EXCLUSIVE DEALING, "FORECLOSURE," AND CONSUMER HARM

Jonathan M. Jacobson*

I. INTRODUCTION

Be wary when encountering Greek soldiers presenting an oversized horse as a gift. But be really wary of antitrust lawyers arguing that the pertinent question is the degree of "foreclosure" when the case involves allegations of exclusionary practices.

For years, the courts have said that the percentage of the market foreclosed is the determinant of antitrust liability in exclusive dealing cases. This focus on foreclosure originated as a device for lessening the plaintiff's burden of proof and making challenges to exclusive dealing easier to maintain. Over the past two decades, however, the level of percentage foreclosure necessary to sustain a case has been raised, raised some more, and then raised again. The decisions have come to recognize that even the highest levels of percentage foreclosure may entail no consumer harm. Knowledgeable defense practitioners have seized on this development, and have with increasing success argued that their clients should prevail because not enough foreclosure has been shown.

In a number of recent cases, however, the plea of "insufficient foreclosure" has been to no avail. Some recent decisions, most prominently the en banc decision of the D.C. Circuit in *Microsoft*,[1] have looked beyond foreclosure to focus instead on the effect of exclusive dealing in creating, enhancing, or preserving the defendant's market power. Courts have found liability in some cases even when the amount of "foreclosure" is

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[1] United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir.), *cert. denied*, 122 S. Ct. 350 (2001).

zero. At the same time, courts have come to appreciate that the typical exclusive dealing arrangement is entirely lawful—that exclusive dealing can serve important business purposes, and is often a preferred means for waging legitimate competition. Exclusive dealing arrangements generally promote more effective distribution by increasing dedication and loyalty; and they can minimize free-riding, improve product quality, and ensure customers and suppliers of a reliable source of supply. Exclusive arrangements are only rarely the source of serious antitrust concern. But when exclusive dealing does harm consumers, the harm can be severe.

Antitrust courts and policymakers have struggled for more than a century to develop analytical methods for distinguishing the malignant exclusive dealing arrangement from the benign. Part II of this article traces the history up to the mid-1990s. As recounted there, prior to enactment of the Clayton Act in 1914, exclusive dealing was regarded as a "partial" restraint and generally upheld, except in the rare instance where the exclusive arrangement created an actual monopoly.[2] From 1914 through *Tampa Electric*[3] in 1961, in contrast, the courts began to focus with increasing single-mindedness on the percentage of relevant business "foreclosed." If the arrangement foreclosed rivals from access to a "substantial" portion of the relevant market, it was usually condemned. Efficiency justifications had little—and sometimes zero—relevance. In the period after *Tampa Electric* and continuing into the 1990s, the focus of analysis shifted again. The courts began to appreciate the ways in which exclusive dealing can provide benefits to consumers and expressed increasing levels of doubt as to whether exclusive dealing arrangements might cause significant competitive harm. Increasingly, cases during this period upheld challenged arrangements unless the percentage of business foreclosed was very high. Foreclosure remained important, but the thresholds for concern were raised higher and higher.[4]

The last few years, starting in 1997, have given us a new wave of exclusive dealing decisions. As Part III of the article explains, these recent cases appear to reflect the beginnings of another evolutionary change in the law. Increasingly, the courts are focusing on the effect of the challenged arrangement on the defendant's market power, rather than foreclosure as such, as the source of potential exclusive dealing liability. Case after recent case has upheld exclusive dealing arrangements that do not threaten to increase price or restrict output in an appropriately defined market, while condemning arrangements—sometimes with-

[2] *See infra* notes 6–27 and accompanying text.

[3] Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961).

[4] *See infra* notes 28–102 and accompanying text.

out regard to percentage foreclosure—that threaten actual consumer harm.[5] By increasing the focus on market power, rather than the degree of foreclosure, the more recent cases have done much to harmonize exclusive dealing analysis with more general analysis of restraints of trade under the rule of reason.

After tracing this history of judicial treatment of exclusive dealing arrangements, the article summarizes in Part IV the teachings of the leading Chicago and post-Chicago economic literature. Part V then analyzes the difficult economic and policy issues exclusive dealing agreements can raise. In particular, how is it possible to distinguish the exclusionary exclusive dealing arrangement from one that is a byproduct of healthy competition? What types of resources or assets are likely to confer market power if tied up through an exclusive arrangement? Can an agreement be exclusionary if its duration is brief? Are arrangements by large firms that increase the costs of smaller rivals necessarily harmful? Can an exclusive dealing agreement lead to significant consumer harm even if rivals remain able to reach ultimate consumers and, in that sense, cannot be said to be "foreclosed"?

The upshot of this analysis is a modest framework, described in Part VI, premised on the litigation reality of a prima facie case and rebuttal, for determining when an exclusive dealing arrangement has run afoul of the law. The analysis concludes that exclusive dealing arrangements may increase the costs of rivals or otherwise impair their ability to compete effectively, but harm consumers only when the impairment of rivals gives the defendant the ability (or a greater ability) to raise prices over competitive levels. This effect will be rare, but is not necessarily dependent on a long-term contract length or the percentage of customers (or suppliers) foreclosed. Instead, consistent with the recent decisions, consumer harm may be found even where foreclosure, by traditional measures, is zero. Accordingly, the focus of the suggested analysis is not on the percentage of business foreclosed, but instead on whether the restraint has created, enhanced, or protected the defendant's market power through the impairment of competitors' ability to act as a meaningful constraint.[6]

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[5] *See infra* notes 103–74 and accompanying text.

[6] A note on scope: This article addresses traditional exclusive dealing cases. Many of the same economic and legal issues arise in vertical merger cases (where the level of customer or supplier foreclosure has been considered crucial to the merger's legality), tying cases (where the tie may foreclose a significant percentage of the tied product market), and bundled discount cases (where the discount may lead to de facto exclusive dealing). Although a few of the cases in these related areas will be discussed below as appropriate, a detailed analysis of other issues raised in these types of cases is outside the scope of this article.

II. EXCLUSIVE DEALING PRIOR TO THE LATE 1990s

A. The Common Law, Early Sherman Act, and Laissez-Faire

Prior to the Industrial Age, exclusive dealing went largely unnoticed by the law. Contractual exclusive dealing implies some sort of ongoing customer-supplier relationship, and was accordingly rare until the development of organized manufacturing and retailing over the course of the 19th century.[7] Exclusive dealing with middlemen, the focus of most exclusive dealing litigation today, came later still. Apart from early arrangements with railroads, telegraph companies, and "express" companies, exclusive dealing with middlemen distributors did not arrive in any appreciable scale until the beginning of the 20th century.

Prior to and immediately following passage of the Sherman Act in 1890, exclusive dealing arrangements were analyzed in much the same way as covenants not to compete ancillary to the sale of a business, employee covenants not to compete, and similar arrangements. The English courts, for example, routinely upheld arrangements pursuant to which a brewer leased or sold land to a tavern operator on the condition that the tavern serve the brewer's beer, ale, or port exclusively.[8] Thus, in *Catt v. Tourle*,[9] decided in 1869, the court relied on "the rule laid down in the leading case of *Mitchel v. Reynolds*" for the dispositive proposition "that where the restraint is not general but partial, and is founded on valuable consideration, then it cannot be said to be an unreasonable restraint."[10] Subsequent decisions of the British courts took the laissez-faire approach quite far. In the famous case of *Mogul Steamship Co. v. McGregor, Gow & Co.*,[11] the House of Lords upheld the practice of a dominant ship-owners' association that conditioned five percent rebates on merchants' agreement to use the association's ships exclusively—notwithstanding considerable evidence that the effect of the rebates was to maintain a substantial monopoly.

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[7] *See generally* HANS THORELLI, THE FEDERAL ANTITRUST POLICY ch. 1 (1954).

[8] *See, e.g.*, Catt v. Tourle, L.R. 4 Ch. App. 654 (1869); Western Union Tel. Co. v. Burlington & S.W. Ry. Co., 11 F. 1, 11 (C.C.D. Iowa 1882) (reporter's note by Francis Wharton) (collecting cases). The earliest case research uncovered was *Gale v. Reed,* 32 Eng. Rep. 103 (K.B. 1806), upholding an exclusive agreement for the supply of cordage for the production of rope.

[9] L.R. 4 Ch. App. 654 (1869).

[10] *Id.* at 659 (citing Mitchel v. Reynolds, 1 P. Wms. 181, 24 Eng. Rep. 347 (Q.B. 1711)). *Mitchel* is the seminal ancillary restraint case, and a direct ancestor of the modern rule of reason. It held that covenants not to compete ancillary to the sale of business (or employment agreement) should be upheld unless overbroad in relation to the consideration provided.

[11] [1892] A.C. 25, [1891–1894] All E.R. Rep. 263 (1891).

Common law decisions by courts in the United States typically upheld exclusive dealing arrangements as "partial restraints" as well. In *Chicago, St. Louis & New Orleans Railroad Co. v. Pullman Southern Car Co.*,[12] for example, the Supreme Court upheld exclusive arrangements between Pullman and a railroad company making Pullman the exclusive supplier of "drawing-room and sleeping cars." In an opinion by Justice Harlan, the Court emphasized that the exclusive contract provided the railroad with assurance of an adequate supply of sleeping cars, which was important so that the railroad "might properly discharge its duty to the public" to provide them. Notwithstanding Pullman's dominant position as a supplier of sleeping cars, and the arrangements' impact on the competitive vitality of Pullman's rivals, the Court could not "perceive that such a contract is at all in restraint of trade."[13] Exclusive contracts were similarly upheld in the *Express Cases*[14] and numerous cases decided by the state courts.[15]

Shortly after passage of the Sherman Act in 1890, a number of cases were brought by the Government—typically by criminal indictment—challenging exclusive dealing arrangements imposed or entered into by the Whiskey Trust and others. The indictments were consistently struck down by the courts, sending these early enforcement efforts to one defeat after another. One of the first significant cases was *In re Corning*.[16] The defendants, who "controll[ed] 75-100 [percent] of the distillery products of the United States,"[17] entered into agreements with distribution agents requiring that the agents sell only defendants' products, and at resale prices set by the defendants. The court concluded that the indictment "wholly fails to charge a crime" because the defendants had "legally

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[12] 139 U.S. 79 (1891).

[13] *Id.* at 89.

[14] 117 U.S. 1 (1886).

[15] *See, e.g.,* Terre Haute Brewing Co. v. McGeever, 198 Ala. 474, 73 So. 889 (1916); Home Pattern Co. v. Mascho, 46 Okla. 55, 148 P. 131 (1915); Walter A. Wood Moving & Reaping Co. v. Greenwood Hardware Co., 75 S.C. 378, 55 S.E. 973 (1906); Brown v. Rounsavell, 78 Ill. 589 (1875); Peerless Pattern Co. v. Gauntlett Dry Goods Co., 171 Mich. 158, 136 N.W. 1113 (1912); J.W. Ripy & Son v. Art Wall Paper Mills, 41 Okla. 20, 136 P. 1080 (1913). *See generally* Note, *The Legality of Contracts of Sale which Prevent the Purchaser-Retailer from Handling Goods of the Wholesaler's Competitors,* 30 HARV. L. REV. 72 (1916). Exclusive dealing was condemned in a few of the common law cases, but only under unique circumstances. Specifically, Western Union entered into a number of agreements with railroads providing that no other telegraph company could establish telegraph lines along the railroad's right of way. These arrangements were uniformly struck down as unlawful restraints of trade. *See, e.g.,* Western Union Tel. Co. v. Baltimore & Ohio Tel. Co., 23 F. 12 (C.C.D. Ind. 1885); Western Union Tel. Co. v. Burlington & S.W. Ry. Co., 11 F. 1 (C.C.D. Iowa 1882).

[16] 51 F. 205 (N.D. Ohio 1892).

[17] *Id.* at 208.

purchased with their own capital three fourths of the distilleries in the United States," had not "obligated the vendors not to build other distilleries," and had not "attempted in any manner . . . to control the business of the remaining one fourth of the distilleries in the United States."[18] The exclusive arrangements, the court said, did not prevent dealers from purchasing from others (i.e., the remaining one-fourth) if they so chose and were therefore not in restraint of trade.[19] *Corning*, a district court decision, was relied on for the dismissal of similar indictments by circuit courts in Ohio[20] and New York.[21]

Although the easy tolerance of *Corning* and similar cases was ultimately brought to an end in the case of horizontal restraints by the Supreme Court's decisions in *Trans-Missouri*[22] and *Joint Traffic*,[23] exclusive dealing arrangements continued to be upheld routinely except in rare instances involving actual monopolization. The most notorious example was the 1903 decision in *Whitwell v. Continental Tobacco Co.*,[24] which upheld rebates provided by the dominant firm in the area to distributors, conditioned on the distributors' agreement to sell Continental's tobacco products exclusively.[25] In a similar fashion, in 1913, the Supreme Court effectively upheld the widely opposed exclusive dealing practices of the United Shoe Machinery Company in *United States v. Winslow*.[26] The leases were again upheld, this time explicitly, by the Court five years later in *United States v. United Shoe Machinery Co.*[27]

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[18] *Id.* at 210–11.

[19] *Id.* at 211.

[20] *In re* Greene, 52 F. 104 (C.C.S.D. Ohio 1892).

[21] *In re* Terrell, 51 F. 213 (C.C.S.D.N.Y. 1892).

[22] United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897).

[23] United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898).

[24] 125 F. 454 (8th Cir. 1903).

[25] *See also* Donovan v. Pennsylvania Co., 199 U.S. 279 (1905) (rejecting a common law challenge to an exclusive arrangement for taxi service at one of the five railroad stations in Chicago). In the few cases striking down exclusive dealing by monopoly firms, the facts were extreme. *See* United States Tel. Co. v. Central Union Tel. Co., 202 F. 66, 70–75 (6th Cir. 1913) (99-year exclusive long-distance service agreement with local telephone monopoly); United States v. Great Lakes Towing Co., 208 F. 733, 744 (N.D. Ohio 1913), *appeal dismissed*, 245 U.S. 675 (1917) (exclusive dealing, through deep rebates, with tow-ship monopolist).

[26] 227 U.S. 202 (1913).

[27] 247 U.S. 32 (1918); *see also* Hanover Shoe Co. v. United Shoe Mach. Corp., 392 U.S. 481, 499–500 (1968) (discussing *United Shoe*).

B. The Clayton Act and the Rise of the Foreclosure Doctrine

The initial era of laissez-faire for exclusive dealing ended in 1914. That year, in response to a broad political consensus favoring stronger antitrust enforcement, Congress passed the Clayton and Federal Trade Commission Acts.[28] One of the underlying concerns expressed by proponents of the new legislation was that the "rule of reason" articulated by the Supreme Court in the *Standard Oil*[29] and *American Tobacco*[30] cases would authorize even the most harmful competitive practices as "reasonable."[31] This concern was exacerbated by the decision in *Henry v. A.B. Dick Co.*,[32] which authorized tying arrangements, and by decisions, such as *Continental Tobacco,*[33] upholding significantly restrictive exclusive dealing arrangements.[34] The exclusive dealing and tying clauses imposed by United Shoe were viewed with special concern, and it was widely believed that current judicial interpretations of the Sherman Act would allow United Shoe and others to continue their practices with impunity.[35] The congressional response was Section 3 of the Clayton Act, a specific provision outlawing tying and exclusive dealing arrangements where the effect of the arrangement "may be to lessen competition substantially or tend to create a monopoly in any line of commerce."[36] These tests were designed to make it far easier for restrictive arrangements to be challenged and prohibited.[37]

Passage of the Clayton Act did in fact result, almost immediately, in more and successful challenges to exclusive dealing arrangements. Early decisions of the Federal Trade Commission, commencing with *Stanley Booking* in 1918,[38] went so far as to treat any exclusive dealing arrangement

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[28] *See* MILTON A. HANDLER, ANTITRUST IN PERSPECTIVE 29–31 (1957); GERARD C. HENDERSON, THE FEDERAL TRADE COMMISSION 16–36 (1924).

[29] Standard Oil Co. v. United States, 221 U.S. 1 (1911).

[30] United States v. American Tobacco Co., 221 U.S. 106, 175–84 (1911).

[31] *See* HANDLER, *supra* note 28, at 30–31.

[32] 224 U.S. 1 (1912), *overruled by* Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502 (1917).

[33] 125 F. 454 (8th Cir. 1903); *see supra* text accompanying notes 24–25.

[34] *See* 51 CONG. REC. 9161–62 (1914) (Rep. Floyd).

[35] *E.g.,* H.R. REP. No. 627, Pt. 1, 63 Cong., 2d Sess. 13 (1914).

[36] Clayton Act § 3, 15 U.S.C. § 14 (2000).

[37] Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356 (1922). *See generally* 2 EARL KINTNER, THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS & RELATED STATUES 994–95 (1978).

[38] Stanley Booking Corp., 1 F.T.C. 212 (1918).

as presumptively unlawful.[39] Moreover, in *American Can*,[40] a Sherman Act case, the defendant's long-term exclusive dealing arrangements with suppliers of modern, low-cost can-making machinery were found to have contributed unlawfully to the defendant's acquisition of a dominant market position in the supply of cans.

1. *Importance of Market Share*

The first exclusive dealing case under Section 3 of the Clayton Act to reach the Supreme Court was *Standard Fashion Co. v. Magrane-Houston Co.*[41] in 1922. The Standard Fashion Company, which held some forty percent of the United States market for dress-making patterns, required its retail dealers to stock its patterns exclusively under agreements of two years duration. Standard brought suit to enjoin Magrane from stocking competing patterns in violation of the agreement. The lower courts, citing Section 3, dismissed the suit and the Supreme Court unanimously affirmed. Justice Day's opinion noted, approvingly, the "special stress" the lower courts had placed on Standard's 40 percent market share. The Court also relied on the fact that, in some local areas, the exclusive arrangement provided Standard with "a monopoly of the business in such community,"[42] and expressed concern that, if enforcement of the agreements were allowed, Standard "instead of controlling two-fifths, will shortly have almost, if not quite, all the pattern business."[43] The Court's reliance on Standard's significant market share and the prospect that it would enhance its share through the exclusive dealing arrangements in issue compares favorably with analysis in the modern exclusive dealing cases.[44]

One week after *Standard Fashion,* the Supreme Court confronted United Shoe's exclusive dealing clauses for the third time in ten years. This time, in *United Shoe Machinery Corp. v. United States*,[45] the Court held the exclusivity provisions unlawful. The prior decisions under the Sherman Act were distinguished on the basis of the different legal stan-

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[39] In addition to *Stanley Booking*, *see* Standard Elec. Mfg. Co., 5 F.T.C. 376 (1923); B.S. Pearsall Butter Co., 5 F.T.C. 127 (1922), *rev'd,* 292 F. 720 (7th Cir. 1923); *see also* FTC v. Sinclair Ref. Co., 261 U.S. 463 (1923) (setting aside four FTC rulings in the retail gasoline industry). *See generally* Richard M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101, 105 n.23 (1983).

[40] United States v. American Can Co., 230 F. 859, 875 (D. Md. 1916), *appeal dismissed*, 256 U.S. 706 (1921).

[41] 258 U.S. 346 (1922).

[42] *Id.* at 357.

[43] *Id.*

[44] *See infra* text accompanying notes 96–100, 237–40.

[45] 258 U.S. 451 (1922).

dard of the now-applicable Clayton Act.[46] Given the legislative history of the Clayton Act, in which United Shoe's practices were cited prominently as one of the reasons the statute was needed,[47] any different result would have been almost unthinkable.

Within a year after *United Shoe,* the Supreme Court made clear in *FTC v. Sinclair Refining Co.*[48] that Section 3 created no per se rule against exclusive dealing. *Sinclair* involved four separate FTC rulings invalidating agreements pursuant to which gasoline refiners, who also supplied retail gasoline pumps, required station owners use the supplier's gasoline exclusively in the pumps and equipment they supplied. Station owners were free to carry more than one brand of equipment (and therefore gasoline). Notwithstanding the FTC's argument that station owners as a practical matter would not use more than one brand of equipment, the Court relied on the fact that the station owner "is free to buy wherever he chooses; he may freely accept and use as many pumps as he wishes and may discontinue any or all of them."[49] The Court also pointed to the positive effects of the exclusivity clauses, noting that "[t]he stuff is highly inflammable and the method of handling it is important to the refiner. He is also vitally interested in putting his brand within easy reach of consumers with ample assurance of its genuineness."[50]

The Supreme Court did not engage in any significant analysis of exclusive dealing arrangements again for twenty-five years.[51] In that intervening period, lower courts generally condemned exclusive dealing arrangements by firms with significant market shares,[52] and upheld

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[46] *Id.* at 459–64.

[47] *See supra* note 35 and accompanying text.

[48] 261 U.S. 463 (1923).

[49] *Id.* at 474.

[50] *Id.* at 475. In another case of the same time period, *FTC v. Curtis Publishing Co.,* 260 U.S. 568 (1923), the Court reversed a Commission cease-and-desist order under Section 3 on the basis that the agreements in issue were agency contracts, not contracts of sale on condition.

[51] Section 3's prohibition of unreasonable exclusive dealing was cited in support of affirmance of the FTC's ruling in *Fashion Originators' Guild v. FTC,* 312 U.S. 457, 464 (1941), but the case primarily involved a group boycott. In *Pick Manufacturing Co. v. General Motors Corp.*, 299 U.S. 3 (1936), *aff'g* 80 F.2d 641 (7th Cir. 1935), the Court affirmed, per curiam, a judgment that GM's requirement that dealers use only GM-made or GM-authorized replacement parts was not unlawful. But the Court's brief opinion relied on a rule that it would not overturn factual determinations of two lower court absent clear error, and provided no substantive discussion of the pertinent legal issues.

[52] *See* Signode Steel Strapping Co. v. FTC, 132 F.2d 48, 54 (4th Cir. 1942) (exclusive arrangements by three firms with combined market shares of 66% to 75%); Carter Carburetor Corp. v. FTC, 112 F.2d 722 (8th Cir. 1940) (50%–60%); RCA v. Lord, 28 F.2d 257, 261 (3d Cir. 1928) (70%–95%); Butterick Co. v. FTC, 4 F.2d 910, 912 (2d Cir. 1925)

arrangements entered into by smaller firms.[53] One of the cases in this period, *United States v. Pullman Co.*,[54] struck down under the Sherman Act the same exclusive dealing arrangements for sleeper cars the Court had upheld under the common law over fifty years earlier.[55]

2. *Quantitative Substantiality*

Although the Supreme Court did not address vertical exclusive dealing issues on the merits from 1923 through 1948, it did consider Section 3 of the Clayton Act in two important tying cases, *IBM v. United States*[56] and *International Salt Co. v. United States*.[57] *International Salt* introduced the idea that it was "unreasonable, *per se*, to foreclose competitors from any substantial market,"[58] a concept the Court soon expanded to the Sherman Act in the monopolization context in *United States v. Griffith*.[59] At the same time, the view was being expressed in some lower courts that "the substantiality of the lessening of competition" under Section 3 should be gauged by "the [dollar] volume of business controlled by the [defendant], not with reference to [the defendant's market share]."[60] This bright-line test, like the per se rule for tying, was viewed as a desirably simple test of illegality, avoiding complex economic investigations that were viewed as unilluminating and costly. The correspondingly negative effect on efficient business practices was not viewed as a significant concern.

In the 1949 *Standard Stations* decision,[61] the Supreme Court adopted a variant—dubbed "quantitative substantiality"—of the bright-line test advocated by some of the lower courts. *Standard Stations*, like *Sinclair* before it, involved exclusive dealing arrangements among gasoline refiners and service stations—except that, by the time of *Standard Stations*,

(same sort of exclusive pattern agreement as in *Standard Fashion*; defendants had about 40% of market).

[53] *See* B.S. Pearsall Butter Co. v. FTC, 292 F. 720, 723 (7th Cir. 1923) (defendant had just over 1% of the national market for margarine; agreements affected only jobbers and "the ultimate distributor of the product, the retailer, is in [no] way bound or restricted").

[54] 50 F. Supp. 123 (E.D. Pa. 1943) (three-judge court).

[55] *See supra* notes 12–13 and accompanying text. Pullman resolved the case by divesting the business to various railroads. Over the Government's objection, the divestiture was approved. 64 F. Supp. 108 (E.D. Pa. 1945), *aff'd by an equally divided Court*, 330 U.S. 806 (1947).

[56] 298 U.S. 131 (1936).

[57] 332 U.S. 392 (1947).

[58] *Id.* at 396.

[59] 334 U.S. 100, 107 (1948).

[60] *E.g., Signode Steel*, 132 F.2d at 54.

[61] Standard Oil Co. (Cal.) v. United States, 337 U.S. 293, 298 (1949).

gasoline retailers were not generally permitted to carry competing brands of gasoline pumps.[62] The Court recognized that, unlike tying arrangements, which had been held illegal per se in *International Salt*, exclusive dealing or requirements contracts "may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public."[63] Per se condemnation was therefore inappropriate. But the Court, anxious to avoid an "economic investigation . . . of the same broad scope as was adumbrated with reference to unreasonable restraints of trade in *Chicago Board of Trade*," and cognizant of the congressional intent underlying Section 3 to reach farther than the rule of reason under Sherman 1, specifically rejected treatment under the rule of reason.[64] Instead, the Court concluded "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."[65] In the case before it, that standard was met by proof that Standard's contracts affected 6.7 percent of the relevant "western area" geographic market, and that similar contracts entered into by Standard's six largest competitors covered another 42.4 percent of retail sales.[66]

Although *Standard Stations* was criticized roundly,[67] its authority led to the routine condemnation of many exclusive arrangements over the next dozen years.[68] The Supreme Court soon afterwards applied a similar analysis to exclusive dealing arrangements under the Sherman Act in *FTC v. Motion Picture Advertising Co.*[69] The Court also condemned under Section 2 of the Sherman Act an exclusive dealing policy imposed by a monopoly radio station owner in *Lorain Journal Co. v. United States,*[70] decided in 1951.

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[62] *Id.* at 303–04; *see also id.* at 295 ("only 1.6% of retail outlets were . . . 'split-pump'").

[63] *Id.* at 306.

[64] *Id.* at 309–13 (citing Chicago Board of Trade v. United States, 246 U.S. 231 (1918)).

[65] *Id.* at 314.

[66] *Id.* at 295, 314.

[67] *E.g.,* MILTON HANDLER, TWENTY-FIVE YEARS OF ANTITRUST 170–74 (1973).

[68] Mytinger & Casselberry, Inc., 57 F.T.C. 717 (1960), *aff'd,* 301 F.2d 534 (D.C. Cir. 1962); Anchor Serum Co. v. FTC, 217 F.2d 867 (7th Cir. 1954); Dictograph Prods., Inc. v. FTC, 217 F.2d 821 (2d Cir. 1954); Automatic Canteen Co. v. FTC, 194 F.2d 433 (7th Cir. 1952), *rev'd on other grounds,* 346 U.S. 61 (1953); Pennsylvania Water & Power Co. v. Consolidated Gas Elec. Light & Power Co., 184 F.2d 552 (4th Cir. 1950); United States v. Sun Oil Co., 176 F. Supp. 715 (E.D. Pa. 1959); Red Rock Bottlers, Inc. v. Red Rock Cola Co., 1952 Trade Cas. (CCH) ¶ 67,375 (N.D. Ga. 1952). *But see* United States v. J.I. Case Co., 101 F. Supp. 856 (D. Minn. 1952); Maico Co., 50 F.T.C. 485 (1953).

[69] 344 U.S. 392 (1953).

[70] 342 U.S. 143 (1951). *See also* Kenneth L. Glazer & Abbott B. Lipsky, Jr., *Unilateral Refusals to Deal Under Section 2 of the Sherman Act*, 63 ANTITRUST L.J. 749 (1995).

3. *Qualitative Substantiality*

The Supreme Court abandoned quantitative substantiality in 1961 in *Tampa Electric Co. v. Nashville Coal Co.,*[71] but the immediate change was nuanced—indeed, slight—and the heavy emphasis on percentage foreclosure remained. The case upheld a long-term coal supply contract that involved $128 million of coal sales over a twenty-year period, but that accounted for only one percent of total sales of bituminous coal in the eastern United States. Citing *Standard Stations, Standard Fashion,* and *United Shoe,* the *Tampa Electric* Court outlined a three-part test for determining whether a lessening of competition was "substantial." First, the line of commerce or product market had to be defined. Second, it was necessary to define the relevant geographic market affected by the challenged arrangement.[72] "Third, and last, the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market."[73] Although this three-part test suggested that substantiality was to be determined solely by the share of the relevant market foreclosed, the Court added the following comment:

> To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence.[74]

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Although the period from the passage of the Clayton Act in 1914 to *Tampa Electric* in 1961 began with the defendant's market share as the principal determinant of liability, and then shifted in *Standard Stations* to a strict focus on percentage foreclosure, it ended with a glimmer of hope from the *Tampa Electric* decision that a broader analysis of competitive impact might be considered. But did the *Tampa Electric* Court authorize full-scale rule of reason analysis? Although later cases have suggested that it did, the Court's own words continued to emphasize percentage foreclosure as the key determinant.

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[71] 365 U.S. 320 (1961).

[72] Geographic market definition proved to be dispositive in *Tampa*. If the market were limited to peninsular Florida and southern Georgia as the respondents argued, the foreclosure would have been 18%; but in the larger eastern state producing area, the figure was just 0.77%. *Id.* at 331, 333.

[73] *Id.* at 328.

[74] *Id.* at 329.

C. THE POST-*TAMPA ELECTRIC* EMPHASIS ON SIGNIFICANT FORECLOSURE

The Supreme Court has not revisited exclusive dealing in the more than forty years since *Tampa Electric* was decided. The first twenty years represented little change from the *Standard Stations* era, with the courts emphasizing foreclosure and not much else. Commencing with the important *Beltone* decision of the Federal Trade Commission in 1982,[75] however, the courts began moving closer to treatment under the rule of reason. The cases reduced the focus on foreclosure and placed greater emphasis on the need to prove market power and actual consumer harm.

1. *The Cases Prior to* Beltone

Cases in the two decades following *Tampa* paid little attention to the more qualitative factors the *Tampa* decision had introduced. Foreclosure in the range of 10 to 30 percent was generally condemned,[76] although lower levels of foreclosure usually resulted in a judgment for the defense.[77] In *Brown Shoe Co. v. FTC*,[78] the Supreme Court upheld an FTC order barring exclusive dealing involving just one percent of the retail shoe market. But the decision was based on the view that the Commission has broad powers to prohibit practices that violate the "spirit" of the Sherman or Clayton Acts, and exclusive dealing doctrine as such was not perceived to have been revised.

2. Beltone *and Its Aftermath*

The first major shift in doctrine towards a rule of reason approach to exclusive dealing came in the FTC's 1982 decision in *Beltone Electronics Corp.*[79] *Beltone* upheld exclusive dealing arrangements covering sixteen percent of the hearing aid market. Commissioner Clanton's decision treated exclusive dealing as a nonprice vertical restraint subject to rule of reason treatment under the Supreme Court's landmark 1977 decision in *Continental T.V., Inc. v. GTE Sylvania Inc.*[80] *Sylvania* had overruled the per se rule against vertical exclusive territorial arrangements, and held

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[75] Beltone Elecs. Corp., 100 F.T.C. 68 (1982).

[76] *See, e.g.*, Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291 (9th Cir. 1982) (24%); Cornwell Quality Tools Co. v. CTS Co., 446 F.2d 825 (9th Cir. 1971) (10–15%); Luria Bros. v. FTC, 389 F.2d 847 (3d Cir. 1968) (21–34%). *But see* American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230 (3d Cir. 1975) (more evidence required rather than mere proof of 14.7% foreclosure).

[77] Magnus Petroleum Co. v. Skelly Oil Co., 599 F.2d 196 (7th Cir. 1979) (1%); JBL Enters. v. Jhirmack Enters., 509 F. Supp. 357, 379 (N.D. Cal. 1981) (5%).

[78] 384 U.S. 316 (1966).

[79] 100 F.T.C. 68 (1982).

[80] 433 U.S. 36 (1977).

that vertical restraints other than price fixing were to be analyzed under the full rule of reason as set forth in *Chicago Board of Trade*—the same rule of reason the Supreme Court had expressly rejected for exclusive dealing in *Standard Stations*.[81] Applying the rule of reason in *Beltone*, the Commission concluded that the foreclosure effect of the restrictions was outweighed by the increased sales penetration the restriction encouraged, the reduction of free-rider effects, the fact of new entry and expansion by competitors, and the intensity of interbrand competition.

Although commentators noted important differences between territorial restraint analysis (on which *Beltone* relied) and analysis of exclusive dealing,[82] the decision was the first to give significant consideration to efficiency justifications and was generally hailed as an important advance in the law.[83] And *Beltone*, coupled with the general ascendancy at that time of the Chicago School laissez-faire approach to vertical restraints, contributed to a trend towards upholding exclusive dealing arrangements even at increasingly higher levels of foreclosure.[84]

Post-*Beltone* decisions routinely sustained the legality of exclusive dealing arrangements with foreclosure percentages of 40 percent or less.[85] The cases also indicated that agreements of short duration (or short-term terminability) would normally be upheld,[86] including an important opinion by Judge Posner in the *Roland* case stating that exclusive arrangements of one year or less are "presumptively lawful."[87] Following an influential article by Richard Steuer,[88] the cases also began to focus on the level of distribution at which the exclusive dealing arrangement was

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[81] *Id.* at 47–59 (overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967)).

[82] *See, e.g.,* Steuer, *supra* note 39, at 103, 113–16.

[83] *See, e.g., id.* at 111–13.

[84] *See generally* Howard P. Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1, 23–24 (1982) ("exclusive dealing is not likely to be adopted as a device which serves to erect significant entry barriers" and is likely to be harmful "only when the manufacturer . . . is very nearly a monopolist" or if the restraint is imposed by a cartel).

[85] *See, e.g.,* Sewell Plastics, Inc. v. Coca-Cola Co., 720 F. Supp. 1196, 1212–14 (W.D.N.C. 1989) (40%), *aff'd mem.*, 912 F.2d 463 (4th Cir. 1990); Kuck v. Benson, 647 F. Supp. 743 (D. Mo. 1986) (37%); Gonzales v. Insignares, 1985-2 Trade Cas. (CCH) ¶ 66,701, at 63,335 (N.D. Ga. 1985) (40%); Satellite Television & Associated Res. v. Cont. Cablevision, 714 F.2d 351, 357 (4th Cir. 1983) (8%). The only major cases finding exclusive dealing unlawful during this period involved foreclosure in excess of 50%. *See* Kohler Co. v. Briggs & Stratton Corp., 1986-1 Trade Cas. (CCH) ¶ 67,047 (E.D. Wis. 1986) (62%); United States v. Dairymen, Inc., 1985-1 Trade Cas. (CCH) ¶ 66,638 (6th Cir. 1985) (50–60%).

[86] *See, e.g.,* Paddock Publ'ns, Inc. v. Chicago Tribune Co., 103 F.3d 42, 47 (7th Cir. 1996); Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 236–38 (1st Cir. 1983); Balaklaw v. Lovell, 14 F.3d 793, 799 (2d Cir. 1994); U.S. Healthcare v. Healthsource, 986 F.2d 589, 596 (1st Cir. 1993).

[87] Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984).

[88] Steuer, *supra* note 39.

employed. If the arrangement affected only middlemen, and alternative means of reaching retailers or consumers were viable and effective, exclusivity was upheld.[89] Significantly, the courts also expressed greater and greater willingness to accept procompetitive justifications for exclusive dealing, and were increasingly deferential to defendants' reasons for seeking to impose exclusive arrangements.[90] In *Barry Wright Corp. v. ITT Grinnell Corp.*,[91] for example, then-Circuit Judge Breyer emphasized the buyer's desire for assurance of adequate supply as one reason for upholding a purchase agreement that accounted for some fifty percent of annual sales in the relevant market.[92]

Notwithstanding the trend towards a broader rule of reason approach to exclusive dealing in the post-*Beltone* cases, the primary focus in most of the cases continued to be on the degree of foreclosure, defined as the percentage of a market subject to the exclusive dealing arrangement in question. In *Jefferson Parish Hospital v. Hyde,*[93] Justice O'Connor's concurring opinion for four Justices articulated a number of procompetitive effects and potential anticompetitive consequences of exclusive dealing, but ultimately concluded that "[e]xclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal."[94] As the threshold of illegality of foreclosure moved higher and higher, in fact, the focus on foreclosure levels began to be asserted by defendants—not plaintiffs—as a basis for quick dismissal of a claim.[95]

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[89] *See, e.g.,* Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1235–36 (8th Cir. 1987); Roy B. Taylor Sales, Inc. v. Hollymatic Corp., 28 F.3d 1379, 1384–85 (5th Cir. 1994); Seagood Trading Corp. v. Jerrico, Inc., 924 F.2d 1555, 1572–73 (11th Cir. 1991); McDaniel v. Greensboro News Co., 1984-1 Trade Cas. (CCH) ¶ 65,792, at 67,287 (M.D.N.C. 1983); Stearns v. Genrad, Inc., 564 F. Supp. 1309, 1313 (M.D.N.C. 1983), *aff'd mem.,* 752 F.2d 942 (4th Cir. 1984). Similar reasoning had been applied many years before in *B.S. Pearsall Butter Co. v. FTC,* 292 F. 720, 723 (7th Cir. 1923).

[90] *See, e.g.,* Orson, Inc. v. Miramax Film Corp., 79 F.3d 1358, 1372 (3d Cir. 1996); *Seagood Trading,* 924 F.2d at 1569–70; Chuck's Feed & Seed Co. v. Ralston Purina Co., 810 F.2d 1289, 1295 (4th Cir. 1987); *Satellite Television,* 714 F.2d at 354, 357; Hendricks Music Co. v. Steinway, Inc., 689 F. Supp. 1501, 1514, 1545–48 (N.D. Ill. 1988); Joyce Beverages, Inc. v. Royal Crown Cola Co., 555 F. Supp. 271, 275–79 (S.D.N.Y. 1983).

[91] 724 F.2d 227 (1st Cir. 1983).

[92] The court also noted the relatively short duration of the agreement. *Id.* at 236–39; *see also* Interface Group, Inc. v. Massachusetts Port Auth., 816 F.2d 9 (1st Cir. 1987) (Breyer, J.).

[93] 466 U.S. 2 (1984).

[94] *Id.* at 45. The majority did not address exclusive dealing.

[95] For example, in *United States v. Microsoft Corp.,* 87 F. Supp. 2d 30, 52–53 (D.D.C. 2000) (conclusions of law), *aff'd in part, rev'd in part,* 253 F.3d 34 (D.C. Cir.) (en banc), *cert. denied,* 122 S. Ct. 350 (2001), Microsoft obtained dismissal of the Government's exclusive dealing claim, asserted under § 1 of the Sherman Act, on the ground that Netscape had

3. *The Beginnings of Market Power Analysis*

Despite the emphasis of the post-*Beltone* cases on foreclosure, an increasing number of the decisions analyzed whether the exclusive arrangements would likely create or enhance market power—the power to increase market prices or restrict market output—in contrast to bare percentages. Judge Posner's 1984 decision in *Roland Machinery* was among the first. As one element of a plaintiff's required proof, *Roland* required a showing "that the probable (not certain) effect of the exclusion will be to raise prices above (and therefore reduce output below) the competitive level, or otherwise injure competition . . . ."[96] The Eighth Circuit's 1987 decision in the *Ryko* case expressly conflated the foreclosure and market power inquiries, holding that foreclosure rate alone will carry the day only "[w]here the degree of foreclosure caused by the exclusivity provisions is so great that it invariably indicates that the supplier imposing the provisions has substantial market power . . . ."[97] The *Sewell Plastics* court carried the point further, expressing the view that, "[w]ithout evidence of market power, there is no basis for finding 'undue' foreclosure of the relevant market."[98]

These beginnings of a shift to a market power focus occurred at around the same time as an important development in the "post-Chicago" economic theory of vertical restraints: the raising rivals' cost theory.[99] As expressed by two of its most articulate proponents, the raising rivals'

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not been "excluded . . . altogether from access to [at least] 40 percent of the browser market." *See infra* text accompanying note 130.

[96] 749 F.2d at 394. The opinion also requires proof that the restraint "is likely to keep at least one significant competitor of the defendant from doing business in a relevant market." *Id.* This requirement, which appears without benefit of citation, has not been widely followed. *Compare* Kellam Energy, Inc. v. Duncan, 668 F. Supp. 861, 885 n.34 (D. Del. 1987) ("The Court declines to adopt this test") *with* Bepco, Inc. v. Allied-Signal, Inc., 106 F. Supp. 2d 814, 828 (M.D.N.C. 2000) (citing test approvingly).

[97] Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1233 (8th Cir. 1987).

[98] *Sewell,* 720 F. Supp. at 1218–19. (The author represented the defendants in the *Sewell* case.) *See also* Collins v. Associated Pathologists, Ltd., 844 F.2d 473 (7th Cir. 1988) (failure to prove relevant market doomed exclusive dealing claim); Futurevision Cable Sys. of Wiggins, Inc. v. Multivision Cable TV Corp., 789 F. Supp. 760 (S.D. Miss. 1992), *aff'd mem.*, 986 F.2d 1418 (5th Cir. 1993) (exclusive arrangements for local cable broadcasting of The Learning Channel and ESPN rejected in light of lack of market power); *cf.* Advanced Health-Care Servs., Inc. v. Radford Cmty. Hosp., 910 F.2d 139 (4th Cir. 1990) (Rule 12(b)(6) dismissal of exclusive dealing and monopolization claims reversed given allegations of defendant hospitals' monopoly power).

[99] *See* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price,* 96 YALE L.J. 209 (1986) [hereinafter *Raising Rivals' Costs*]; Thomas G. Krattenmaker & Steven C. Salop, *Competition and Cooperation in the Market for Exclusionary Rights,* 76 AM. ECON. REV. 109 (1986). For an early preview of this concept—directly from Chicago—see Aaron Director & Edward Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 280, 290 (1956).

costs approach, or RRC, posits that an exclusionary arrangement (such as exclusive dealing) can raise the market price of a product, and thereby harm consumers, if the exclusive arrangement (1) is imposed by a firm with actual or potential market power, (2) increases the costs of rivals (through foreclosure or otherwise) sufficiently to diminish their capability to constrain the firm's market power, and (3) thereby permits the firm to raise prices to customers in the relevant market. As with *Roland, Ryko,* and *Sewell,* the focus of this analysis was on market power. What was new was the articulation of ways in which an old and seemingly discredited theory—foreclosure—could prove harmful to consumers if (but only if) 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.[100]

4. *Convergence of Clayton Act Section 3 and Sherman Act Section 1*

One additional aspect of the post-*Tampa* period bears mention. After *Tampa* was decided, the distinction between the legal standard governing liability under Section 3 of the Clayton Act and Section 1 of the Sherman Act became increasingly elusive and ultimately, for practical purposes, disappeared almost completely.[101] As Judge Bork put it: "Section 1 . . . has come to apply doctrine distinguishable from the doctrine of Clayton 3 only by a metaphysician."[102] The focus today is whether exclusive dealing is unreasonably anticompetitive. Which statute is used as the basis for challenge no longer really matters.

D. THE FIRST CENTURY IN SUMMARY

The first century of federal antitrust analysis of exclusive dealing arrangements was marked by significant pendulum swings. From 1890 to the passage of the Clayton Act in 1914, the approach was almost pure laissez-faire. After passage of the Clayton Act, however, the focus turned first to the defendant's market share and then to the percentage of the market foreclosed, to a point where foreclosure was virtually the only relevant factor. In the 1980s and 1990s, the courts began to recognize that other factors—principally those that govern rule of reason analysis generally, such as the defendant's market power and the reasonable business justifications for a given arrangement—were equally important. But the decisions tended to be resolved simply by raising the foreclosure

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[100] Krattenmaker & Salop, *Raising Rivals' Costs, supra* note 99, at 262–66.

[101] *See Roland,* 749 F.2d at 393; 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1800c4 (1998) (surveying cases and concluding that the Clayton Act test is viewed as more aggressive by a majority of courts, but not in a way that can be quantified in any predictable manner).

[102] ROBERT H. BORK, THE ANTITRUST PARADOX 299 (1978).

thresholds higher and higher. No one appeared to doubt that foreclosure was still the most (and often only) relevant question.

III. THE RECENT CASES

A number of new decisions, commencing with *Omega Environmental, Inc. v. Gilbarco, Inc.*[103] in 1997, have addressed important legal and policy issues relevant to exclusive dealing doctrine and exclusionary practices generally. These decisions, as a group, have reinforced the importance of a market power focus and shifted the analysis to one that is more broadly consistent with general rule of reason analysis. The courts, for the most part, have demanded rigorous proof of the relevant market in which market power is assessed; have required plaintiffs to distinguish exclusive dealing contracts won through aggressive competition from those that are profitable only because of their negative effect on rivals; and have given extended consideration to proffered efficiency justifications. The focus on true market power in these cases is not attributable to a concern that market power in the abstract, unrelated to the challenged conduct, is harmful (although that is often true). The concern is instead that creating or increasing market power through exclusive dealing is the means by which the defendant is likely to increase prices, restrict output, reduce quality, slow innovation, or otherwise harm consumers.

The recent cases fall into five broad categories of subject matter: (a) cases involving exclusive dealing arrangements with distributors; (b) cases where exclusive dealing is attacked as a means of monopolization; (c) loyalty discount cases; (d) cases involving exclusive promotions or displays; and (e) one case where exclusive dealing standards were asserted solely as a basis of defense, not attack. A careful review of these decisions is worthwhile. Although the fact patterns vary, they are all representative of a recent shift to a focus on market power and competitive impact.

A. Exclusive Dealing with Distributors

1. Omega v. Gilbarco

The *Gilbarco* case involved important questions as to the effect of exclusive dealing in distribution when alternate forms of distribution are available, and when gaining an exclusive is itself the product of competition on the merits rather than an exclusionary act. The case was the first appellate decision to hold that alternative means of distribution could provide a complete defense even at high levels of foreclosure, and one of the first to recognize that exclusive dealing contracts with

[103] 127 F.3d 1157 (9th Cir. 1997).

distributors may not be harmful where suppliers compete for the distributors' business on the merits.

Echoing *Standard Stations* and *Sinclair*, *Gilbarco* involved the distribution of retail gasoline dispensers, devices that accept payment and pump gas into automobiles at gas stations and convenience stores. Gilbarco was the market leader with 55 percent of domestic sales. The plaintiff, Omega, was created with a strategy of acquiring and consolidating distributors, and then offering customers a choice of all brands. Given Gilbarco's market leadership, carrying the Gilbarco line was important to Omega's strategy. Gilbarco, however, responded to Omega's initiative by announcing a policy of dealing only with those distributors that carried the Gilbarco line exclusively. Omega's authorization to distribute Gilbarco dispensers was accordingly terminated, and litigation followed. A jury returned a verdict in Omega's favor under Section 3 of the Clayton Act and the district court entered judgment in Omega's favor in the amount of $27 million, after trebling.[104]

The court of appeals, dividing two to one, reversed. The panel majority, in an opinion by Judge Wright, acknowledged that Gilbarco's exclusive arrangements "foreclosed roughly 38% of the relevant market for sales," a figure that "appear[ed] significant . . . ."[105] Nevertheless, the court concluded that Omega's evidence was legally insufficient because alternate means of distribution existed, including direct sales and potential distribution through service contractors, and "[t]hese alternatives eliminate substantially any foreclosure effect Gilbarco's policy may have."[106] The court also emphasized "the short duration and easy terminability of [the exclusive] arrangements," which "negate[d] substantially their potential to foreclose competition."[107]

Omega's response was to argue that Gilbarco had tied up the most effective distributors with the strongest customer relationships, and that these distributors would not likely abandon market-leading Gilbarco for other brands. The panel majority determined, however, that Omega's evidence in these respects established only the superiority of Gilbarco's products and its ability to contract with the best available distributors—concluding "that the antitrust laws were not designed to equip [retail gasoline dispenser competitors] with Gilbarco's legitimate competitive advantage."[108] There was nothing in the evidence, the majority con-

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[104] 1996-1 Trade Cas. (CCH) ¶ 71,296 (W.D. Wash. 1995).

[105] 127 F.3d at 1162.

[106] *Id.* at 1163.

[107] *Id.*

[108] *Id.* at 1163.

cluded, to support the view that the exclusive arrangements had deterred entry into the market, facilitated tacit price coordination among manufacturers, or otherwise had given Gilbarco an ability to increase prices. On the contrary, the evidence demonstrated "increasing output, decreasing prices, and significantly fluctuating market shares."[109] Thus, notwithstanding the "apparently significant" foreclosure at the distributor level, the plaintiff had failed to demonstrate an actual adverse effect on competition.[110]

2. CDC v. IDEXX

In evaluating the effect of an exclusive arrangement, the competitive significance of the exclusive resource is often important, a point highlighted by the Second Circuit's decision in *CDC*.[111] The decision recognized that even exclusive dealing arrangements imposed by a firm with a very high market share may be competitively insignificant if the distributor's role in effecting sales is unimportant.

IDEXX is the largest manufacturer of "in-clinic hematology analyzers for use by veterinarians," the relevant market in issue in the *CDC* case, achieving an estimated market share of 80 percent.[112] Plaintiff CDC had entered this market prior to IDEXX, selling both directly and through distributors. "Distributors," however, do not actually sell the products in question. They provide, instead, the names of "qualified leads" or veterinarians who had expressed interest in the product. Actual sales are handled directly by manufacturers. IDEXX contracted exclusively with fifty percent of available distributors, and internal IDEXX documents "gloated about competitors' having 'poor distribution' and about IDEXX's plans to '[b]lock [competitors' products] at [the] [d]istribution [c]hannel[s].'"[113] CDC filed suit, challenging the exclusive arrangements under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton

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[109] *Id.* at 1164–65.

[110] Judge Pregerson dissented. In his view, Omega had presented sufficient evidence to allow the jury to conclude that Gilbarco's exclusive dealing arrangements had "create[d] entry barriers for new manufacturers" and "inflate[d] the prices at which existing manufacturers sell retail petroleum dispensers to their distributors." *Id.* at 1167–68. In *Western Parcel Express v. United Parcel Service*, 190 F.3d 974 (9th Cir. 1999), another Ninth Circuit panel affirmed a summary judgment dismissing exclusive dealing and monopolization claims under Sections 1 and 2 of the Sherman Act in reliance on *Gilbarco*. The *Western Parcel* court pointed to the short-term nature of the agreements, the entry and expansion of competitors, and a lack of probative evidence that UPS had market power. *Id.* at 976–77.

[111] CDC Techs., Inc. v. IDEXX Labs., Inc., 186 F.3d 74 (2d Cir. 1999).

[112] CDC Techs., Inc. v. IDEXX Labs., Inc., 7 F. Supp. 2d 119, 126, 130–32 (D. Conn. 1998), *aff'd*, 186 F.3d 74 (2d Cir. 1999).

[113] 186 F.3d at 76.

Act. The district court upheld the magistrate judge's recommendation to grant summary judgment, and CDC appealed.

The Second Circuit affirmed in all respects. Analyzing the arrangements under the rule of reason, the court concluded that CDC had failed to make out a prima facie case of adverse effect on competition. The court pointed to evidence that distributors, given their limited role, had "never been critical to CDC's sales strategy,"[114] that the exclusive arrangements were terminable on short notice, and that barriers to entry appeared low in light of the entry of a new competitor that achieved national distribution and the fact that CDC's own sales had increased notwithstanding the exclusive arrangements.[115] Despite IDEXX's large market share, market share evidence alone provided insufficient evidence of market power in light of the lack of substantial barriers to entry. As in *Gilbarco,* the plaintiff's claim failed because it could not show actual anticompetitive effects or a reasonable probability of anticompetitive effects based on possession of market power.[116]

3. 3M v. Appleton

Although courts typically find short duration and the option to terminate nearly dispositive of exclusive dealing claims, some recent decisions have indicated that terminability should focus on economic practicality, rather than the words in a written agreement. The *Appleton* decision[117] was the first such case. It involved exclusive dealing arrangements in the market for carbonless paper sheets, used primarily for business forms and credit card charges. Appleton was by far the leading manufacturer. Over the ten years prior to the decision, its share had increased from 50 percent to 67 percent, while plaintiff 3M's share had dropped correspondingly from 26 percent to 13 percent. 3M charged that the change was attributable to Appleton's exclusive dealing arrangements with fine paper merchants. It asserted claims under Section 3 of the Clayton Act and Sections 1 and 2 of the Sherman Act. Appleton moved for summary judgment, but its motion was denied.

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[114] *Id.* at 80.

[115] *Id.* at 80–81.

[116] *Id.* The court affirmed dismissal of the § 2 claims on largely the same reasoning. *Id.* (adopting 7 F. Supp. 2d at 130–31). The court "agree[d] with the Ninth Circuit's conclusion [in *Gilbarco*] that 'if competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution, it is unclear whether [exclusive dealing arrangements with distributors] foreclose from competition *any* part of the relevant market." *Id.* at 80 (quoting *Gilbarco,* 127 F.3d at 1163).

[117] Minnesota Mining & Mfg. Co. v. Appleton Papers, Inc., 35 F. Supp. 2d 1138 (D. Minn. 1999).

In evaluating 3M's Section 1 and Section 3 claims, the district court emphasized that Appleton "concede[d], for purposes of this motion, that it currently possesses market power"[118]; the court determined that the exclusive arrangements with the fine-paper merchants led to significant foreclosure because of the "'nearly precise correlation between distribution coverage/share and manufacturer/brand market share.'"[119] Appleton argued that there was no foreclosure, and therefore no harm to competition, because its exclusive arrangements were terminable at will. The court rejected the argument. Based on evidence of significant switching costs and proof that Appleton's incentives "have the practical effect of tying up of the paper sheet inventory of a merchant over a period of several years,"[120] the court concluded that there was an issue of fact as to whether the agreements were truly terminable or not. The court also determined that the concession of market power, coupled with the exclusionary impact of the exclusive dealing arrangements and other (unspecified) allegedly predatory conduct, barred summary judgment on the monopolization claims under Section 2. Thus, although the court did not require evidence of actual anticompetitive effects in the form of increased prices or reduced output, the plaintiff in *Appleton* (unlike the plaintiffs in *CDC* and *Gilbarco*) was able to defeat summary judgment through proof of a market structure that made such anticompetitive effects reasonably likely.[121]

4. Dentsply

Enforcement agency challenges to vertical exclusive dealing arrangements have been rare in recent years, but *Dentsply* was such a case. In 2001, the district court denied a summary judgment motion by the defendant seeking dismissal of the Justice Department's claims under

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[118] *Id.* at 1143.

[119] *Id.* at 1144 (citation omitted).

[120] *Id.*

[121] *Id.*; *cf.* Bepco, Inc. v. Allied-Signal, Inc., 106 F. Supp. 2d 814 (M.D.N.C. 2000). *Bepco* rejected exclusive dealing claims in the sale of re-manufactured valves and compressors used in truck airbrake systems. Although the asserted foreclosure rates of 18.5 to 21.5% "lie on the margin of what is considered to be significant," the court found that there was nothing to suggest that this foreclosure was significantly harmful to competition. Bepco could expand through another dealer channel and through direct sales to automotive claim stores. Moreover, the relevant markets were characterized by the presence and expansion of numerous competitors, new entry, and "vigorous competition." The agreements, moreover, were terminable on 30 days' notice. They also eliminated forms of free riding and were, therefore, on balance procompetitive. These factors led to dismissal of the § 1 and § 3 exclusive dealing claims, and to a conclusion that Bepco had failed to prove sufficient market power to support an actual or attempted monopolization claim under § 2. *Id.* at 828–32.

Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act.[122] Reinforcing *Appleton*, the district court's decision established that the mere availability of alternate means of distribution and brief contract duration are not conclusive defenses in all cases.

Dentsply is the nation's largest manufacturer of artificial teeth, with a market share that has ranged from 70 to 80 percent over the last ten years. The Government challenged Dentsply's exclusive dealing policy with thirty independent dealers, through which all of Dentsply's teeth were sold. Dentsply did not dispute, for purposes of its motion, that the sale of artificial teeth in the United States was an appropriate relevant market or that Dentsply had monopoly power in that market. Its motion for summary judgment was based primarily on two arguments: (1) that any foreclosure was insubstantial because competitors could sell directly to dental laboratories, use non-Dentsply dealers, or induce dealers not stocking artificial teeth to begin doing so; and (2) that Dentsply's exclusive arrangements were terminable at will without cause at any time, allowing competing teeth suppliers to compete for the distribution business of Dentsply's distributors at all times.

The district court rejected both arguments and denied the motion. With regard to the argument that other dealers and distribution channels were available, the court concluded that issues of fact precluded a determination that these alternatives were necessarily viable.[123] The Government pointed to evidence that direct sales were considerably more costly than selling through established dental dealers and that the non-Dentsply dealers cited by the defense in fact had little experience or effectiveness in distributing artificial teeth to dental laboratories, the purchasers of artificial teeth.[124] With regard to the argument that the dealer agreements were terminable at will at any time, the district court again found that issues of fact precluded summary judgment but, apart from distinguishing generally the cases where the short-term nature of exclusive agreements led to rulings in defendants' favor,[125] the court did not really explain why the short-term aspect of Dentsply's arrangements did not warrant judgment as a matter of law.[126] The argument advanced in the Government's brief, on which the district court presumably relied, was

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[122] United States v. Dentsply, Inc., 2001-1 Trade Cas. (CCH) ¶ 73,247 (D. Del. 2001).

[123] *Id.* at 90,140–41. Dentsply also argued that its business justifications warranted summary judgment. The district court had little difficulty rejecting that argument. *Id.* at 90, 141.

[124] Government's Memorandum in Opposition to Motion for Summary Judgment at 26–35, United States v. Dentsply, Inc., No. 99-005 (D. Del. filed May 3, 2000), *available at* www.usdoj.gov/atr/cases/f7000/7048.pdf [hereinafter *DOJ Dentsply Memorandum*].

[125] *See* cases cited *supra* note 86.

[126] 2001-1 Trade Cas. at 90,139–41.

that, "as a practical matter, [the agreements were] self-perpetuating" because no dealer would abandon the powerful Dentsply line altogether to carry one of the smaller brands.[127] The Government, relying on *Appleton*,[128] argued that the short-term nature of the agreements was a factor to be considered, but not controlling, absent proof that a sufficient number of dealers would switch to competing suppliers to facilitate meaningful entry into the relevant market. Perhaps most importantly, the Government also presented evidence that the effect of exclusive distribution had been to allow Dentsply to raise market prices, restrict output, and reduce market quality by precluding the effective distribution of superior artificial teeth products.[129] This evidence of actual anticompetitive effects places the *Dentsply* ruling comfortably within the pattern of the other post-*Gilbarco* decisions.

B. Monopolization Through Exclusive Dealing

1. Microsoft

The facts of the *Microsoft* case are well known, and the discussion here will be limited to the exclusive dealing aspects of the proceedings. Microsoft had entered into arrangements with various computer manufacturers (OEMs), Internet access providers, Internet content providers, independent software vendors, and Apple Computer providing for some measure of exclusivity for its Internet Explorer browser (IE) versus Netscape's Navigator. Most of the agreements were entered into at times when Navigator held a substantial lead over IE in browser usage. Microsoft was able to achieve its exclusive arrangements through the power of its Windows operating system—insisting, for example, that OEMs not display Navigator on their computers' initial start-up screens, or that the Internet access providers distribute IE rather than Netscape Navigator as a condition for inclusion in the Windows "online services" folder.

The Government challenged the exclusive and partially-exclusive arrangements in three "exclusive dealing" contexts: (1) as unlawful exclusive dealing under Section 1 of the Sherman Act; (2) as supporting an attempt to monopolize the market for Internet browsers; and (3) as contributing to the maintenance of monopoly power in the operating systems market by the suppression of Netscape's Navigator as "middleware"—a platform for the launching of software applications independent of the underlying operating system. The district court ruled for Microsoft on the Section 1 claim, but found in the Government's favor

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[127] *DOJ Dentsply Memorandum*, *supra* note 124, at 24–25.

[128] 35 F. Supp. 2d 1138 (D. Minn. 1999); *see supra* notes 117–21 and accompanying text.

[129] *DOJ Dentsply Memorandum*, *supra* note 124, at 16–17.

on both the attempted monopolization and monopoly maintenance claims under Section 2.

The district court rejected the Section 1 claim because Microsoft had not "completely excluded Netscape" from reaching any potential user in that Netscape could be (and regularly was) downloaded free on the Internet or made available widely through independent distribution of free CD-ROMs. Focusing on percentage foreclosure instead of competitive effects, the district court determined that Section 1 had not been violated because the evidence failed to demonstrate "that Microsoft's arrangements excluded Netscape altogether from access to [at least] forty percent of the browser market."[130] With regard to the Section 2 claims, however, the district court found that the arrangements had excluded Netscape from the most efficient means of distribution without sufficient justification and therefore contributed unlawfully to an attempt to monopolize the browser market and to the unlawful maintenance of the monopoly of PC operating systems.

The court of appeals affirmed in part and reversed in part. The Government did not appeal the ruling on the Section 1 claim, leaving it intact at the appellate level—but the court of appeals clearly signaled its disagreement.[131] The court said that a monopolist's use of exclusive contracts may violate Section 2 "even though the contracts may foreclose less than the roughly 40% or 50% share usually required" under Section 1, but it otherwise ruled that the standards under Sections 1 and 2 for evaluating exclusionary conduct are essentially the same.[132] The appeals court held that Microsoft's arrangements had violated Section 2, permitting Microsoft to maintain its operating system monopoly, by denying Netscape the most cost-effective means of distribution without sufficient competitive justification. The court flatly rejected any "total exclusion" test, holding that "although Microsoft did not bar its [browser] rivals from all means of distribution, it did bar them from the cost-efficient ones."[133] By raising its rivals' costs, Microsoft was able to maintain its market position notwithstanding the availability of alternative but less efficient means of distribution for rivals. The court ruled that each category of exclusive dealing arrangement, considered individually, violated Section 2 as an exclusionary act designed to block the middleware threat represented by Netscape, allowing Microsoft to maintain its

[130] United States v. Microsoft Corp., 87 F. Supp. 2d 30, 52–53 (D.D.C. 2000), *aff'd in part, rev'd in part,* 253 F.3d 34 (D.C. Cir.), *cert. denied,* 122 S. Ct. 350 (2001).

[131] *See* 253 F.3d at 70 ("Even assuming the [district court's § 1] holding is correct, however, we nonetheless reject Microsoft's contention.").

[132] *Compare* 253 F.3d at 70 *with* 87 F. Supp. 2d at 58–59.

[133] 253 F.3d at 64.

monopoly of the market for PC operating systems.[134] The evident inconsistency between the district court's finding of no Section 1 liability and the affirmance by the court of appeals of liability under Section 2 (finding the same conduct anticompetitive) was attributable to the circuit court's rejection of the district court's reliance on percentage foreclosure rather than competitive effect.

The district court's attempted monopolization ruling, however, was reversed. Despite the determination that Microsoft's arrangements had denied Netscape access to the most cost-effective means of distribution of its browser, the court of appeals concluded that the Government had failed to establish that browsers comprised a valid relevant product market or that barriers to entry protect a putative monopolist's power within such a market. Because a "court's evaluation of an attempted monopolization claim must include a definition of the relevant market" and a showing of barriers to entry, the attempt claim was deficient as a matter of law. Proof of exclusionary conduct, without proof of power, was not enough.[135]

2. PepsiCo v. Coca-Cola

The *PepsiCo* decision was important in reinforcing the need for proof of real market power in a well-defined relevant market to sustain an exclusive dealing claim. The facts of the case centered on the fountain syrup channel of the soft-drink industry.[136] Fountain syrup is sold to restaurants, movie theatres, sports venues, convenience stores, and other retail outlets. It is then mixed with carbonated water at the point of sale and served to consumers for on-premise consumption.

Pepsi historically had relied on its bottling system for all its fountain distribution. Coke, however, used a variety of distributors, including "foodservice distributors" (FSDs), companies that deliver most of their restaurant-customer's supplies (including meat, sauce, utensils, and the like) on a single truck. Just as Pepsi bottlers were prohibited from carrying Coca-Cola products, Coke prohibited all its distributors—bottlers, wholesalers, and FSDs—from carrying any competing cola products, especially Pepsi. Thus, in 1997, when Pepsi revised most of its bottler agreements to permit FSD delivery for the first time, Coca-Cola enforced the "Conflict-of-Interest" clauses in its distributor agreements (which precluded

[134] *Id.* at 59–74.

[135] *Id.* at 80–81, 95 (citing Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993)).

[136] PepsiCo, Inc. v. Coca-Cola Co., 114 F. Supp. 2d 243 (S.D.N.Y. 2000), *appeal pending*, No. 00-9342 (2d Cir. argued Oct. 11, 2001). (The author represents The Coca-Cola Company in this case.)

the FSDs from carrying competing colas) and the vast majority of the FSDs unsurprisingly elected to stay with Coke.

Perhaps recognizing that the *Gilbarco* decision had made challenges to exclusive dealing arrangements with distributors much more difficult in contexts where alternate means of distribution were available, as well as the case law supporting the legality of Coke's agreements with the FSDs because they were terminable at will on ten days notice,[137] Pepsi characterized its case primarily as one for actual or attempted monopolization under Section 2 of the Sherman Act, confining the market to fountain syrup sales made through FSDs only. This, at least in theory, made the foreclosure percentages much higher and allowed Pepsi to rely on Section 2 refusal to deal cases, especially *Lorain Journal Co. v. United States,*[138] as an answer to the argument that the agreements were terminable on short notice. Initially, Pepsi's strategy worked. Coke moved to dismiss the complaint based on the inadequacy of the relevant market and the short-term nature of the agreements, but the district court denied the motion in all respects.[139] Relying on cases like *Staples*[140] and *Cardinal Health*,[141] the district court held that a relevant market could be limited to one method of product distribution if it could be shown, as Pepsi alleged, that other methods were not acceptable substitutes.

On summary judgment, however, the district court rejected Pepsi's case as unsupported by the evidence.[142] The district court ruled that proof of a valid product market was an indispensable element of Pepsi's claims both under Section 1 and Section 2 of the Sherman Act and that Pepsi's proof of a product market limited to fountain syrup distributed by FSDs was legally insufficient. The district court determined that FSD delivery, however desirable, was just one of many factors considered—and therefore insufficient to establish a separate market.[143]

Pepsi also argued that there was a significant cost difference between the methods of delivery and that Pepsi's exclusion from FSD delivery raised its costs, allowing Coca-Cola to exercise market power. Yet any

137 *E.g., Gilbarco,* 127 F.3d at 1163–64; Balaklaw v. Lovell, 14 F.3d 793, 799 (2d Cir. 1994); Paddock Publ'ns v. Chicago Tribune Co., 103 F.3d 42, 44 (7th Cir. 1996); Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984).

138 342 U.S. 143 (1951).

139 PepsiCo, Inc. v. Coca-Cola Co., 1998-2 Trade Cas. (CCH) ¶ 72,257 (S.D.N.Y. 1998).

140 FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

141 FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34 (D.D.C. 1998).

142 114 F. Supp. 2d at 247–59. Pepsi also advanced a claim that Coca-Cola's agreements with the FSDs amounted to a per se unlawful horizontal group boycott. That claim was dismissed as well. *Id.* at 259–60.

143 *Id.* at 256-59.

cost difference, if there was one, did not translate into a price difference. Nor was there any evidence that Coca-Cola's margins were any higher on sales of FSD-delivered syrup, the supposedly monopolized product, than on syrup delivered by other means. Thus, in contrast to cases like *Staples*, where office superstore prices were 13 percent higher when not faced with competition from other superstores,[144] the district court found no basis for concluding that the cost differences Pepsi alleged had any material impact on reasonable interchangeability from the buyer's perspective. Absent any evidence of impact on prices to customers, the court concluded that evidence of cost differences provided no basis for defining a separate product market.[145] The lack of evidence of actual or probable harm to competition entitled Coca-Cola to summary judgment.

C. Loyalty Discounts

Section 3 of the Clayton Act and Section 1 of the Sherman Act apply, not just to take-it-or-leave-it exclusive dealing, but to agreements where the availability of discounts or rebates is conditioned on exclusive dealing (or at least on the commitment of a large portion of the buyer's requirements). The text of Section 3, in fact, refers expressly to any agreement to sell or lease goods "or [to] fix a price charged therefor, or discount from, or rebate upon, such price" conditioned on an agreement not to deal with the goods of a competitor.[146] And many of the earliest cases involving challenges to exclusive dealing arrangements were based on exclusivity procured through significant discounts or rebates.[147]

Some recent cases have involved allegations that the defendant's discount programs amounted to de facto exclusive dealing, invoking the Supreme Court's rulings in *United Shoe* and *Tampa Electric* that exclusive dealing analysis applies to agreements that have exclusivity as their "practical effect" as well as those that impose exclusivity expressly.[148] One well-known proceeding, the original *Microsoft* 1994 consent decree, involved Microsoft's "per processor" license, pursuant to which computer manufacturers were required to pay Microsoft a license fee for each computer sold, whether the Microsoft operating system (DOS at the time) was

[144] 970 F. Supp. at 1074–78.

[145] 114 F. Supp. 2d at 257–58. The court also noted the testimony of the former CEO of Pepsi-Cola North America, Brenda Barnes, that "never ever would I think of or refer to a delivery method as a market." *Id.* at 253.

[146] Clayton Act § 3, 15 U.S.C. § 14 (2000).

[147] *See* cases cited *supra* notes 11, 23–24.

[148] *Tampa Elec.*, 365 U.S. at 326; *United Shoe*, 258 U.S. at 457.

used or not—a program that obviously dissuaded computer manufacturers from using other operating systems.[149]

More recently, the Eighth Circuit in *Concord Boat Corp. v. Brunswick Corp.*[150] reversed a treble-damage award of over $130 million premised on claims of de facto exclusive dealing resulting from an allegedly coercive discount program. Brunswick was the leading seller of "inboard and stern drive marine engines," i.e., the motors in most recreational motor boats. Its share of this market ranged from 50 to 75 percent, fluctuating from year to year. Brunswick initiated a pricing program under which buyers taking sixty percent of their requirements from Brunswick obtained a one percent discount. The discount increased to 2 percent for a 70 percent commitment and 3 percent for an 80 percent commitment. Commitments were of one year's duration, but discounts amounting to an additional 1–2 percent were available for commitments of two to three years. Volume discounts of up to 5 percent, based on total quantities purchased, also were available.[151] Concord, a competing engine supplier, charged that the discount program effectively coerced customers into obtaining the dominant portion of their requirements from Brunswick.

The Eighth Circuit held that Brunswick was entitled to judgment as a matter of law because the discount program did not confer or enhance any ability to charge supracompetitive prices.[152] Although the court recognized that a discount program could be sufficiently coercive to amount to de facto exclusive dealing, the evidence presented did not show that it was in fact economically difficult for customers to switch, and in fact there was considerable evidence of switching. This fact, coupled with the easily terminability of the agreements and the absence of barriers to entry, persuaded the court there was no substantial foreclosure.[153] Because customers benefited from the lower prices and were not likely to face higher prices in the future, the plaintiff's claim failed as a matter law.

[149] United States v. Microsoft Corp., 59 Fed. Reg. 42,845 (D.D.C. Aug. 19, 1994) (consent decree). *See* United States v. Microsoft Corp., 56 F.3d 1448 (D.C. Cir. 1995) (upholding decree).

[150] 207 F.3d 1039 (8th Cir. 2000).

[151] *Id.* at 1044.

[152] *Id.* at 1056, 1058–61.

[153] *Id.* at 1059–60. The court of appeals placed some emphasis on the fact that several Brunswick customers purchased a greater portion of their requirements from Brunswick than they had to in order to qualify for the maximum discounts. Why this fact was viewed as so important is unclear. Perhaps the court believed that these purchases indicated that the discounts were not coercive. It seems at least as plausible, however, that a buyer obtaining 80% of its boat engines from one supplier to achieve the maximum discount would purchase the remainder from the same supplier as a matter of convenience.

Avery Dennison Corp. v. ACCO Brands, Inc.[154] reached a different result. The case involved the market for "the sale of machinable labels to commercial customers," i.e., customers that sell office supply products to businesses. The district court concluded that, for summary judgment purposes, ACCO had provided sufficient evidence to create an issue of fact in support of this market definition and to demonstrate that Avery (with a 75 percent share) had monopoly power in the market.[155] The court also found sufficient evidence of significant barriers to entry and competitive expansion.

The conduct challenged by ACCO consisted primarily of cash payments and rebates paid for exclusivity—such as a $2 million payment for three-year exclusivity at Corporate Express, another $2 million for exclusivity at United Stationers, and rebates paid to other customers. There was also evidence, consisting primarily of internal Avery documents, that Avery believed its programs would lead ACCO to contract its sales expansion strategy and that the cost of the programs would be recouped by Avery through supracompetitive pricing.[156] The court denied Avery's motion for summary judgment, concluding that the evidence of anticompetitive conduct was sufficient to create an issue of fact.[157] ACCO prevailed where Concord Boat had failed because the *Avery* court found a likelihood of actual consumer harm in the form of higher prices.

[154] 2000-1 Trade Cas. (CCH) ¶ 72,882 (C.D. Cal. 2000).

[155] *Id.* at 87,554–57. The principal "barriers," however, were "entrenched buyer preferences" and "Avery's ties with its commercial customers." Why these factors qualified as entry barriers, rather than the consequences of competition, was not stated.

[156] *Id.* at 87,559. ("The consumer leverage we develop will allow us to renegotiate better backend deals upon the termination of the multiyear deals."). There appears to have been no suggestion, however, of pricing below cost. Some aspects of the *Avery* decision seem questionable and even troubling. The court, for example, viewed trade promotional activities in response to Acco's initiatives as anticompetitive based only on evidence that Avery reduced promotional support for those customers who reduced Avery's proportion of the products sold. *Id.* Why offering better net pricing to customers that provide greater support for the supplier's products is harmful to competition was not explained.

[157] *See generally* Willard K. Tom, David A. Balto & Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615 (2000). Some other recent cases involved allegations of "bundling" of discounts—assertions that a firm with a dominant position in one product line has used that position to force sales of a related product in which the firm faces more substantial competition. *Compare* LePage's Inc. v. 3M, 277 F.3d 365 (3d Cir. 2002) (rejecting claim), *rehearing en banc granted, judgment vacated*, Nos. 00-1368, 00-1473 (3d Cir. Feb. 25, 2002), *and* Virgin Atl. Airways Ltd. v. British Airways PLC, 257 F.3d 256 (2d Cir. 2001) (rejecting claim) *with* SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056 (3d Cir. 1978) (accepting claim), *and* Ortho Diag. Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455 (S.D.N.Y. 1996) (accepting some claims, rejecting others). Although these cases can involve issues relevant to exclusive dealing analysis, the decisions more typically focus on tying and other doctrines. A full discussion of these cases is outside the scope of this article.

D. Exclusive Promotions or Displays

A few cases have been based, not on exclusive *dealing*, but on partial exclusivity or preferential treatment in retail promotional activity or retail displays. Because the plaintiffs' products in these cases remain available in retail stores, the cases involve no traditional "foreclosure" as such at all. One recent case found the arrangement in issue sufficiently problematic as to grant the plaintiffs a preliminary injunction, but later reversed course and granted summary judgment for the defense. Other cases have typically rejected the plaintiffs' theories out of hand.

R.J. Reynolds Tobacco Co. v. Phillip Morris Inc. (RJR I)[158] involved a challenge by several tobacco companies to the "Retail Leaders" program instituted by Philip Morris. This program provided a number of levels of funding to retailers in return for specified display space. In 1999, the smaller cigarette firms moved for a preliminary injunction barring continued implementation of the Retail Leaders program, and the court granted the motion. At that stage of the case, based on evidence that Phillip Morris' market share was approximately 50 percent, the court found that Phillip Morris had market power in the relevant market. The court determined that the Retail Leaders program extended that market power by requiring display space and signage requirements substantially in excess of Phillip Morris' market share. Because of restrictions against advertising and visibility of cigarettes, display place and visibility were "uniquely critical in the cigarette industry."[159] The court concluded that "[t]he Retail Leaders program is a classic example of [the use] of market power to gain a significant competitive advantage by handicapping rivals and diminishing their ability to compete," and that "[e]arlier cases involving shelf space are readily distinguishable from this case . . . in that a serious question as to the defendant's power to coerce retailers was not present in those cases."[160]

In 2002, however, the same court granted summary judgment dismissing the case.[161] On the more complete record generated by discovery, the *RJR II* court found the evidence insufficient to establish that Philip Morris had market power. Notwithstanding "the fact that [Philip Morris] owns a dominant share of the market,"[162] the evidence demonstrated recent entry and expansion by small fringe firms, competitive pricing,

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[158] 60 F. Supp. 2d 502 (M.D.N.C. 1999).

[159] *Id.* at 505.

[160] *Id.* at 510–11.

[161] R.J. Reynolds Tobacco Co. v. Phillip Morris Inc. (*RJR II*), 199 F. Supp. 2d 363 (M.D.N.C. 2002), *appeal docketed,* No. 02-1595 (4th Cir. June 2002).

[162] *Id.* at 383.

and significant excess capacity possessed by Philip Morris's rivals. These factors, the court said, precluded any inference of market power. And because market power was an essential element of the plaintiffs' claims, the court granted summary judgment.[163] As an alternative ground, the court held that summary judgment would be required even if Phillip Morris had market power because there was insufficient evidence of foreclosure and, hence, no proof of competitive harm. Even if the Retail Leaders program was viewed as having foreclosed 34 percent of the market, the court concluded that "Plaintiffs can successfully compete against Retail Leaders" and that, particularly in light of the ability of customers to terminate Retail Leaders agreements without penalty on thirty days' notice, "retail product and display space are subject to uninterrupted competitive bidding, and Plaintiffs are not substantially foreclosed from the relevant market."[164]

Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co.[165] reached the same result. In *Louisa,* a bottler of Coca-Cola alleged that the local Pepsi bottler had unlawfully excluded it from retail promotional activity. As in most other cases involving arrangements for preferred shelf or display space or promotional activity,[166] the court in *Louisa* concluded that the defendant's better treatment from retailers resulted from hard competition for the retailer's business and that, absent some evidence that the plaintiff's products were in fact excluded from retail outlets, no antitrust violation could be found. Greater promotional efforts and lower prices had a negative effect on the plaintiff's sales, but that effect was the expected (and desired) result of the competitive process.[167]

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[163] *Id.* at 384–85. Fringe expansion was only from a 0.6% share in 1996 to 4.1% in 2001. Cigarette prices, moreover, are notoriously high in part because of state and federal taxes. Accordingly, the most important factor in the court's analysis was excess capacity. Reliance on that factor in an exclusivity case seems odd. An effective exclusive arrangement prevents excess capacity from being utilized.

[164] *Id.* at 391.

[165] 94 F. Supp. 2d 804 (E.D. Ky. 1999).

[166] *See, e.g.,* Bayou Bottling, Inc. v. Dr Pepper Co., 725 F.2d 300, 304–05 (5th Cir. 1984); Jays Foods, Inc. v. Frito-Lay, Inc., 664 F. Supp. 364 (N.D. Ill. 1987), *aff'd mem.*, 860 F.2d 1082 (7th Cir. 1988); Beverage Mgmt., Inc. v. Coca-Cola Bottling Corp., 653 F. Supp. 1144, 1148 (S.D. Ohio 1986); Frito-Lay, Inc. v. Bachman Co., 659 F. Supp. 1129, 1134 (S.D.N.Y. 1986).

[167] 94 F. Supp. 2d at 813–15.

E. Exclusive Dealing as a Defense

United States v. Visa USA, Inc.[168] involved two matching expulsion rules imposed by Visa and MasterCard upon their card-issuing bank members. For years, banks have been able to issue cards on the Visa network, the MasterCard network, or both. Visa By-law 2.10(e) allows any issuer of Visa payment cards to issue cards on the MasterCard network, but it requires the expulsion of any member bank that issues cards on the American Express or Discover networks. MasterCard's Competitive Programs Policy (CPP) similarly allows MasterCard issuers to issue Visa cards, but requires expulsion of members issuing any American Express or Discover cards.[169]

The Department of Justice challenged these "exclusionary rules" under Section 1 of the Sherman Act. The complaint alleged that By-law 2.10(e) was a horizontal combination of the bank members of Visa that restrained trade unreasonably in the market for issuing credit and charge cards to consumers and in the distinct market in which banks obtain card network services from the networks. The CPP was challenged, on the same bases, as a combination of the bank members of MasterCard. After a lengthy trial, the district court concluded that By-law 2.10(e) and the CPP were "clearly show[n]" to have a significant adverse impact on competition and consumer welfare in both markets and, therefore, "should be abolished."[170]

The district court concluded that both Visa and MasterCard had market power, collectively and individually, in the market for providing credit and charge card network services to bank issuers. And within that market, the court held that the exclusionary rules harmed competition and consumers. Banks represented essentially all the customers of network services, but were limited to just two choices, Visa and MasterCard. Because American Express and Discover would have competed for the business of banks by offering better financial terms than Visa and MasterCard and different, potentially superior, network services, the effect of the exclusion rules in reducing price competition, restricting output, impairing innovation, and reducing quality and consumer choice was apparent.[171]

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[168] 163 F. Supp. 2d 322 (S.D.N.Y. 2001), *appeal pending*, No. 02-6074 (2d Cir.). (The author represents American Express in this case.)

[169] These rules exist only in the United States. Because of opposition from the European Union and other competition authorities abroad, 2.10(e) and the CPP have been abandoned (or prevented) everywhere else in the world. *Id.* at 380.

[170] *Id.* at 327, 329–30.

[171] *Id.* at 388–99. The effect in the network services market was an important factor distinguishing *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958 (10th Cir. 1994), on which

The Government asserted no exclusive dealing claim. Rather, the defendants in *Visa* raised exclusive dealing issues as an attempted defense. Specifically, the defendants, relying on the district court decision in *Microsoft*,[172] maintained that the ability of American Express and Discover to reach all consumers through the mail precluded any kind of finding of consumer harm. The district court rejected the argument on several grounds. Most importantly, the exclusionary rules adversely affected price, output, consumer choice, and innovation in the relevant network services market *notwithstanding* the ability of American Express and Discover in the issuing market to reach all consumers through the mail. Moreover, even if foreclosure had been the issue, the defense argument ignored the foreclosure effect in the network services market. The customers in that market were the banks, and the exclusionary rules blocked American Express and Discover from access to any of them.[173] This foreclosure was competitively significant because banks were far more than mere distributors in the card-issuance market. Banks established the features and product configurations on the cards issued and were more properly viewed as co-manufacturers rather than distributors. Banks also provided access to consumer bank accounts that were not merely desirable but indispensable in allowing the American Express and Discover networks entry into the market for debit cards and for the future development of multi-function cards with combined debit, credit, smart chip, and other functions dependent on consumer bank account access.[174] Thus, notwithstanding the ability of American Express and Discover, as issuers, to reach consumers on their own, By-law 2.10(e) and the CPP were found to impair competition. The defendants' efforts to use exclusive dealing standards as a defense therefore failed.

Visa heavily relied. That case involved Visa By-law 2.06, which prevented a bank owned by Discover from joining Visa and issuing Visa cards. The court ruled against Discover for the basic reason that the preclusion of one bank from issuing Visa cards had no substantial adverse effect on credit card issuance because thousands of other issuers remained. For purposes of that analysis, the focus necessarily was at the issuer level, not the network level. The addition of Discover to the Visa network would also have allowed Discover to free ride on Visa's network—a consideration absent in the current *Visa* case where American Express and Discover were seeking to have banks ride on *their* networks. 163 F. Supp. 2d at 404–05.

[172] United States v. Microsoft Corp., 87 F. Supp. 2d 30, 53 (D.D.C. 2000), *aff'd in part, rev'd in part,* 253 F.3d 34 (D.C. Cir.), *cert. denied,* 122 S. Ct. 350 (2001). *See supra* text accompanying note 130.

[173] 163 F. Supp. 2d at 383.

[174] *Id.* at 392–94. In addition, even as "distributors," banks provided capabilities that American Express and Discover could not achieve through other means, including effective cross-selling opportunities with bank customers, many thousands of branches as points of sale, and additional scale and merchant acceptance. Visa and MasterCard had the benefit of thousands of issuers apiece and acknowledged that they would be much less

IV. LESSONS FROM THE ECONOMICS LITERATURE

The rise of Chicago School economic thought in the 1970s and 1980s included, unsurprisingly, a healthy dose of criticism for exclusive dealing doctrine of the time. The classic Chicago School critique, Judge Robert Bork's *The Antitrust Paradox*,[175] held that judicial treatment of exclusive dealing was "excessively harsh" because the courts' emphasis on foreclosure gave little if any weight to efficiencies and condemned arrangements that created no danger of consumer harm.[176] The analysis pointed out that, to gain an exclusive, even a monopolist must offer discounts or other advantages to buyers, and must do so for the life of the contract, "which means that, in terms of cutting out rivals, the [exclusive] contract offers [the monopolist] no advantages it would not have without the contract. The advantage of the contract must be the efficiency, and [there are] a variety of efficiencies that such contracts may create."[177] Accordingly, exclusion (as opposed to efficiency) was unprofitable and therefore unlikely.

As a number of "post-Chicago" writers have pointed out, this classic Chicago model implicitly assumes that buyers act in unison, that the seller cannot discriminate among buyers or negotiate with each one sequentially, and that buyers are final consumers or do not otherwise impose externalities on downstream purchasers.[178] Post-Chicago analyses demonstrate that, when these assumptions are relaxed, exclusive contracts can profitably deter entry by more efficient suppliers and otherwise harm consumers by enhancing the incumbent's market power.

The point is well illustrated in an article by Segal and Whinston.[179] As they explain, if there is no single buyer and buyers cannot coordinate their responses to an offer of exclusive contracts, anticompetitive exclu-

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effective competitors if limited, as were American Express and Discover, to just one. *Id.* at 389–92, 395.

[175] BORK, *supra* note 102, at ch. 15.

[176] *Id.* at 304–08.

[177] *Id.* at 304–05. *See also* RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 203–11 (1st ed. 1976); Howard Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982). For Judge Posner's more recent views, see RICHARD A. POSNER, ANTITRUST LAW 229–38 (2d ed. 2002).

[178] *See* JOHN SIMPSON & ABRAHAM WICKELGREN, THE USE OF EXCLUSIVE CONTRACTS TO DETER ENTRY 1 (FTC Working Paper No. 241, June 27, 2001), *available at* www.ftc.gov/be/workpapers/wp241.pdf; Ilya R. Segal & Michael D. Whinston, *Naked Exclusion: Comment*, 90 AM. ECON. REV. 296, 296–97 (2000).

[179] *See* Segal & Whinston, *supra* note 178. An earlier, and significant, "post-Chicago" paper on exclusive dealing was Phillipe Aghion & Patrick Bolton, *Contracts as a Barrier to Entry*, 77 AM. ECON. REV. 388 (1987). Their analysis demonstrated that an incumbent monopolist can sign long-term contracts that do not preclude entry completely but exclude enough lower cost entry to make exclusion profitable.

sion is possible to prevent an entrant or smaller existing competitor from realizing necessary economies of scale. For example, a monopoly seller may be able to tie up some key buyers (or distributors) with significant discounts, offering progressively lower discounts to the next and the next. The early buyers will be motivated to sign exclusives by reason both of the discount and the belief that other buyers will grab the best discounts if they do not. When enough buyers are signed to prevent smaller firms or entrants from achieving efficient scale, remaining buyers will have to pay a price at or near the monopoly level. In this scenario, blocking entry is profitable both for the seller and for the early buyers who benefit from the discounts that later signers are denied; the later buyers pay supracompetitive prices, as do consumers who paid increased prices to the distributors whose costs (and therefore prices) have been elevated by the exclusionary arrangement.[180] The same result can be achieved, without dealing sequentially, through price discrimination.[181] As the "raising rivals' costs" literature demonstrates, the effect of these strategies may be to deter or impede entry or, similarly, to weaken the ability of existing smaller rivals to constrain the defendant's market power.[182]

These post-Chicago models in fact underlie the theory—but not necessarily the facts—behind the recent cases discussed in Part III above. In these cases, the plaintiff has made some variant of the argument that the defendant has made financially compelling offers to (usually downstream) buyers that make competitive expansion by smaller rivals difficult or impossible. As Judge Posner points out, however, this is only one piece of the analysis: "The issue is not the exclusion of a lower-cost entrant; it is the preservation of monopoly."[183] Put differently, exclusion of rivals (or increasing their costs) is harmful only if the exclusion is

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[180] Segal & Whinston*, supra* note 178, at 304, 307. To the same effect, see Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why* Aspen *and* Kodak *Are Misguided*, 68 ANTITRUST L.J. 659, 667–70 (2001). In addition, as explained in SIMPSON & WICKELGREN, *supra* note 178, a similar result can be achieved even in the absence of scale economies by offering buyers discounts geared to later time periods. Buyers who decline to sign lose profits to those that do sign, creating a prisoner's dilemma motivating all buyers to sign.

[181] Segal & Whinston*, supra* note 178, at 305. David Sibley provides the following example. The market has a single monopoly seller (*M*) and fifteen buyers. If entry is excluded, *M*'s monopoly profit is $3 per customer. If entry occurs, however, each buyer gains $5 in savings. Due to high fixed costs, entry is not profitable if five or more buyers sign long-term contracts with *M;* but *M* must discount price by $5 to get the buyers to sign. Under this scenario, signing five buyers and deterring entry is profitable. The fifteen total buyers at $3 yield revenue of $45, reduced by the cost of five exclusives at $5 each, or $25—a net profit of $20.

[182] *See supra* notes 99–100 and accompanying text.

[183] POSNER, ANTITRUST LAW, *supra* note 177, at 233.

not based on efficiencies or competition on the merits *and* if it creates or protects market power. The post-Chicago analyses thus aid the understanding that exclusive dealing can be both competitively harmful and profitable, but determining whether exclusive dealing in a given case *is* harmful requires further analysis—as addressed in Part V below.

V. CONSUMER HARM AND BENEFITS FROM EXCLUSIVE DEALING

On the most basic level, the outcomes in the many recent exclusive dealing decisions were different. The plaintiff prevailed in *Appleton, Visa, Avery, RJR I,* and *Dentsply*, won some and lost some in *Microsoft*, and lost in *Pepsi, Gilbarco, RJR II, CDC, Louisa,* and *Concord*. But in fundamental respects, the decisions were entirely consistent.

In each instance in which the relevant market was established and the defendant's market power shown, the defendant lost. Where the market was not proven or where market power was otherwise not shown, the defendant won—even where the defendant's share was very high. This was no fluke. Proof that real market power was subject to expansion or protection by the exclusive arrangements in issue was central to any viable theory of competitive harm the plaintiffs advanced. There was fundamental agreement in the decisions that exclusive dealing—particularly with distributors or other intermediaries—poses no threat to consumers unless it raises the costs of (or otherwise impairs) rivals to a substantial extent *and*, in so doing, permits the defendant to raise (or maintain) prices above or restrict output below the competitive level.

In the cases where liability was found, there was substantial proof of actual or likely consumer harm from the exercise of market power. In *Pepsi*, *Louisa,* and *Concord*, the failure to prove market power, coupled with the undisputed evidence of competitive pricing, demonstrated the absence of consumer injury. The court in *Avery*, in contrast, emphasized the evidence that Avery expected to raise prices once the competitive threat from Acco had been removed. In *Dentsply*, at least for summary judgment purposes, the Government prevailed based on its direct evidence of increased prices and diminished quality. In *Visa*, the exclusion rules led directly to higher prices and reduced output in the market for card network services, and to reduced output, innovation, and brand competition in the credit and charge card issuance market. In *Microsoft*, the proof of consumer harm was considerably more subtle, but nevertheless substantial. The possession of monopoly power in computer operating systems harms consumers immediately through increased prices—consider, for example, Microsoft's 2001 pricing initiatives with corporate customers and the "activation" feature for Windows XP[184]—and over the longer run through diminished innovation.[185] Microsoft's liability was based on findings that the exclusionary arrangements contributed to the maintenance of its monopoly power.

Considered as a group, these recent exclusive dealing decisions can help place some structure and order on the method for analyzing exclusive dealing arrangements in any given case. The principal teachings are set forth below.

A. The Focus on Consumer Harm

As with the larger body of modern U.S. antitrust law, it is common to say that the focus of exclusive dealing analysis should be on "consumer harm." But what does that mean? There is general agreement that consumer harm includes reductions in allocative efficiency—the "deadweight" or welfare loss reflected in standard microeconomic models, generally derived from a restriction in output, and usually associated with an increase in price or reduction in quality.[186] Some observers include also (or instead) the "wealth transfer" effect that arises when, for example, prices are increased to consumers (and wealth is accordingly transferred to producers) without a reduction in output, as when a monopolist engages in perfect price discrimination.[187] Without re-engaging that debate in this article, the focus of the following discussion is on allocative efficiency.[188] Put differently, the source of the consumer harm addressed here is the creation, enhancement, or protection of market power—the power to increase prices, reduce output, diminish quality, or significantly restrict consumer choice.

What weight should be given to the interests of competitors? As a general proposition, the interests of competitors are adverse to those of

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[184] *See generally* Rebecca Buckman, *Microsoft Plan for Licenses Sparks Gripes*, WALL. ST. J., Sept. 25, 2001, at B3.

[185] *See* Jonathan M. Jacobson, *Do We Need A "New Economy" Exception for Antitrust?* ANTITRUST, Fall 2001, at 89, 91–92. *But cf.* Jonathan I. Gleklen, *Per Se Legality for Unilateral Refusals to License IP Is Correct as a Matter of Law and Policy*, ANTITRUST SOURCE, July 2002, *at* www.abanet.org/antitrust/source/July02/gleklen.pdf.

[186] *See* F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 21–29 (3d ed. 1990); 2A PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 502 (2d ed. 2002); BORK, *supra* note 102, chs. 4, 5.

[187] *Compare* Robert Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: the Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65 (1982) *with* BORK, *supra* note 175, chs. 2–6.

[188] One aspect of allocative efficiency that is considered here, and is often highly relevant in evaluating the impact of exclusionary conduct, is the social loss that arises when the resources of excluded rivals or customers are diverted from their most efficient uses. *See* Herbert Hovenkamp, *Antitrust's Protected Classes*, 88 MICH. L. REV. 1, 17–20 (1989).

consumers. Competitors make money when prices rise and consumers suffer correspondingly. But focusing on consumer harm does not mean that harm to rivals is irrelevant. On the contrary, harm to rivals can be critical because, in an exclusion case, impairment of competitors' ability to constrain the exercise of market power by the defendant is the mechanism by which consumer harm is caused. If the harm to rivals has no such consequence, it can be ignored. But if rivals' ability to constrain has been impaired or reduced, that effect ultimately can prove to be important.

B. FACTORS IN DETERMINING WHETHER THE ABILITY TO CONSTRAIN IS IMPAIRED

The cases, and general economic analysis, identify a number of factors relevant to the determination whether an exclusive arrangement is harmful to rivals in a way that also harms consumers. Although the cases still generally speak of this inquiry as one of "foreclosure," the percentage of the market "foreclosed" by an exclusive arrangement is rarely determinative and, often, not even interesting.

1. *Nature of the Exclusive Arrangement*

An initial inquiry into the nature of the exclusive arrangement is essential.[189] In each case, the court will be asked to distinguish between hard competition and exclusion. Every contract of sale is "exclusionary" in the sense that, once the sale is made, other sellers have been "excluded" from the transaction. That, of course, is not the law's concern. The issue is whether the exclusionary arrangement is likely to benefit consumers by making rivals compete harder (by lowering prices, improving quality, or the like) or to harm consumers by reducing rivals' ability to constrain defendants' market power.

In many cases, the exclusive arrangement will be one that has either expressly or implicitly been put up for bid by the customer in an effort to secure the best possible deal. This process may tend to favor larger or stronger firms, but where sought out or desired by the customer, it is fair to assume in the absence of contrary proof that the outcome is more likely to result in lower prices rather than to enhance the defendant's market power. For many customers, moreover, there may be valid reasons—such as the scarcity of shelf space or other resources—for wanting one rather than multiple suppliers in a given category. As Judge

[189] In this discussion, it is assumed that the "agreement" element of a claim under § 1 or § 3 has been satisfied. For a thorough discussion of this issue, see HOVENKAMP, *supra* note 101, ¶ 1821a.

Frank Easterbrook has explained, the competition to win an exclusive agreement may be particularly meaningful and beneficial:

> Competition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe, and it is common. Every year or two, General Motors, Ford, and Chrysler invite tire manufacturers to bid for exclusive rights to have their tires used in the manufacturers' cars. Exclusive contracts make the market hard to enter in mid-year but cannot stifle competition over the longer run, and competition of this kind drives down the price of tires, to the ultimate benefit of consumers.[190]

No test for separating the competitive exclusive arrangement from those that are exclusionary is likely to be determinative in each instance. But one of the key questions to be asked of any exclusive arrangement is whether it is profitable as a strategy without regard to the ability to raise prices once rivals have been weakened or removed.[191] Judge Bork put it this way in a related context:

> Predation involves the deliberate seeking of monopoly power by means other than superior efficiency, by means that would not be employed in the normal course of competition. Thus, predation involves aggression against business rivals through the use of business practices that would not be considered profit maximizing except for the expectation that (1) actual rivals will be driven from the market, or the entry of potential rivals blocked or delayed, so that the predator will gain or retain a market share sufficient to command monopoly profits, or (2) rivals will be chastened sufficiently to abandon competitive behavior the predator finds threatening to its realization of monopoly profits.[192]

The facts are often ambiguous on this point. Where they are, "ties" should go to the defendant—both because the plaintiff bears the burden of proof and because cases where exclusivity is truly harmful to consumers are sufficiently rare as to make reasonable a rebuttable presumption that the defendant is engaged in hard (rather than harmful) competition.

Several specific questions can aid the analysis. Is the agreement one for partial or complete exclusivity? Is the exclusivity take-it-or-leave-it or conditioned on a discount? If conditioned on a discount, are there viable alternatives for rivals and the affected customers or is the discount coercive? Is the likely effect of the arrangement to threaten the viability of competitors in a way to which they cannot respond, or to cause them to look harder to seek viable alternative means for reducing costs?

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[190] Paddock Publ'ns, Inc. v. Chicago Tribune Co., 103 F.3d 42, 45 (7th Cir. 1996).

[191] *See* Janusz Ordover & Robert Willig, *An Economic Definition of Predation: Pricing and Product Innovation,* 91 YALE L.J. 8 (1981).

[192] Neumann v. Reinforced Earth Co., 786 F.2d 424, 427 (D.C. Cir. 1986).

2. *Nature of Exclusive Resource*

Ascertaining the likely impact of an exclusive dealing arrangement also requires an analysis of the significance of the customer or other relationship asserted to have been foreclosed. Exclusive dealing with ultimate purchasers may block efforts by rivals to market their products. Conversely, as Richard Steuer's article explained, and as many courts have since ruled, exclusive dealing with a middleman is harmful only where the role of the middleman is especially important to effective competition.[193] In *CDC*, for example, the fact that the distributors in question provided only "qualified leads" was one of the most important factors in the Second Circuit's decision rejecting the plaintiff's claim. Similarly, in *Pepsi*, the evidence that PepsiCo competed effectively, and was able to cause Coca-Cola to reduce its prices significantly, without using the services of foodservice distributors, was compelling evidence that Coke's exclusive dealing arrangements with these distributors were not a meaningful source of market power or otherwise harmful to consumers. In *Visa*, in contrast, the only route to debit or other bank account-based card functionality was through banks; banks designed and established the features of the products that were sold; and banks provided customer relationships that could not be utilized as effectively through other means. And in *Avery*, *Dentsply*, and *Appleton*, the resources tied up by the defendants' exclusive arrangements were found to be sufficiently important as to allow the defendants to charge higher prices or, at least, to have an expectation of a future ability to do so.

Some cases, such as *Microsoft,* involve markets with significant network effects, i.e., where the product's utility increases with each additional user. Access to available distribution channels tends to be more important in network markets to enable rivals to achieve needed economies of scale and to avoid potential "tipping" of the market to a dominant firm.[194]

3. *Duration*

Two related factors long recognized as bearing significantly on the likely effect of an exclusive dealing agreement are the agreement's duration and the terms on which termination may be accomplished. Many cases have held that agreements terminable on short notice are lawful even if they nominally "foreclose" a significant portion of the relevant

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[193] Steuer, *supra* note 39; cases cited *supra* notes 53, 111, 143.

[194] *See* Posner, Antitrust Law, *supra* note 177, at 251–54. This was true in both *Visa* and *Microsoft.* For an invaluable discussion of network effects and exclusivity, see David Balto, *Networks and Exclusivity: Antitrust Analysis to Promote Network Competition*, 7 Geo. Mason L. Rev. 523, 530–37 (1999).

market. Indeed, several courts have held that ground alone to be a sufficient basis to reject an exclusive dealing claim.[195]

As several of the recent cases demonstrate, however, the short-term nature of an exclusive arrangement does not excuse careful analysis. Short duration is only dispositive where there is a real—not hypothetical—ability to terminate the agreement. *Dentsply* and *Appleton,* under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act, and the motion to dismiss decision in *Pepsi*, under Section 2, considered this issue squarely and rejected arguments that the mere fact of contractual language providing for terminability at will or on short notice made out a complete defense. In *Microsoft* and *Visa*, the issue was not addressed, but the agreements in those cases were generally not of long duration and yet that fact was not considered to be critical to the competitive analysis. In these cases, the duration of the agreements had little to do with the real-world lack of any credible ability of the affected customers to switch to alternatives. In *RJR II, CDC, Gilbarco*, and *Brunswick*, in contrast, the plaintiffs failed to raise an issue of fact suggesting that customers' ability to terminate was illusory or exaggerated.

4. *Increasing Rivals' Costs*

The main way in which exclusive dealing arrangements impair the ability of competitors to constrain the market power of firms imposing the arrangements is by increasing their costs. Thus, an agreement that in fact forecloses competitors from access to a substantial portion of a market may reduce the ability to constrain a dominant firm's market power by diminishing the competitor's customer base and, thus, its economies of scale. An exclusive with distributors may similarly cause rivals to incur greater costs in seeking out new avenues of distribution or in using higher cost distributors or methods of distribution.

But the implications of increasing rivals' costs are ambiguous for competition, and it is emphatically not true that raising rivals' costs alone suffices to establish consumer harm. The effect on rivals' costs may well be neutral or even a beneficial consequence of competition. The arguments advanced in cases like *Pepsi* demonstrate the point. PepsiCo argued that, at least in a market with just two significant competitors,

[195] *See supra* note 86 and accompanying text; *Gilbarco*, 127 F.3d at 1163–64; *Balaklaw,* 14 F.3d at 793; *Roland*, 749 F.2d at 395; *Barry Wright Corp.*, 724 F.2d at 237; *RJR II*, 199 F. Supp. 2d at 390–91; Main St. Publishers, Inc. v. Landmark Communications, Inc., 701 F. Supp. 1289, 1295 (N.D. Miss. 1988); Fran Welch Real Estate Sales, Inc. v. Seabrook Island Co., 621 F. Supp. 128, 137 (D.S.C. 1985); *In re* Apollo Air Passenger (Computer Reservation Sys.), 720 F. Supp. 1068, 1077 (S.D.N.Y. 1989); Satellite Fin. Planning v. First Nat'l Bank, 633 F. Supp. 386, 397 (D. Del. 1986); Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

an increase in the primary rival's costs—without more—is sufficient proof of consumer harm.[196] In *Pepsi*, however, the only proven consequence of Coke's exclusive dealing arrangements was that Pepsi was induced to compete more effectively and to improve its offering to customers. Prices to customers went down, and consumers gained the benefit.

If there is absolutely nothing else going on, an increase in marginal costs for the market as a whole would indeed represent an allocative efficiency loss and create grounds for concern. But apart from a case of bombing the plant of the competitor's distributor or the like, there are few scenarios in which the *only* impact of an exclusive dealing arrangement is an increase in rivals' costs.[197] There are almost always *some* efficiencies associated with exclusive dealing at the distributor level. Exclusive distribution provides incentives to the distributor to maximize sales of the supplier's brand. Even if the distributor performs no sales function, exclusivity provides a similar incentive to perform the basic delivery function more effectively. Having exclusive distributors, moreover, necessarily reduces the supplier's costs in monitoring the performance of the distributors to make sure they are not improperly favoring the rival's brand. The *strength* of any of these efficiencies may be questioned in any given case, but usually not their existence.

The nature of the increase in the rival's costs also needs to be examined carefully, for in many cases it may be a simple byproduct of competition. That would be the case, to cite one example, if a retailer put out invitations for an exclusive placement in return for the lowest cost bid. Exclusivity in this sense would increase rivals' costs in the sense of requiring them to reduce their margins (increasing the "cost" of discounts) but not in any way necessarily harmful to competition. And a rule that prevented monopolists from competing for these offered exclusives would result in higher, not lower, prices for consumers. Similarly, with respect to exclusivity with distributors, if the defendant, for example, procures exclusives with all the most effective distributors while its rivals remain idle, rivals' costs may increase but not in any way that necessarily poses a threat to the competitive process.[198] The effect of exclusivity in this instance may be instead to encourage the rival to develop new

[196] *See* Reply Brief for Plaintiff-Appellant PepsiCo, Inc. at 2–9, PepsiCo, Inc. v. Coca-Cola Co., No. 00-9342 (2d Cir. argued Oct. 11, 2001).

[197] The *Visa* case presents such a scenario, but it is not an exclusive dealing case. The Visa/MasterCard rules excluded smaller rivals—but not each other. The efficiencies normally associated with exclusive dealing were absent. Similarly, in *Conwood Co. v. United States Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002), unauthorized removal of competitors' products from retail stores involved costs to all affected parties but no efficiency gains.

[198] *See Gilbarco*, 127 F.3d at 1163.

methods of distribution, or to come up with programs designed to make the weaker distributors (not committed to the defendant) more effective, or to outbid the defendant the next time around for the contracts with the distributors the defendant is using.[199] A rule that would allow an inference of consumer harm without considering these potential effects as well has not received any support in the cases.

The character of the costs in issue must also be considered. Distribution is typically one of many inputs into a final product and may represent a relatively small portion of total costs. Even if distribution represents as much as 10 percent of total product costs and the exclusive arrangement raises distribution costs by 10 percent, the impact on total product costs is only one percent. Competitive effects of such low magnitude are not usually the source of serious antitrust concern. The point is underscored by the reality that firms' production costs differ, often dramatically, in every case. Plaintiff *P* may well be able to offset defendant *D*'s distribution cost advantage by reducing its ingredient costs, its labor costs, or through other means.[200] Courts have typically not inferred any enhanced ability to raise price from an adverse impact on rivals' distribution costs, without more.

An increase in rivals' costs may prove to be important in analyzing the competitive impact of a practice. But, standing alone, an increase in competitors' costs is not evidence of consumer harm.

C. Effect on Market Structure and Performance

Exclusive dealing arrangements may have a material effect on market structure. If they eliminate rivals altogether, for example, they may lead to increased market concentration and increase the potential for monopoly or coordinated interaction. They may directly reduce consumer choice. The significance of these effects can vary enormously, however, from case to case.

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[199] *See Paddock Publications,* 103 F.3d at 45.

[200] Importantly, however, in network market contexts, relatively lesser degrees of impairment or cost increase may prove to be competitively significant. In the *Microsoft* fact setting, for example, it is now a matter of historical reality that the exclusive and quasi-exclusive arrangements favoring Internet Explorer led to the wholesale displacement of Netscape Navigator as the browser of choice on the vast majority of computers in use today. And this occurred notwithstanding the fact that Netscape had numerous alternative means of distribution to consumers, including free downloads over the Internet. Netscape's ability to develop into a potential threat to Microsoft's operating system monopoly cratered as a direct result. Similar effects were present in *Visa*, 163 F. Supp. 2d at 392–95, and *United States v. FTD Corp.*, 60 Fed. Reg. 40,859 (E.D. Mich. 1995). *See generally* Balto, *supra* note 194, at 525–33.

1. *Market Concentration and Entry Barriers*

At the extreme, an exclusive dealing arrangement can create or maintain a complete monopoly. In *Pullman*, for example, the exclusive arrangements between the Pullman Company and the railroads helped preserve Pullman's sleeping car monopoly for many decades.[201] Similarly, in *Microsoft I,* the per-processor license allowed Microsoft to keep and maintain a virtual monopoly of operating systems for Intel-based personal computers.[202] In both instances, rivals were unable as a practical matter to compete for the business of any relevant customer. In other cases, an exclusive arrangement can tie up enough of the customer base—but not all—to permit the survival of just two or three firms. In yet other cases, such as *American Can*,[203] exclusive arrangements for the available low cost supply can force the exit of some or all competing firms, again reducing the number of market participants to few firms or even just one.

By essentially the same mechanisms, exclusive dealing can also raise barriers to entry. In *United Shoe,* for example, United was able to preserve its monopoly in the production of shoe-making machinery through the exclusive and tying arrangements it had with shoe manufacturers. Entry into the market for producing shoe-making machinery was difficult because a successful new entrant would have to produce more than a single type of machine or enter the shoe-making business itself to create a customer for the new venture.[204] The effect was not so pronounced as to exclude all competitors but, in the face of the agreements, none of United Shoe's smaller rivals was able to expand in any way sufficient to challenge the company's dominant position. Similarly, in *Visa*, entry barriers into the market for charge and credit card network services were significantly increased through the Visa and MasterCard arrangements that effectively required a prospective entrant to provide sufficient issuing volume on its own to support the new network—with the result that no new entry had even been attempted since Discover in the 1980s.

Increasing market concentration and raising barriers to entry can lead to consumer harm in several ways. First, allowing a dominant firm to preserve or increase its market power will create at least the ability to maintain supracompetitive prices or restrict output. Second, on a similar basis, if the costs of competing firms (or at least the costs of the lowest cost competing firm) are raised (and other conditions are met), the associated reduction in capability to constrain will allow the defendant

[201] United States v. Pullman Co., 50 F. Supp. 123 (E.D. Pa. 1943).

[202] *See supra* note 149 and accompanying text.

[203] 230 F. 859 (D. Md. 1916), *appeal dismissed,* 256 U.S. 706 (1921).

[204] *See generally* 11 HOVENKAMP, *supra* note 101, ¶ 1802e.

to increase prices. Third, if the market becomes concentrated in the hands of a sufficiently small number of firms, the resulting oligopoly—at least in theory—can raise prices through coordinated interaction.[205]

2. *Effect on Consumer Choice*

A reduction in consumer choice is a potential negative effect of an exclusive dealing arrangement. But the issue can be complex, as illustrated by one of the arguments advanced by Visa and MasterCard in the *Visa* case. Their contention was that, in terms of analyzing effects in the credit and charge card issuance market, it was irrelevant that consumers could not get bank-issued American Express and Discover cards; consumers had ample choices in bank-issued Visa or MasterCards and in cards issued by American Express and Discover on their own networks.[206] Given the abundance of record evidence in the case that, in fact, new and different products would result if banks were permitted to issue cards on the American Express or Discover networks, the district court rejected the argument as a factual matter.[207] But what if the argument were supported by evidence—would a reduction in network choices for banks from four to two, or a reduction in credit or charge card variety and choices to consumers by a similar ratio, suffice to prove consumer harm?

Choice and variety comprise one dimension of output. A material reduction in the choices available is no different in kind than a reduction in quality, and all agree that a deterioration in quality is a cognizable form of consumer harm.[208] There must, however, be some limiting principle. Most horizontal mergers, for example, involve some likely reduction in choice as product lines are combined. A reduction in the choice of suppliers of a commodity product, such as salt, from 1000 to 999 does not make for much of an antitrust case. And, unlike a case involving an objective reduction in quality, relative degrees of choice can become largely matters of subjective taste.

Choice is also more important in some contexts than in others. For garden-variety commodity products, degrees of choice may be insignifi-

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[205] Although this consequence is frequently addressed in the cases, e.g., *Beltone,* 100 F.T.C. at 210–12, and by the commentators, e.g., 11 HOVENKAMP, *supra* note 101, ¶ 1805, the only case where it appears to have been shown was *Visa.* There, the exclusion of competing networks from an ability to compete for the business of banks was found to have allowed Visa and MasterCard to raise the effective price charged to banks for network services.

[206] Defendants' Joint Proposed Findings of Fact & Conclusions of Law, pt. VII, at 49–52, United States v. Visa USA, Inc., 163 F. Supp. 3d 322 (S.D.N.Y. 2001) (No. 98-CV-7076).

[207] *Visa,* 163 F. Supp. 2d at 395–99.

[208] The classic case is *National Macaroni Manufacturers Ass'n v. FTC,* 345 F.2d 421 (7th Cir. 1965) (reduction in durum wheat content in macaroni).

cant. For products differentiated by brand only, choice will matter but it will not necessarily matter much. For products differentiated by content, features, price, or quality, choice will matter more.

The difficult question is determining when a reduction in consumer choice rises to the level of material consumer harm.[209] Any answer, unfortunately, is probably arbitrary. One way of evaluating the issue is to look to principles of horizontal merger law. In a well-defined market, provided there is evidence of barriers to entry, mergers reducing the number of competitors from three to two are invariably condemned—even in cases involving substantial efficiencies.[210] Correspondingly, however, mergers reducing the number of competitors from ten to nine or, under current practice, from six to five, or even five to four, are rarely challenged.[211] Using horizontal merger principles as a rough proxy, a reduction in choices from three to two would be presumptively harmful (at least for reasonably differentiated products), the loss of one choice with five or more remaining would be presumptively lawful, and cases in the middle would remain presumption free.

D. JUSTIFICATIONS

Exclusive dealing has fared well in the decisions at least in part because the courts have recognized, explicitly or implicitly, the significant business justifications present in a typical case. There are many, and any listing will necessarily be incomplete, but the major justifications include the following:

1. *Dedication and Loyalty*

One of the main reasons for many exclusive dealing arrangements is to encourage a more dedicated sales, service, and quality effort by the affected distributor or retailer. If the distributor carries only one brand, it will necessarily have a greater incentive to push that brand than if it carries others as well. In the *Joyce Beverages* case, the court recognized the legitimate interest of Royal Crown Cola in maintaining exclusivity for distribution of colas by its bottlers.[212] Had the plaintiff bottler been authorized to distribute a competing cola beverage, as it sought to do, it would have been subject to conflicting interests and less likely to

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[209] *See generally* Robert H. Lande, *Consumer Choice as the Ultimate Goal of Antitrust*, 62 U. PITT. L. REV. 503 (2001).

[210] FTC v. H.J. Heinz Co., 246 F.3d 708, 717 (D.C. Cir. 2001).

[211] *See* cases cited in ABA SECTION OF ANTITRUST LAW, 2000 ANN. REV. ANTITRUST L. DEV. 92–94 (2001).

[212] Joyce Beverages v. Royal Crown Cola Co., 555 F. Supp. 271, 276–77 (S.D.N.Y. 1983).

promote RC as effectively. The decision in *Steinway* involved similar issues and the court's ruling was to the same effect.[213]

2. *Avoiding Free Riding*

Exclusive dealing also encourages suppliers to provide dealer-specific investments by eliminating or reducing the concern that the dealer will use the benefits provided in support of a competing brand. As recognized in *Ryko,* a supplier, for example, will be more inclined to provide (and pay for) fixtures for a dealer's showroom and to arrange for sales training programs for the dealer's sales force if the supplier knows that the dealer will not turn around and use the showroom and the sales force to push competing products instead.[214]

3. *Quality Assurance/Prevention of Passing Off*

Exclusive dealing is also effective in preventing a dealer from passing off an inferior product as the supplier's own and otherwise in helping assure product quality. Passing off was one of the concerns the Supreme Court validated in the *Sinclair* case, where part of the gasoline refiners' defense was that, absent a requirement that the retail gas station use the refiner's brand exclusively in the refiner's tanks and pumps, it would be easy for the station owner to pass off inferior gasoline as the branded refiner's own.[215] (Coca-Cola's fountain sales Conflict-of-Interest Policy, at issue in the *PepsiCo* case, had its origins in the same concerns—distributors passing off inferior brands of cola to fountain retail outlets.) Similarly, as the *Pick* decision established, using exclusive dealing to ensure that quality products are used when associated with the supplier's brand is a recognized justification.[216] Exclusive dealing can provide quality assurance both directly, by requiring use of the supplier's brand only,

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[213] Hendricks Music Co. v. Steinway, Inc., 689 F. Supp. 1501, 1514, 1545–48 (N.D. Ill. 1988) ("[I]t is perfectly legitimate and, in fact, procompetitive, for manufacturers to insist that their dealers devote undivided loyalty to their products and not to those of their competitors."); *see also* Brattleboro Auto Sales, Inc. v. Subaru, 633 F.2d 649, 651 n.4 (2d Cir. 1980); Deltown Foods v. Tropicana Prods., 219 F. Supp. 887, 890–91 (S.D.N.Y. 1963); 11 HOVENKAMP, *supra* note 101, ¶ 1812 & cases cited *id.* n.17. In certain relatively rare instances, exclusivity may be requested by the *customer* rather than the supplier. In those cases, there is a strong presumption that exclusive dealing is being used to generate efficiencies rather than to create or enhance market power. Richard M. Steuer, *Customer-Instigated Exclusive Dealing,* 68 ANTITRUST L.J. 239 (2000).

[214] Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1234 & n.17 (8th Cir. 1987); *see* Beltone Elecs. Corp., 100 F.T.C. 68, 181 (1982); Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984).

[215] 261 U.S. at 475–76.

[216] Pick Mfg. Co. v. General Motors Corp., 299 U.S. 3 (1936); *see also* Santos v. Columbus-Cuneo-Cabrini Med. Ctr., 684 F.2d 1346 (7th Cir. 1982).

and indirectly, by providing the dealer with an incentive to provide better service or support to promote a product's sales.

4. *Reliable Supply Assurance*

Exclusive dealing can also provide sellers with an increased incentive to meet the customer's full purchase requirements steadily and reliably. Long-term coal supply contracts, such as the one in issue in *Tampa Electric,* provide the supplier with sufficient volume to justify the investment in production and transportation facilities sufficient to ensure that the buyer's needs are met.[217]

5. *Volume Commitments for Scale Economies*

Similarly, exclusive dealing contracts can provide assurances of volume sufficient to enable the seller to achieve economies of scale and, thus, to reduce production costs and resulting selling prices. Exclusive dealing can also be an important factor in this regard in providing an incentive for new entry. In the *Sewell Plastics* case, southeast area Coke bottlers formed a cooperative to produce plastic soft-drink bottles. Construction of the plant was expensive, however, as was the purchase of the necessary bottle-making machinery and equipment. Exclusive dealing contracts justified the substantial investment by ensuring committed volume. Over time, the cooperative in fact was able to achieve sufficient economies of scale to provide bottles to the co-op's members at less than half the price they had paid before. The co-op's success, moreover, stirred competition among the independent buyers to a substantial extent—resulting in significantly greater output and lower prices marketwide.[218]

6. *Decreased Out-of-Stocks*

For distributors or retail dealers carrying multiple product lines, out-of-stocks can be a significant problem. By requiring the dealer to focus on a single line, exclusive dealing tends to reduce out-of-stocks by reducing the number of SKUs or product lines carried—and also by eliminating the incentive to substitute a different brand for the product whose stock has run out.[219]

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[217] *See* Standard Oil Co. (Cal.) v. United States, 337 U.S. 293, 306 (1949); *Barry Wright Corp.,* 724 F.2d at 236–39; Southern Snack Foods v. J&J Snack Foods Corp., 79 F.R.D. 678, 680 (D.N.J. 1978).

[218] Sewell Plastics, Inc. v. Coca-Cola Co., 720 F. Supp. 1196, 1207–12 (W.D.N.C. 1989), *aff'd mem.,* 912 F.2d 463 (4th Cir. 1990); *see also* Great Lakes Carbon Corp., 82 F.T.C. 1529, 1656 (1973).

[219] *See Sinclair,* 261 U.S. at 475–76; *Seagood Trading Corp.*, 924 F.2d at 1571.

7. *Confidentiality*

Dealers handling multiple competing product lines may encounter confidentiality concerns. For example, one supplier may be planning a deep discount promotion for the Memorial Day holiday. That promotion will have to be coordinated with the dealer to make sure that the additional volume and revised pricing receive sufficient planning and preparation. If the dealer is carrying a competing line, however, the confidential promotional strategy could be leaked—advertently or inadvertently—spoiling the supplier's promotion and creating a disincentive for future promotional activities. Exclusive dealing eliminates this problem by forcing the dealer to focus on a single line.[220]

8. *Reduced Monitoring and Transaction Costs*

Because suppliers will tend to have concerns about potential opportunistic behavior by dealers carrying competing products, the suppliers may incur significant costs in monitoring dealer behavior and in adopting preventative measures. Multiple brand dealers may also cause suppliers and dealers to incur increased transaction costs in ensuring proper separation of competing product lines at the point of sale.[221]

9. *Alternative to Vertical Integration*

Finally, exclusive dealing provides a contractual alternative to vertical integration. To avoid the types of concerns identified in the discussion above, some suppliers would choose to integrate vertically if the option of contractual exclusive dealing arrangements were denied. Indeed, in *Standard Stations,* Justice Douglas—in an opinion labeled neither a concurrence nor a dissent—commented that the majority opinion "consciously pushes the oil industry in that direction" and thus "helps remake America in the image of the cartels."[222] Douglas's hyperbole aside, vertical integration by merger is often inefficient and costly as compared with the partial integration that contractual exclusive dealing can achieve.

E. "NAKED" EXCLUSION

Some arrangements have been characterized as "naked exclusion"—exclusion supported by no justification at all. The Areeda/Hovenkamp treatise, for example, so describes Alcoa's contracts with electric utilities

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[220] *E.g.,* Joyce Beverages, Inc. v. Royal Crown Cola Co., 555 F. Supp. 271, 276 (S.D.N.Y. 1983); *see* R.W. Int'l Corp. v. Welch Foods, Inc. 13 F.3d 478 (1st Cir. 1994).

[221] *See, e.g., Joyce,* 555 F. Supp. at 275–77. Similarly, exclusive dealing can also help intellectual property licensors prevent piracy. *See* POSNER, ANTITRUST LAW, *supra* note 177, at 230, 240–41.

[222] 337 U.S. at 321.

pursuant to which the utilities agreed that they would supply no power to competing producers of aluminum, pointing out that "Alcoa purchased nothing but the exclusionary right."[223] *Lorain Journal,*[224] where a monopoly newspaper refused to accept advertising from anyone who advertised on the area radio station, has been described in a similar fashion.[225] A more recent case, *Conwood Co. v. United States Tobacco Co.*,[226] involved unusually "naked" exclusion. The defendant there simply removed competitors' shelving from retail stores without any approval (or even knowledge) of the retailer.

In cases involving traditional vertical exclusive dealing arrangements, truly "naked" exclusion appears unusually rare. Although it is hard to see any justification for Alcoa's practice or Conwood's, one can imagine a nonfrivolous (albeit weak) argument on behalf of the Lorain Journal that the value of the newspaper as an advertising medium might be diluted if the same messages were available elsewhere. Analysis should not rule out the possibility of "naked" exclusion, but the plausible *genuine* justifications for vertical exclusive dealing are pervasive enough to create a fairly strong presumption that some justification is present. [227]

F. RELEVANCE OF FORECLOSURE

"Foreclosure" has for decades been the critical issue in evaluating any exclusive dealing claim. Under *Standard Stations,* foreclosure (in the bare sense of the statistical percentage of the relevant market subject to exclusive dealing) was the only relevant issue. Even under the modified doctrine of *Tampa Electric*—the Supreme Court's last exclusive dealing case, albeit over forty years ago—"substantial foreclosure" was identified as the basis for exclusive dealing liability. Yet one of the unique—and, to many, one of the most endearing—features of antitrust law is that the law can change so radically without a kick, or even a wink or a nod, from the Supreme Court.[228] That feature surely is in evidence in the

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[223] 3A PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 768a6, at 144 (2d ed. 2002) (discussing United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945)).

[224] 332 U.S. 143 (1951).

[225] *See also* Byars v. Bluff City News Co., 609 F.2d 843, 858 (6th Cir. 1979) (suggesting that it is "inherently anti-competitive" for a monopolist to "refus[e] to deal with customers who deal with its rivals").

[226] 290 F.3d 768 (6th Cir. 2002).

[227] *Visa,* in contrast, was neither a vertical case nor an exclusive dealing case. With Visa prohibiting banks from dealing with American Express and Discover, but *not* MasterCard, and MasterCard adopting a reciprocal provision, the court found no evidence of justification at all. *Visa,* 163 F. Supp. 2d at 400–06.

[228] Consider, for example, vertical merger law. The Court's last vertical merger decision, *Ford Motor Co. v. United States*, 405 U.S. 562 (1972), struck down Ford's acquisition of

exclusive dealing arena, and nowhere more so than in assessing the relevance of foreclosure.

Today, at most, as the court of appeals explained in *Microsoft*, "the requirement of a significant degree of foreclosure" is viewed as "serv[ing] a useful screening function."[229] In cases where foreclosure is asserted as the basis for a finding of competitive harm, the *Microsoft* court's statement accurately states the point. The recent decisions uniformly favor defendants where foreclosure levels are 40 percent or less, and so it is fair to say that foreclosure in excess of that amount is a threshold requirement where foreclosure is the asserted basis of the antitrust violation.[230] Even so, a number of cases, such as *CDC*, involve very high levels of nominal foreclosure, and yet there is no antitrust violation because the actual or probable effect on prices of the arrangement is essentially nil. Absent a viable theory, supported by evidence, that customer or supplier foreclosure will affect price, output, quality, or choice, even the highest levels of foreclosure provide no basis for a claim. The magnitude of this change in the law can be seen, with some irony, merely by observing the manner of recent advocacy. Seizing on the cases that have raised the numeric thresholds for foreclosure higher and higher, "foreclosure" has in several instances—including *Microsoft* and *Visa*—become a rallying cry for defendants, not plaintiffs, seeking rapid dismissal of the claims against them.

But just as foreclosure is no more a magic wand for plaintiffs, neither does the absence of "substantial foreclosure" provide a defense for firms whose exclusive dealing practices in fact threaten significant harm. The foreclosure concept was developed as a useful proxy for analyzing harm to competition. If "substantial foreclosure" was shown, the courts presumed that the competitive process had been damaged and the restraint was condemned accordingly. As the sophistication of antitrust analysis has increased, however, the foreclosure proxy has been found inadequate. A large amount of percentage foreclosure, without more, proves nothing, but the absence of percentage foreclosure is equally unilluminating. In all cases, the relevant question is instead whether there has been an adverse effect on price, output, quality, choice, or innovation in the market as a whole. If there has been no adverse effect, the degree of foreclosure will not help the plaintiff prevail. But if price, output, quality,

Electric Autolite, a spark plug manufacturer with some 15% of the spark plug market, solely on the basis that the foreclosure of sales to Ford (10% of the market) would harm competition. The case would have a hard time today surviving a motion to dismiss. *See generally* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 362–67 (5th ed. 2002).

[229] *Microsoft*, 253 F.3d at 69.

[230] *See supra* note 85 and accompanying text.

choice, or innovation have been harmed, the lack of percentage foreclosure is no defense.

Several recent cases have in fact found exclusive dealing and similar arrangements unlawful despite minimal, or even zero, levels of percentage foreclosure from access to the ultimate consumer. In *Microsoft,* as an example, Netscape was not "foreclosed" at all. It could reach all consumers through free Internet downloads or CD-ROM mailings. Yet the restrictions on access to OEMs, ISVs, and IAPs substantially impaired Netscape's ability to provide a future constraint on the market power of Microsoft's Windows—and that sufficed to establish liability. Similarly, in *Visa,* American Express and Discover could reach all potential cardholders through mailings, but the exclusion from bank issuers raised the price of network services to banks and deprived consumers of the card products on the American Express and Discover networks that only bank issuers could provide. And in *Avery,* as well as *RJR I,* where the amount of "foreclosure" was essentially zero, the restraints in issue were found to have enhanced or protected the defendants' market power, and that was a sufficient basis for illegality.

True enough, virtually all of the recent cases continue to use the phrase "foreclosure" repeatedly. Many cases still devote significant attention to determining the precise percentage of the market asserted to be foreclosed. Increasingly, however, that appears to be a wasteful exercise. Few serious cases today are based on assertions that foreclosure alone is the source of the asserted competitive harm. Foreclosure, as we have known it, does remain useful as a "screening device" in some cases—specifically, those in which the factfinder is asked to infer competitive harm from the fact that a large percentage of the relevant market has been tied up by the challenged arrangement. But with that exception, foreclosure is a concept that analysis has largely forgotten. The time seems right for the courts to come out and say so explicitly.

G. RULE OF REASON

Although exclusive dealing has long been considered a "rule of reason" restraint, it curiously has been kept apart from general rule of reason doctrine. While vertical territorial restraints, restraints ancillary to a joint venture, mergers, and other restrictions not subject to per se condemnation have been analyzed by focusing on their net impact on price, quality, quantity, or choice, the exclusive dealing cases of the past looked instead to the percentage of business foreclosed. One of the important aspects of the recent de-emphasis on percentage foreclosure is that it has freed exclusive dealing analysis to conform to more general analysis of trade restraints under the rule of reason.

Years ago, a common complaint was that the rule of reason was contentless, standardless, subjective, and too complicated and therefore too costly to apply.[231] That, indeed, was the sentiment that led the Supreme Court in *Standard Stations* expressly to reject rule of reason analysis for exclusive dealing and to limit analysis to the bare question of the percentage of business foreclosed.[232] Today, however, it is no longer fair to describe the rule of reason as undefined. In the wake of the reopening of the rule of reason in *Sylvania,* cases and commentators have moved towards general agreement at least on the basic parameters of rule of reason analysis. Of course, some differences remain[233] and certain questions are still unanswered.[234] But there is basic agreement that a plaintiff must demonstrate actual or probable consumer harm in the sense of an increase in price, or reduction in output, quality, or choice.[235] The litigation framework for applying these basic tests in an exclusive dealing case should be reasonably straightforward, as outlined below.

VI. ANALYSIS OF CONSUMER HARM IN EXCLUSIVE DEALING CASES

Analysis of consumer harm in exclusive dealing cases under the rule of reason requires recognition of the ways in which cases are presented in court—on motion to dismiss, motion for summary judgment, trial, or motion for judgment as a matter of law. The plaintiff must make out a prima facie case, the defendant is entitled to undermine the plaintiff's showing and/or to present an affirmative defense, and in appropriate cases the plaintiff is entitled to (and sometimes must) rebut. The recent cases, especially *Microsoft,* suggest an appropriate way for analyzing exclusive dealing claims under the rule of reason utilizing this basic structure.[236] The following iteration, while not set forth in precisely this form in any of the cases, represents a fair synthesis of the courts' methods of analysis.

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[231] *E.g.,* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958).

[232] *See supra* text accompanying note 64.

[233] *See* A. Douglas Melamed, *Exclusionary Vertical Agreements* (Apr. 2, 1998), *available at* www.usdoj.gov/atr/public/speeches/1623.htm.

[234] For example: If justifications are presented, to what extent are they controlling? Can the plaintiff rebut not only their existence and scope, but their strength in relationship to the competitive harm in question? The answer seems to be yes, *e.g.*, *Microsoft,* 253 F.3d at 59; Delaware & Hudson Ry. v. Consolidated Rail Corp., 902 F.2d 174, 178 (2d Cir. 1990), but some decisions suggest otherwise. *E.g.*, Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich, 63 F.3d 1540, 1550 (10th Cir. 1995); Oahu Gas. Serv., Inc. v. Pacific Res. Inc., 838 F.2d 360, 368–69 (9th Cir. 1988).

[235] *See* ABA ANTITRUST SECTION, MONOGRAPH NO. 23, THE RULE OF REASON (1999).

[236] *See generally Microsoft,* 253 F.3d at 58–59 (structured rule of reason under § 2); MONOGRAPH NO. 23, THE RULE OF REASON, *supra* note 235.

A. STEP 1: PLAINTIFF'S PRIMA FACIE CASE

1. *Proof of Defendant's Market Power*

The core concern about exclusive dealing is that it will reduce allocative efficiency; that the restraint will empower the defendant, by impairing rivals, to raise the market price of the product in issue (or otherwise harm consumers by reducing output, quality, choice, or innovation). This inquiry cannot proceed in any meaningful fashion absent a determination of the particular price and output in issue, and it requires an assessment of whether an adverse impact on that price or output is likely or feasible. Accordingly, the first task in any vertical exclusive dealing case is to define the relevant market and then assess the defendant's power, if any, in the market. That step is essential to determine whether harm to the competitive process is possible.[237] When plaintiffs have tried to shortcut proof of power in recent exclusive dealing cases (such as in *Pepsi*) by alleging that the exclusionary arrangement represents a "naked" restraint obviating the need for independent proof of the relevant market or the defendant's market power, the courts have typically said "no."[238] As the *Microsoft* court held, when "an exclusive deal is challenged, it is clear that in all cases the plaintiff must . . . define the market" and establish that the defendant has market power.[239] Absent proof of the power to cause consumer harm market-wide, or proof of actual anticompetitive effects—such as higher prices, reduced output, or lower quality—in *the market as a whole*,[240] an exclusive dealing restraint is at worst harmless, and may well be procompetitive.

2. *Proof that Restraint Materially Impairs Rivals*

The second element of the plaintiff's prima facie case is the degree of impairment of rivals the restraint has caused. Although earlier cases referred to foreclosure only in the sense of the percentage of the relevant market covered by the exclusive restraint,[241] more recent authority

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[237] *See, e.g.,* SCFC ILC, Inc. v. Visa USA, Inc. 36 F.3d 958, 965 (10th Cir. 1994) ("Proof of market power, then, for many courts is a critical first step, or 'screen,' or 'filter,' which is often dispositive of the case." (citation omitted)); Valley Liquors, Inc. v. Renfield Imps., Ltd., 822 F.2d 656, 666–67 (7th Cir. 1987).

[238] *PepsiCo,* 114 F. Supp. 2d at 257–58; *see, e.g.,* Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 455–56 (1993).

[239] 253 F.3d at 69.

[240] Todd v. Exxon Corp., 275 F.3d 191, 207–08 (2d Cir. 2001) (the "use of anticompetitive effects to demonstrate market power, however, is not limited to 'quick look' or 'truncated' rule of reason cases," nor is proof of market share required; plaintiff must nevertheless show either market power proven through conventional methods or direct adverse effect on market price or output).

[241] *E.g., Tampa Electric,* 365 U.S. at 328–29, 334–35.

requires a broader analysis of the extent to which rivals have been impaired, for it is the degree of impairment of rivals—not the mere percentage of business at issue—that determines the extent to which the exclusive arrangement may (on satisfying other conditions) allow the defendant to increase prices or otherwise cause consumer harm.[242] A significant impairment in this respect is one that materially reduces the rivals' ability to constrain the defendant's market power. If the restrictive arrangements leave competitors with a continued ability to constrain the defendant's market power, harm to competition has not been shown.

In a typical case involving exclusive dealing arrangements with distributors, demonstrating a material impairment of rivals' ability to constrain the defendant's power will require proof of at least the following: first, that rivals' costs have been increased through the denial of access to the distributors, or that some other major hurdle has been erected damaging the rival's ability to compete; second, that the cost increase (or other hurdle) cannot be avoided through reasonably practical means such as competing for the exclusive distributors, or by using or developing alternative means of distribution; third, that there are impediments to entry into the market by suppliers using different distribution methods or different distributors; and, fourth, that the cost increase is something other than a manifestation of the need to compete more vigorously. The significance of the "foreclosed" distribution resource to effective competition, the presence of potential network effects, the duration of the defendant's contracts, any staggering of the termination dates, and distributors' practical ability to terminate the agreements will be additional key factors in this analysis.

Particular care must be taken to ensure that the plaintiff's alleged cost increase is not purely a byproduct of competition. If the plaintiff's costs are raised because the defendant outbid it in a fair fight for the best distributors, harm to competition has not been shown.

3. *Proof that the Impairment in Fact Allows the Defendant to Harm Consumers*

The third part of the prima facie case, following from the first two, is proof that the exclusive dealing arrangements not only impair rivals but in fact allow the defendant to increase prices or otherwise cause consumer harm. This element will in some cases follow from the second, but that will not necessarily be the case.[243] Proof of an increase in rivals' costs is

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[242] *See* Krattenmaker & Salop, *Raising Rivals' Costs, supra* note 99.

[243] In *RJR II*, for example, there was no doubt that the Retail Leaders program impaired rivals, but the evidence that it created power over price was found insufficient. Similarly,

a necessary but not sufficient condition in establishing consumer harm. A likelihood of elevated prices (or reduced output, quality, choice, or innovation) must also be shown.

B. Step 2: Justification

If the plaintiff fails to establish a prima facie case, of course, the litigation ends. If a prima facie case is proven, however, the burden of producing evidence then is appropriately shifted to the defendant to present evidence in justification of the restraint.[244] The justifications presented are limited to those which may or will promote competition.[245] In an exclusive dealing context, they may include any of the justifications addressed in Part IV.D above. Although the burden of producing evidence shifts to the defense once a prima facie case is established, the burden of persuasion does not. The ultimate burden of persuasion rests with the plaintiff at all times.[246]

C. Step 3: Plaintiff's Response

Once the defendant's case is in, the factfinder may of course reject any of the elements of the plaintiff's original prima facie case—for example, by concluding that the plaintiff's market definition has not been proven, that the defendant lacks market power, or that the plaintiff's ability to constrain was not really impaired. Even if the factfinder accepts the plaintiff's prima facie case after hearing the defendant's evidence, the defendant's justifications will need to be considered. If the defendant has not presented any evidence of justification—an unlikely event in a vertical exclusive dealing case—the plaintiff's prima facie case should prevail. If justification evidence has been presented, the burden of going forward shifts back to the plaintiff, as developed below.

1. *Evidence of Pretext*

The traditional method of rebutting a proffered justification is simply to present evidence that it is not true—either that the reasons underlying the claimed justification do not exist in fact or that, in the particular circumstances, they are merely being used as an excuse to cover up

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in *Pepsi*, whatever the quality of Pepsi's evidence of impairment, it was clear that Coca-Cola obtained no power over price.

[244] *See, e.g.*, Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 483 (1992).

[245] National Soc'y of Prof'l Engrs. v. United States, 435 U.S. 679, 695–98 (1978).

[246] *See In re* Brand Name Prescription Drugs Antitrust Litig., 186 F.3d 781, 787 (7th Cir. 1999).

different and anticompetitive reasons. The Supreme Court in *Kodak* indicated that both of these types of rebuttal evidence may be used.[247]

2. *Achievement of the Same Efficiencies Through Substantially Less Restrictive Means*

Justifications may also be rebutted through evidence of less restrictive alternatives. This does not mean that evidence of some hypothetical less (or "least") restrictive alternative will rebut a procompetitive justification.[248] However, a justification can in most circumstances be rebutted by evidence that the same efficiencies could be achieved by other means that are both reasonably available and *substantially* less restrictive.[249]

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If the plaintiff's evidence negates the evidence of justification, its prima facie case of consumer harm—no longer offset by any efficiency justification—will carry the day and the plaintiff will prevail.

D. STEP 4: BALANCING

Few cases will involve the need for much of a fourth step, and fewer still will call for "balancing" pro- and anti-competitive effects or objectives. Where evidence of both potential consumer harm and material justifications has been presented, however, some balancing will be necessary.[250] The balancing should be *objective*, assessing the net effect on output or allocative efficiency in the market as a whole. Although that task is inherently difficult,[251] a reasonable shortcut is simply to look at whether prices or output have gone up or down, or can be expected with some confidence to be affected negatively in the proximate future. If a procompetitive justification is demonstrated, that will suggest, other things equal, that the arrangement is price-lowering or output-enhancing; but if the arrangement is likely to reduce output, even giving consideration to the justifications advanced, the arrangement is anticompetitive.[252] The determinative question in any case should be the

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[247] 504 U.S. at 483.

[248] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977); American Motor Inns, Inc. v. Holiday Inns, Inc. 521 F.2d 1248–1249 (3d Cir. 1975).

[249] *E.g.,* Bhan v. NME Hosps. Inc., 929 F.2d 1404, 1413 (9th Cir. 1991).

[250] POSNER, ANTITRUST LAW, *supra* note 177, at 229–38.

[251] *See* Rothery Storage & Van Co. v. Atlas Van Lines, 792 F.2d 210, 229 n.11 (D.C. Cir. 1986); New York *ex rel.* Abrams v. Anheuser Busch Inc., 811 F. Supp. 848, 872 (E.D.N.Y. 1993).

[252] Taking as an example the case of exclusive dealing through a critical distribution channel by a monopolist, the more effective distribution attributable to undivided loyalty may be output-enhancing to a degree, but that effect could be overwhelmed by the effect

total effect on output or allocative efficiency and, if a net reduction in output has been shown, giving full consideration to the efficiency defense, the effects have been balanced in an objective sense and there is no further balancing to be done. Only if the net effect on allocative efficiency is genuinely ambiguous will the factfinder need to "balance" the consumer harm against the strength of the defendants' justifications subjectively. The cases where subjective balancing will be necessary should be quite rare.

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The structured analysis this article proposes should not be controversial. Certainly, steps 1 and 2, involving the prima facie case and rebuttal, are not likely to raise objections. With respect to steps 3 and 4, some may argue that proof of a legitimate justification, without more, is sufficient for the defense to prevail.[253] But the suggestion here that a plaintiff may demonstrate that the procompetitive effects are outweighed by anticompetitive effects seems far more consistent with mainstream rule of reason analysis.[254] The major impact of the proposed structure is in its substitution of a more traditional rule of reason analysis for the prior focus on foreclosure. As discussed throughout this article, that is the direction in which the cases should be moving—and appear to be moving—in any event.

VII. CONCLUSION

The analysis reflected in the recent decisions will generally result in the approval, usually through summary disposition, of most exclusive dealing restraints. Exclusive dealing, particularly in distribution, is common in our economy today. Instances of true competitive harm are few and far between. Condemnation should be correspondingly difficult. But in the unusual case where exclusionary dealing creates, enhances, or preserves power over price and output, antitrust intervention remains appropriate—irrespective of the percentage of the market "foreclosed."

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of preserving monopoly power through the exclusion of rivals. The net result in that case would be a reduction in output.

[253] *Cf.* Oahu Gas Serv. v. Pacific Resources Inc., 838 F.2d at 368–69.

[254] *E.g., Sylvania*, 433 U.S. at 49; *Microsoft*, 253 F.3d at 59; *Bhan,* 929 F.2d at 1413.