was used effectively."[25] On this point, the Third Circuit's standard for determining market power and anticompetitive effects appears more lenient than that of other jurisdictions, such as the Seventh and Ninth Circuits, which premise antitrust liability for exclusive dealing on evidence of exclusion and supracompetitive pricing.

---

[24] *Dentsply*, 399 F.3d at 190.

[25] *Id.* at 190–91.

In addition, although exclusive dealing arrangements of short duration typically pose little risk of anticompetitive harm, particularly when they can be canceled at-will and without penalty—as was the case in *Dentsply*—the Third Circuit concluded that the terms of the actual contracts were not relevant.[26] In contrast, in dismissing the government's claims, the district court relied heavily on the ability of customers to cancel the contracts, concluding that the exclusivity arrangements did not impede rival manufacturers from competing for dealer services by offering a better or cheaper product. Rejecting the district court's findings, the Third Circuit embraced its analysis in *LePage's*,[27] explaining that the absence of a formal commitment or specified contractual duration was irrelevant in the face of compelling economic incentives that made the prospect of continued exclusivity a virtual certainty. To illustrate Dentsply's ability to impose exclusivity on its dealers without specified commitments, the Third Circuit highlighted the fact that no rival manufacturer commanded anywhere near enough sales to offer Dentsply's top two dealers, which accounted, respectively, for 28 percent and 39 percent of Dentsply's annual sales, a better deal. The court failed to apply the same reasoning, however, to nineteen of Dentsply's regional dealers, all of which accounted for less than 4 percent of Dentsply's annual sales.

The duration of exclusivity agreements can be a critical factor in assessing the potential for competitive harm, with many courts treating arrangements that last less than one year as presumptively legal.[28] These courts reason that frequent re-bidding provides sufficient opportunity for entry and eliminates the potential for lasting foreclosure effects, as well as the potential for price collusion. Nonetheless, the duration of an agreement is simply a proxy for whether market conditions are such that a buyer realistically will (or even can) exercise a short-notice termination provision in the face of aggressive competition.[29] As explained by the Third Circuit, compelling economic incentives precluded the dealers from switching freely, making it likely that Dentsply's exclusive dealing would extend into perpetuity.[30] For this reason, the court's decision largely to ignore the at-will nature of the exclusive dealing arrangements was justified.

Other Factors to Consider: In finding that Dentsply possessed market power, the Third Circuit relied on assumptions where a more thorough inquiry could have yielded a better understanding of Dentsply's ability to control price or restrict output. For example, rather than presume that ten years of relative stability in Dentsply's market shares resulted from Dentsply's exclusive dealing arrangements, the court should have looked more carefully at the reasons why Dentsply was able to maintain that share and keep its distributors, even though the agreements were limited in duration and terminable at will. The Third Circuit brushed aside the district court's findings that Dentsply's competitors failed to win business because their products were not as well-suited for the American market, and not as high quality as Dentsply's. This analysis, however, is essential in

---

[26] *Id.* at 193–94 & n.2.

[27] *LePage's*, 324 F.3d at 157–58.

[28] *See* Omega Envt'l, Inc. v. Gibarco, Inc., 127 F.3d 1157, 1164 (9th Cir. 1997); *see also* Roland Mach. Co. v. Dresser Indus. Inc., 749 F.2d 380, 394–95 (7th Cir. 1984) (one-year contracts presumptively legal); U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 (1st Cir. 1993) (termination on 30 days notice normally a de minimis constraint); Beltone Elecs. Corp., 100 F.T.C. 68, 271 (1982) (termination on thirty days notice an "escape valve dilut[ing] somewhat the limitation on . . . access to" distributors).

[29] See Jacobson, *supra* note 10, at 351–52 for a thorough discussion.

[30] Conversely, in *Omega*, the court was presented with a far more competitive and fluid market, which was deemed unlikely to be affected by exclusive dealing, given undisputed evidence of "increasing output, decreasing prices, and significantly fluctuating market shares among the major manufacturers." 127 F.3d at 1164–65. Further, rival distributors had proven themselves equally efficient to one another, distinguished only by their reputations, and capable of growth notwithstanding the 90-day duration of most of the exclusive arrangements at issue.

any determination of what caused the stability in market shares. While it certainly may be true that Dentsply used bully tactics to lock up the most efficient means of distribution, the court did not inquire whether distributors would have switched—or pushed back against Dentsply's exclusivity policy[31]—if competitors' products were better, cheaper, or more suited for end-use customers than Dentsply's.

As explained by the Third Circuit, a determination of market power must also include an examination of whether there are barriers to entering the market. Here, the Third Circuit only looked at whether Dentsply had created barriers to obstruct competitors from "flipping" dealers already locked up with exclusive agreements. As the court held: "Entrants into the marketplace must confront Dentsply's power over the dealers" who have been locked up with Dentsply exclusives.[32] Nowhere in the opinion did the court consider whether competitors could have (a) established a rival distribution chain, (b) built up existing distributors not privy to Dentsply's exclusive arrangements, or (c) entered through a hybrid approach of selling directly (which the court acknowledged was profitable) and through expansion of alternative distribution methods. Likewise, the court did not analyze whether existing non-Dentsply dealers were capable of quickly repositioning their operations to provide laboratories with distribution services comparable to Dentsply's dealers, in terms of speed, quality, and cost efficiency.

Exclusive dealing arrangements affect markets in the same manner as do vertical mergers. Consequently, the Department of Justice's 1984 Vertical Merger Guidelines should provide relevant guidance as to how to examine the effects of such arrangements. If the Third Circuit had embraced the Guidelines' approach when analyzing Dentsply's exclusive dealing policy—a policy which in effect accomplished the same objective as a vertical integration of services—the analysis would have been more complete and informative. The Guidelines provide that a vertical merger can produce horizontal anticompetitive effects by making entry less likely if (1) as a result of the merger, a new entrant would have to enter simultaneously into two or more markets, and (2) such simultaneous entry would make entry less likely. Essential to this vertical theory of harm is an analysis of whether the merger creates new and significant barriers to entry.[33] In addition, under the Guidelines, the government must also demonstrate that a market is highly concentrated and therefore, "so conducive to noncompetitive performance that the increased difficulty of entry will likely affect its performance."[34]

After determining whether alternative distribution methods could support sufficient and timely entry (merely demonstrating fringe entry is insufficient under a Guidelines approach), expansion or repositioning, a Guidelines analysis asks whether rival manufacturers are currently in a position—or could position themselves—to generate enough gross sales to entice such uncommitted entry. This is where the *Dentsply* decision is most lacking: the court did not consider the scale and scope of operations necessary for a manufacturer to produce at a cost-efficient level. These same considerations are relevant to considering whether a rival manufacturer can generate sufficient market penetration to entice any of Dentsply's smaller regional rivals (nineteen of which

---

[31] The district court opinion noted that Dentsply was forced to abandon its plans to distribute directly to certain accounts due to fear of backlash from its larger dealers. *See Dentsply*, 277 F. Supp. 2d at 405–06.

[32] *Dentsply*, 399 F.3d at 194.

[33] U.S. Dept. of Justice, Antitrust Division, Non-Horizontal Merger Guidelines (1984), *available at* http://www.usdoj.gov/atr/public/guidelines/2614.htm (commonly referred to, and hereinafter cited, as 1984 Vertical Merger Guidelines).

[34] *Id.* § 4.21.

comprise less than 4 percent of Dentsply's sales) and remain competitively viable. The Third Circuit properly dismissed the likelihood that a rival manufacturer could recruit one of Dentsply's national dealers, but the same analysis was not extended to all dealers.

In contrast, the Second Circuit in *Visa* determined that the cost of developing an alternative network capable of generating sufficient sales volume and merchant acceptance to challenge Visa and MasterCard's extensive nationwide credit network was overwhelming.[35] Further, the court explored the infeasibility of one-tier entry, finding that Visa and MasterCard's control over member banks precluded rival networks from offering a variety of valuable, and highly coveted, services related to the integration of credit cards and customer bank accounts.[36]

[T]he Third Circuit missed an opportunity to explain that even inefficient competitors offer some level of restraint against dominant firms, thus benefiting consumers.

Anticompetitive Effects.

THE *DENTSPLY* DECISIONS: The district court found that Dentsply's exclusive dealing did not harm competition, citing the absence of supracompetitive pricing and the availability of alternate means of accessing end-use customers. The Third Circuit reached the opposite conclusion, finding Dentsply's twenty-three dealers to be a necessary "gateway" to accessing dental laboratories and critical for a rival manufacturer to make enough sales "to pose a real threat to Dentsply's market share."[37] As such, the Third Circuit likened Dentsply's "authorized dealers" to "high volume retailers." The fact the dealers were distributors and not retailers "is a distinction in name without a substantive difference." As was true in *LePage's*, "[s]elling to a few prominent retailers provided substantially reduced distribution costs and cheap, high volume supply lines."[38] From this perspective, the Third Circuit's analysis reveals the dual concern that Dentsply's exclusionary conduct increased distribution costs for rivals and denied competitors access to a significant group of consumers—a perspective that partially reveals the court's unique view that dealers should be included in the relevant market. Curiously absent from the Third Circuit's analysis, however, is a discussion of the significance to consumers of rivals the district court found to be inefficient and unwilling to compete aggressively. In this respect, the Third Circuit missed an opportunity to explain that even inefficient competitors offer some level of restraint against dominant firms, thus benefiting consumers.[39]

In explaining the manner in which competition was harmed, the Third Circuit relied heavily on the comparative advantage of distribution through dealers. While recognizing that direct dealing was both possible and theoretically more cost effective (i.e., by eliminating a "middle man"), the Third Circuit concluded that direct dealing was economically infeasible in the market for artificial teeth.[40] The court held that rival manufacturers were incapable of replicating Dentsply's comprehensive contact list or business relationships. Further, the court held that a rival manufacturer would not be well equipped to offer laboratories similarly attractive credit financing packages, return policies, or the convenience benefits of one-stop shopping.

---

[35] *See* 344 F.3d at 240–41.

[36] *See id.* at 241.

[37] *Dentsply*, 399 F.3d at 191.

[38] *Id.* at 196 (internal quotation marks and citations omitted).

[39] *See* Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 YALE L.J. 941 (2002).

[40] In its petition for rehearing, Dentsply argues that the Third Circuit erred in setting aside the district court's findings that direct distribution is viable, a claim the government views as nothing more than "a disagreement about the application of the clear error standard." *See supra* note 20.

That other competitors were profitable despite relying primarily, if not exclusively, on direct dealing was also deemed irrelevant by the Third Circuit, given that such dealers had not yet grown to a level capable of challenging Dentsply in the marketplace. Notably, the court did not point to evidence that reliance on dealers resulted in lower prices—in fact, the court specifically concluded (adopting the district court's findings), that Dentsply's prices were not the lowest in the industry, and there is no specific finding that Dentsply's margins were more attractive than those of other manufacturers.

Notably, the court did not point to evidence that reliance on dealers resulted in lower prices . . .

Other Recent Section 2 Case Law: According to the Third Circuit in *Dentsply*, when determining whether a challenged restriction creates anticompetitive effects, the court need not conclude that there is "total foreclosure, but [instead,] whether the challenged practices bar a substantial number of rivals[,] . . . severely restrict the market's ambit[,]" or raise the costs of rivals to do business.[41] A survey of recent Section 2 case law shows that the most significant types of harm stemming from a defendant's exclusionary conduct include:

1. *Downstream Effects:* the exclusion of rivals from a substantial portion of the market, making entry unlikely or precluding competitors from achieving the economies of scale and scope necessary to achieve efficient levels of operation, making it more likely that a dominant firm can exercise market power unilaterally (i.e., raise prices or reduce quality), and
2. *Upstream Effects:* raising the costs for other firms to compete against the defendant by tying up low-cost resources or the most economical and efficient methods of reaching end-users (i.e., "raising rivals' costs").

When analyzing the anticompetitive effects that flow from a monopolist's exclusive dealing, courts generally limit their focus to the harm that stems from foreclosing access to end-users and methods of distribution. Where an exclusive dealing arrangement impairs the ability of competitors to access a substantial portion of the market, which therefore reduces their ability to constrain a dominant firm's market power by diminishing the competitor's customer base or economies of scale, courts conclude that such exclusive arrangements harm competition (harm #1 above). On the other hand, courts have been less concerned with exclusive dealing contracts that occur at the distribution level, believing that direct dealing and new entry can counteract or undermine the anticompetitive effects that might typically follow from a similar degree of foreclosure at the end-user level. Only where such exclusive arrangements tie up existing and more efficient avenues of distribution,[42] resulting in rivals' costs being raised because they must either create new avenues of distribution, or use higher-cost distributors, do courts find harm to competition in such circumstances (harm #2 above).

In *Visa*, the defendants established exclusivity provisions with banks that prohibited American Express and Discover, most prominently, from being able to distribute their credit cards through member banks. Because all banks in the United States were member banks, American Express and Discover ostensibly were foreclosed from distributing their cards through every bank in the

---

[41] *Dentsply*, 399 F.3d at 191.

[42] The concept that primary lines of distribution can evolve into a necessary, low-cost delivery alternatives is not unfamiliar to Section 2 jurisprudence. *See* Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 604 n.31 (1985) ("In any business, patterns of distribution develop over time; these may reasonably be thought to be more efficient than alternative patterns of distribution that do not develop. The patterns that do develop and persist we may call the optimal patterns. By disturbing optimal distribution patterns one rival can impose costs upon another, that is, force the other to accept higher costs.") (quoting Robert Bork, The Antitrust Paradox 156 (1978)); *Microsoft*, 253 F.3d at 63–64; *see also* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209 (1986).

country.[43] The defendants argued that a demonstrated increase in the price of network card services provided to banks after exclusivity was imposed did not constitute consumer harm because network card services was not a relevant market. Instead, the defendants contended that the banking network represented nothing more than a distribution method to reach credit card end-users. Therefore, the correct relevant market, according to the defendants, included all end-users of credit cards, with whom American Express and Discover dealt "directly" through mailings. In fact, American Express and Discover were so successful that they were, respectively, the first and fifth largest dispensers of credit cards in the country.[44]

The Second Circuit disagreed, concluding first that there was a separate market for network services, and that the network service banks indeed represented end-users who were harmed by not being able to offer American Express or Discover Cards. More pertinent for purposes of our *Dentsply* analysis, the Second Circuit held that access to network services was essential to competing in the market to attract sufficient numbers of end-users: "Nor do we fault the district court's determination that certain types of products combining unique features of cards offered by Amex and Discover with the advantages of linkage to cardholders' bank accounts would likely become available" if American Express and Discover had access to that distribution channel.[45] In other words, the "distributors" in the *Visa* case did far more than simply "ship" the credit cards to end-users; they provided important value-added services, enhancing the end-use product. The foreclosure of the distribution channel raised competitors' costs significantly.

In *Conwood*, the Sixth Circuit concluded that United States Tobacco Corporation (USTC) had sufficient market power in the market for moist snuff to make its practice of foreclosing competitors from retail rack space sufficiently exclusionary. The plaintiff maintained that USTC harmed competition through exclusion when it:

(1) removed racks from stores without the permission of store management and discarded and/or destroyed these racks, while placing Conwood products in USTC racks in an effort to bury Conwood's products and reduce their facings;

(2) trained their operatives to take advantage of inattentive store clerks with various "ruses" such as obtaining nominal permission to reorganize or neaten the moist snuff section, in an effort to destroy Conwood racks;

(3) misused its position as category manager by providing misleading information to retailers in an effort to dupe retailers into believing, among other things, that USTC products were better selling so that retailers would carry USTC products and discontinue carrying Conwood products; and

(4) entered into exclusive agreements with retailers in an effort to exclude rivals' products.[46]

Although *Conwood* involved radically different exclusionary behavior than *Visa*, the court applied the same rationale. The Sixth Circuit held that USTC used its market power in the moist snuff market to affect materially the downstream point-of-sale advertising and racks that housed the moist snuff tobacco products. USTC effectively stifled competition by abusing its position as

---

[43] 344 F.3d at 242.

[44] *Id.* at 242–43.

[45] *Id.* at 243.

[46] 290 F.3d at 783.

market leader by improperly taking "shelf presence" that served to "keep [] products off the shelf, and once it's there to get rid of it."[47]

In *PepsiCo, Inc. v. Coca Cola Co.*,[48] Pepsi challenged Coca-Cola's exclusive arrangements with independent foodservice distributors (IFDs). Coca-Cola prohibited its IFDs from carrying any competitive products, including those offered by Pepsi. Pepsi contended that IFD delivery was cheaper than other forms of delivery, thus raising Pepsi's costs to compete against Coca-Cola because Pepsi could not make use of Coca-Cola's IFDs. The district court rejected Pepsi's contentions, concluding that the IFDs were but one way for soft drink vendors to reach end-use customers, and Pepsi failed to demonstrate that its so-called increased costs either resulted in lower margins than Coca-Cola maintained, or higher prices for end-use consumers. The court methodically examined the market, and concluded that IFD delivery did not foreclose Pepsi from the soft-drink market in any material respect and did not affect the ultimate end-use prices adversely (nor did it affect Pepsi's margins) in the soft-drink market.[49] In other words, Coca-Cola's exclusive arrangements did not raise Pepsi's costs.

In another example, *Omega Environmental, Inc. v. Gilbarco, Inc.*, although the defendant's exclusive dealing contracts with distributors "foreclosed roughly 38 percent of the relevant market for sales," the court declined to find that this level of foreclosure was likely to cause anticompetitive effects because alternative means of distribution existed, including direct sales and other (less frequently utilized) distributors, which "eliminate[d] substantially any foreclosure effect Gilbarco's policy might have."[50] Similarly in *CDC Technologies v. Idexx*, the Second Circuit held that "if competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution, it is unclear whether [such arrangements] foreclose from competition any part of the relevant market."[51] Central to the *Idexx* decision, however, was compelling evidence that direct dealing was far more efficient and profitable than third-party distribution. Again, in these cases, the courts concluded that the foreclosure in distribution did not raise rivals' costs.

Business Justification/Role of Intent. A valid business justification that serves to offset the perceived harm of exclusionary conduct can serve as a defense to a monopoly maintenance claim, provided that the defendant can demonstrate that the exclusivity provisions are efficiency enhancing, reasonably necessary to the agreement, and ultimately are procompetitive. By recognizing that justified exclusivity provisions can have a net beneficial effect on competition, monopolization analysis closely resembles the Guidelines' approach to balancing the harm likely to occur through market foreclosure against the benefits of merger-specific efficiencies.[52] Accordingly, courts have held that the use of exclusivity provisions to, for example, safeguard asset value, control quality, and pursue efficiency "might be legitimate competitive reasons" to impose restrictions

---

[47] *Id.* at 789–90.

[48] 114 F. Supp. 2d 243 (S.D.N.Y. 2000), *aff'd*, 315 F.3d 101 (2d Cir. 2002).

[49] *Id.* at 255–58 (citations omitted).

[50] 127 F.3d at 1162–63; *see also supra* note 30.

[51] 186 F.3d at 80 9quoting Omega Envt'l, Inc. v. Gilbarco, Inc., 127 F.3d 1157 (9th Cir. 1997)).

[52] *See* 1984 Vertical Merger Guidelines, *supra* note 33, § 4.24; *see also* Kratenmaker & Salop, *supra* note 42 (advancing a consumer welfare test for analyzing exclusionary conduct); *but see infra* note 60 (describing the DOJ's profit-sacrifice test for identifying anticompetitive conduct).

on a distributor's ability to carry competitive lines, while, on the other hand, "the desire to maintain a monopoly market share or thwart the entry of competitors would not."[53]

In some cases, it is easy for plaintiffs to demonstrate that proffered business justifications are pretextual because there is direct evidence that the restraints imposed are unrelated to efficiency concerns. For example, in *Dentsply*, each of the "grandfathered" dealers (i.e., those allowed to continue their prior practice of distributing competitive products) proved to be equally efficient and effective as those carrying Dentsply's artificial teeth exclusively. With this evidence the Third Circuit summarily affirmed the district court's findings that Dentsply's proffered justification was mere pretext.[54] Based upon similar evidence, the Second Circuit dismissed the justification for exclusivity offered by defendants in *Visa/MasterCard*, given that "there is no evidence that the defendants' network cohesion has been harmed overseas, where, in the absence of exclusionary rules, Amex has contracted with Visa and MasterCard member banks to issue Amex-branded payment cards."[55]

[C]ourts often fall back on evidence of subjective intent to determine whether consumer welfare has been enhanced or harmed by exclusionary conduct.

Apart from cases like *Dentsply* and *Visa*, where there is direct evidence that the defendants' proffered business justifications were unnecessary to meet their legitimate business goals, courts often fall back on evidence of subjective intent to determine whether consumer welfare has been enhanced or harmed by exclusionary conduct. Most notably, in *Image Technology Services, Inc. v. Eastman Kodak Co.*, the Ninth Circuit held that Kodak's refusal to license its intellectual property to competing service technicians was actionable because Kodak's conduct was motivated solely by a subjective intent to deny market access, rather than a bona fide attempt to safeguard the quality or value of its IP assets.[56]

More fundamental to the development of Section 2 jurisprudence, however, is the increasing significance that intent evidence is accorded in establishing the prima facie elements of a monopoly maintenance claim. As previously noted, hornbook antitrust law instructs that the focus of Section 2 should be on the effect that exclusionary conduct has on competition, not upon the intent behind it. Nonetheless, "[e]vidence of [] intent . . . is relevant only to the extent it helps us understand the likely effect of the monopolist's conduct."[57] Indeed, recent case law reveals that intent evidence, when coupled with a clear demonstration of market power, seemingly reduces a plaintiff's burden to prove competitive harm, presumably based upon the theory that a monopolist—which by definition is unconstrained by market forces—is capable of succeeding in its goal to prevent one or more new or potential competitors from gaining a foothold in the market.[58]

---

[53] *LePage's*, 324 F.3d at 163 (internal quotations and citations omitted); *see also id.* at 159 ("When a monopolist's actions are designed to prevent . . . 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.").

[54] *Dentsply*, 399 F.3d at 197.

[55] *Visa*, 344 F.3d at 243.

[56] 125 F.3d 1195, 1219 (9th Cir. 1997) ("Neither the aims of intellectual property law, nor the antitrust laws justify allowing a monopolist to rely upon a pretextual business justification to mask anticompetitive conduct.").

[57] *Microsoft*, 253 F.3d at 59 (citing *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918), for the proposition that "knowledge of intent may help the court to interpret facts and to predict consequences").

[58] *See, e.g.*, Andrew I. Gavil, *A Comment on the Seventh Circuit's* Republic Tobacco *Decision: On Utility of "Direct Evidence of Anticompetitive Effects,"* ANTITRUST, Spring 2005, at 59; David L. Meyer, *Direct Evidence of What?:* Republic Tobacco *and the Proper Use of "Direct Evidence" of Anticompetitive Effects*, ANTITRUST, Spring 2005, at 67.

Dentsply and *LePage's* prove the point well. In each of those cases, the defendants had market power, and demonstrated the intent to harm competition. The courts in both cases were confronted, however, with countervailing evidence that the defendants' rivals were relatively inefficient, and the courts were forced to decide whether the market structure was *caused or maintained* by the exclusivity provisions or by inefficient competition. For example, in *Dentsply*, the court concluded that Dentsply had the best artificial teeth products on the market (and in fact, its competitors' products were not adapted for American customer preferences, including their size, shape, color, and texture), which it offered at a price below many of its rivals. Further, the Third Circuit recognized that there was little evidence of supracompetitive pricing, although both parties' experts indicated that prices to end-users might drop if the exclusivity provisions were invalidated. The combination of these facts (i.e., relatively strong products, inefficient competitors, and comparable prices) could have explained Dentsply's ability to maintain high margins and market shares, as well as the failure of Dentsply's rivals to convince Dentsply's exclusive dealers to carry their competitive offerings. Nevertheless, the Third Circuit cited to and relied upon pervasive testimonial evidence of Dentsply's predatory intent to "block competitive distribution points" and "not allow competition to achieve toeholds in dealers"[59] as a primary means to solidify the government's theory of competitive harm, without addressing the government's proffered "profit-sacrifice" test[60] or delicate questions of antitrust causation.

Likewise, in *LePage's*, the plaintiff produced substantial evidence that 3M intended to harm the plaintiff's competitive position through its bundled rebate program, which factored prominently in the court's analysis of competitive harm.[61] This evidence of intent overcame evidence proffered by the defendant (and relied upon extensively in a dissent that sought to thoroughly discredit the majority's opinion and its reliance on such intent evidence) that the market structure was not caused by defendant's bundled rebates, but rather by plaintiff's status as an inefficient competitor. (It was a high cost producer.)[62]

Conclusion

Dominant firms are increasingly finding their practices challenged by smaller competitors and scrutinized carefully by the courts and antitrust agencies—a trend that may gather momentum following *Dentsply* and other recent exclusionary conduct cases. Nonetheless, Section 2 jurisprudence appears far from settled, as the courts have yet to resolve a number of significant analytical issues highlighted by *Dentsply*'s treatment of exclusive dealing:

---

[59] *See Dentsply*, 399 F.3d at 189–90 (quoting testimony of former Dentsply managers). Intent also mitigates causation problems in damages cases. For example, in *Conwood*, it was apparent that plaintiff's damages award was not reduced, despite (a) a relatively weak case on the merits in terms of antitrust liability, and (b) more importantly, a problem with demonstrating that the anticompetitive conduct was the cause of the consumer harm. The Sixth Circuit relied upon evidence of bad intent in its decision to avoid mitigating the damages award. *See Conwood*, 290 F.3d at 797–98.

[60] In addition to testimonial evidence, the government also attempted to prove predatory intent circumstantially, using a "profit-sacrifice" test. At trial and in its appellate briefing, the government offered extensive evidence that Dentsply incurred significant costs (in terms of time, costs, and good-will) to enforce its exclusivity policies and deny rival teeth manufacturers access to under-utilized dealers. Given the absence of any efficiency-enhancing business justifications, the government argued that Dentsply imposed exclusivity as a means of fortifying its monopoly position; sacrificing short-term profits for greater rewards in the future.

[61] *LePage's*, 324 F.3d at 144–45.

[62] *See id.* at 173 (Greenberg, J., dissenting) ("[T]he evidence [] demonstrates that LePage's lost business for reasons that could not possibly be attributable to any unlawful conduct by 3M.").

(1) Although it is likely that the Third Circuit reached the correct conclusion in *Dentsply*, its market definition analysis is problematic and at odds with the decisions of several other courts. Specifically, the court's decision to define the market to include both end-users of artificial teeth (i.e., laboratories) and distributors of such teeth runs counter not only to recent case law, but also to the emerging understanding of how foreclosure harms competition.

(2) In recent cases, including *Dentsply*, the plaintiffs prevailed because they demonstrated that the defendant had market power, rather than simply relying on evidence that the defendant's exclusive arrangements created a high degree of market foreclosure. Plaintiffs proved that this market power, in turn, enabled the defendant to foreclose competitive alternatives in a manner that could not be countered by the defendant's rivals, even using more efficient means.

(3) When making the determination of whether a defendant has market power and whether the challenged conduct harmed competition, courts are not consistent or clear in their analysis, including *Dentsply*. The DOJ's 1984 Vertical Merger Guidelines offer a useful approach for analyzing market power and competitive effects in the exclusive dealing context. Specifically, courts should undertake (1) a rigorous market definition analysis as prescribed by the Guidelines, (2) a prospective evaluation of whether the exclusivity arrangements make it more difficult to compete by requiring either simultaneous entry into not only the product market, but the distribution market as well, and (3) a factual analysis of whether, as a result of the exclusivity, the defendant's conduct harmed competition.

(4) Intent is relevant in exclusionary conduct cases. Even though intent is not an affirmative element of a monopoly maintenance claim under Section 2, courts do rely upon evidence of a defendant's predatory intent in their analyses. Obviously, such evidence is viscerally important—even to a judge sitting as trier of fact. Recent cases reveal, however, that intent evidence may play a more significant role in the affirmative examination of whether the monopolist's exclusionary conduct harms competition (again, even though intent is not an element of monopoly maintenance), or advances legitimate efficiency-enhancing business concerns (which under Section 2 serves as a defense to otherwise illegal conduct). Interestingly, the district court in *Dentsply* properly ignored evidence of predatory intent, concluding that even though the business justifications offered by Denstply for its exclusive dealing arrangements were pretext, such evidence was irrelevant if competition was not actually harmed by the conduct.[63]" ●

---

[63] *Dentsply*, 399 F.3d at 196–97.