

Exclusive Dealing in Distribution

Richard M. Steuer

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EXCLUSIVE DEALING IN DISTRIBUTION

Richard M. Steuer†

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INTRODUCTION

The standards for judging exclusive dealing arrangements have undergone substantial modification in recent years, but remain in need of considerable refinement. Exclusive dealing is one of the most common practices within the sweep of the antitrust laws, yet because it is marked by apparent contradictions, it is also one of the most misunderstood. It is a vertical restraint, but unlike territorial or customer restraints it limits purchasing rather than resale. It is the converse of a resale restraint, limiting interbrand competition, but not intrabrand competition.¹ It normally is governed by the broadly worded illegality standard of sec-

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¹ Interbrand competition is "competition among the manufacturers of the same generic product." Intrabrand competition is competition among distributors "of the product of a

tion 3 of the Clayton Act,² rather than the narrower standard of the Sherman Act,³ but in contrast to tying, which section 3 also governs, it never has been subject to per se illegality.⁴

"Exclusive dealing," as defined in the legal literature, is a restriction that a supplier imposes on a customer, forbidding the customer from purchasing some category of products from any other supplier.⁵ Necessarily, it forecloses other suppliers from selling those products to the customer, but it can also increase efficiency and promote competition.⁶ Suppliers frequently employ exclusive dealing to restrain wholesalers and retailers, although they may also impose it upon end-users of their products.⁷ This article considers only exclusive dealing provisions involving distributors, both wholesalers and retailers, and explains that they warrant special analysis, including consideration of factors as yet unexamined by the courts.

The Federal Trade Commission's decision in *Beltone Electronics Corp.*⁸ is the most recent analytical bench mark on this subject. Prior cases judged exclusive dealing by counting the number of dealers in a

particular manufacturer." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19 (1977).

² 15 U.S.C. § 14 (1982).

³ 15 U.S.C. § 1 (1982).

⁴ Exclusive dealing has persistently suffered from mislabeling, often being confused with "exclusive dealerships" (also known as "exclusive distributorships" or simply as "exclusives"). Exclusive dealerships actually are restraints upon suppliers, not distributors, prohibiting suppliers from appointing more than one distributor within a defined territory. See ABA ANTITRUST SECTION, MONOGRAPH NO. 9, REFUSALS TO DEAL AND EXCLUSIVE DISTRIBUTORSHIPS 25-34 (1983). Exclusive dealerships do not in themselves limit the distributors, although they are frequently coupled with territorial restraints to keep the dealers out of each other's exclusive territories. The economics and business literature have also confused these terms.

⁵ A variation of exclusive dealing is the "requirements contract," which binds the customer to purchase all or part of its requirements from a particular supplier, and the supplier to fulfill those requirements.

⁶ In *Standard Oil Co. v. United States*, 337 U.S. 293, 306-07 (1949), hereinafter referred to as the *Standard Stations* case, Justice Frankfurter observed that

[r]equirements contracts . . . may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public. . . . From the seller's point of view, requirements contracts may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and—of particular advantage to a newcomer to the field to whom it is important to know what capital expenditures are justified—offer the possibility of a predictable market. See Stockhausen, *The Commercial and Anti-Trust Aspects of Term Requirements Contracts*, 23 N.Y.U.L.Q. REV. 412, 413-14 (1948). They may be useful, moreover, to a seller trying to establish a foothold against the counterattacks of entrenched competitors.

See generally P. AREEDA, ANTITRUST ANALYSIS 810-13 (3d ed. 1982); Lockhart & Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913, 923-31 (1952).

⁷ *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961), involving a "requirements contract," is the leading example of imposition of exclusive dealing on an end-user.

⁸ [1979-83 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,934 (F.T.C. 1982).

market foreclosed from carrying the goods of competing suppliers, and by totaling those dealers' annual sales. The *Beltone* decision calls for a broader and more meaningful inquiry, weighing the procompetitive effects against the anticompetitive effects, and incorporating the economic principles that the Supreme Court recognized in *Continental T.V., Inc. v. GTE Sylvania Inc.*⁹ However, although *Beltone* advanced the analysis of exclusive dealing in distribution appreciably, it did not fully explain the differences between the analysis applied in *Sylvania*, which involved a type of territorial restraint, and the analysis that exclusive dealing arrangements require.

This article will demonstrate that the procompetitive and anticompetitive effects of exclusive dealing differ from those of territorial restraints and other vertical restrictions. It will argue that there are important variables, not fully explored in *Beltone*, which should figure prominently in any analysis of exclusive dealing arrangements between suppliers and distributors. The article will examine each of these variables in detail, after briefly reviewing the legal history which led up to the *Beltone* decision.

I LEGAL HISTORY

Although exclusive dealing has been the subject of antitrust litigation throughout this century, relatively few of the vertical restraint cases decided over the past few years have addressed it. Historically, exclusive dealing has been a violation in search of a standard—subject to a crazy quilt of statutes and analytical approaches. Section 3 of the Clayton Act,¹⁰ section 5 of the Federal Trade Commission Act,¹¹ and, when “commodities” are not involved, section 1 of the Sherman Act, each may govern exclusive dealing.¹² As already noted, exclusive dealing does not fit the pattern of other vertical restraints, and can have unique effects upon competition. The treatment of exclusive dealing by the courts and the Federal Trade Commission has reflected these ambigu-

⁹ 433 U.S. 36 (1977). The *Sylvania* test is discussed in: Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171 (1978); Handler, *Changing Trends in Antitrust Doctrines: An Unprecedented Supreme Court Term—1977*, 77 COLUM. L. REV. 979, 980-89 (1977); Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1 (1978); Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1 (1977); Steuer, *Beyond Sylvania: Reason Returns to Vertical Restraints*, 47 ANTI-TRUST L.J. 1007 (1979).

¹⁰ 15 U.S.C. § 14 (1982).

¹¹ 15 U.S.C. § 45 (1982).

¹² 15 U.S.C. § 1 (1982). Cases not involving “commodities” have applied the Sherman Act. See *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1250 (3d Cir. 1975). Section 3 of the Clayton Act applies only to “commodities” and the FTC Act is not applicable to private suits. Therefore, private exclusive dealing cases involving services rather than commodities must be brought under the Sherman Act.

ties and has vacillated considerably over the years.¹³

Section 3 of the Clayton Act is the central piece of legislation bearing on exclusive dealing.¹⁴ Congress enacted the Clayton Act in reaction to the Supreme Court's 1911 decision in *Standard Oil Co. v. United States*,¹⁵ in which the Court announced the "rule of reason," and as a result of the congressional hearings that followed.¹⁶ It became law in 1914, soon after President Wilson's call for legislation to prohibit the anticompetitive practices then being employed by the trusts.¹⁷ Criticism of the tying¹⁸ and exclusive dealing practices of the United Shoe Machinery Company leveled by Louis D. Brandeis provided the specific impetus for including section 3 in the Act.¹⁹ Support for this section also grew in response to the Supreme Court's 1912 decision upholding the tying practices of the A.B. Dick Company,²⁰ and the Eighth Cir-

¹³ See Handler, *Some Misadventures in Antitrust Policymaking—Nineteenth Annual Review*, 76 YALE L.J. 92, 95-96 (1966).

¹⁴ Prior to enactment of the Clayton Act in 1914, some courts invalidated exclusive dealing arrangements under the Sherman Act where the arrangements extended over an unreasonable period of time or constituted part of an otherwise unlawful scheme. See *United States Tel. Co. v. Central Union Tel. Co.*, 202 F. 66 (6th Cir.) (long distance telephone contract with 99 year duration was restrictive with tendencies toward monopoly, and hence violated Sherman Act, *cert. denied*, 229 U.S. 620 (1913); *United States v. Great Lakes Towing Co.*, 208 F. 733 (N.D. Ohio 1913) (unreasonably broad noncompetition agreements violated Sherman Act), *modified*, 217 F. 656 (N.D. Ohio 1914), *appeal dismissed*, 245 U.S. 675 (1917). Where, however, an arrangement did not expressly bind the purchaser to deal exclusively with one seller but did induce him not to carry competing merchandise by offering him price rebates or discounts as an incentive, courts found neither a contract nor a restraint of trade within the meaning of the Sherman Act. See *Whitwell v. Continental Tobacco Co.*, 125 F. 454 (8th Cir. 1903); *In re Corning*, 51 F. 205 (N.D. Ohio 1892); *In re Terrell*, 51 F. 213 (S.D.N.Y. 1892); *In re Greene*, 52 F. 104 (S.D. Ohio 1892); *accord* *W.T. Rawleigh Medical Co. v. Osborne*, 177 Iowa 208, 158 N.W. 566 (1916) (restrictive contract clause considered security for credit arrangements and not restraint of trade).

At common law, courts generally considered exclusive dealing arrangements valid. See Note, *The Legality of Contracts of Sale which Prohibit the Purchaser-Retailer from Handling Goods of the Wholesaler's Competitors*, 30 HARV. L. REV. 72 (1916).

¹⁵ 221 U.S. 1, 62 (1911).

¹⁶ E. KINTNER, *THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES* 994 (1978).

¹⁷ W. LETWIN, *LAW AND ECONOMIC POLICY IN AMERICA* 271-73 (1965).

¹⁸ "Tying" requires a purchaser who desires to buy product *A* also to buy some quantity of product *B*. See *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610 (1977) (indicating other prerequisites to tying claim as well). Exclusive dealing requires a purchaser who desires to buy product *A* to refrain from buying any of product *A* from another supplier. Where product *A* consists of a line of merchandise, such as shoes, rather than a totally unitary product, such as milk, it is sometimes difficult to distinguish between tying (or its variant, full line forcing) and exclusive dealing. See ABA ANTITRUST SECTION, *MONOGRAPH NO. 8, VERTICAL RESTRICTIONS UPON BUYERS LIMITING PURCHASES OF GOODS FROM OTHERS* 95-97 (1982); M. PORTER, *INTERBRAND CHOICE, STRATEGY, AND BILATERAL MARKET POWER* 63 (1976).

¹⁹ E. KINTNER, *supra* note 16, at 994-95.

²⁰ *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912). See E. KINTNER, *supra* note 16, at 995. The *A.B. Dick* case was later overruled in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 518 (1917).

cuit's 1903 decision allowing the Continental Tobacco Company to grant rebates to customers that did not carry competing brands.²¹

Section 3 emerged as a broad prohibition against tying and exclusive dealing. It became unlawful to lease or sell commodities in interstate commerce "on the condition, agreement, or understanding" that the lessee or purchaser will not deal in commodities of a competitor of the lessor or seller, where the effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce."²²

A. Supreme Court Precedents

The Supreme Court first addressed exclusive dealing in the context of distribution in 1922, in *Standard Fashion Co. v. Magrane Houston Co.*²³ The Court invalidated an arrangement under which retailers purchasing sewing patterns from Standard Fashion agreed not to carry patterns of competing suppliers. This arrangement bound forty percent of the pattern agencies in the country, and the Court determined that this amounted to a substantial lessening of competition and tended to create a monopoly in violation of section 3. Not only did the arrangement foreclose a high overall percentage of outlets nationwide, but, the Court assumed, in larger cities it would deny competitors access to the most desirable shops, while in smaller communities it would exclude them altogether.²⁴

²¹ *Whitwell v. Continental Tobacco Co.*, 125 F. 454 (8th Cir. 1903). See 51 CONG. REC. 9161 (1914) (remarks of Rep. Floyd).

²² 15 U.S.C. § 14 (1982). The full section reads:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Committee treatment of the bills that eventually became § 3 is described in Handler, *Recent Antitrust Developments*, 71 YALE L.J. 75, 85-86 (1961), and Lockhart & Sacks, *supra* note 6, at 934-35.

²³ 258 U.S. 346 (1922). Prior to *Standard Fashion*, the Federal Trade Commission had applied a virtual rule of per se illegality to exclusive dealing arrangements under § 3 in a number of cases. *Standard Elec. Mfg. Co.*, 5 F.T.C. 376 (1923); *B.S. Pearsall Butter Co.*, 5 F.T.C. 127 (1922); *Stanley Booking Corp.*, 1 F.T.C. 212 (1918). See Bok, *The Tampa Electric Case and the Problem of Exclusive Arrangements Under the Clayton Act*, 1961 SUP. CT. REV. 267, 273, 327.

²⁴ Critics have argued that the evidence of record did not support all of the Court's factual assumptions. See Bok, *supra* note 23, at 321-22.

Almost twenty years later, in *Fashion Originators Guild v. FTC*,²⁵ the Court again emphasized the substantial market share involved. It held that a concerted effort by a guild of textile and garment manufacturers, which accounted for over sixty percent of sales in the relevant market, to prevent their customers from dealing in merchandise copied from guild members' designs, violated both section 3 of the Clayton Act and the Federal Trade Commission Act. The Court also found the arrangement unlawful under sections 1 and 2 of the Sherman Act.

Exclusive dealing came in for its harshest treatment in two subsequent Supreme Court decisions, *Standard Oil Co. v. United States*,²⁶ (the "Standard Stations" case) and *FTC v. Brown Shoe Co.*²⁷ The *Standard Stations* case ushered in what became known as the rule of "quantitative substantiality," predicating illegality entirely upon the percentage of distributors foreclosed. The Court invalidated an exclusive dealing arrangement entered into between a gasoline supplier, having a market share of twenty-three percent,²⁸ and a group of independent service stations. The group comprised sixteen percent of the independent service stations in the relevant market and accounted for 6.7% of gasoline sales. The Court also considered the fact that the supplier's six major competitors, who accounted for another forty-two percent, all employed similar arrangements. Observing that "serious difficulties would attend" any attempt to apply more complex economic tests,²⁹ the Court held that "§ 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected."³⁰

The Court went further in 1966 when it decided *Brown Shoe*³¹ under the Federal Trade Commission Act. It held that percentages are of little or no importance, and that an exclusive dealing arrangement between the nation's second largest shoe manufacturer and its 650 retail outlets violated the Act simply because the arrangement foreclosed competing manufacturers from a "substantial number" of distributors.³² The

²⁵ 312 U.S. 457 (1941).

²⁶ 337 U.S. 293 (1949).

²⁷ 384 U.S. 316 (1966).

²⁸ The 23% share included sales both through the supplier's wholly owned service stations and through independent stations.

²⁹ 337 U.S. at 308; *cf.* *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 611 (1972) (courts are "ill-equipped" for economic decision making). *But cf.* *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (calling for economic analysis); *Marco Co.*, 50 F.T.C. 485, 488 (1953) (FTC was "specifically designed" to make complex economic decisions and should "exercise [its] talents" even though courts may feel "ill suited" to weigh all relevant factors).

³⁰ 337 U.S. at 314. The *Standard Stations* opinion is discussed in *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1251 (3d Cir. 1975), and in M. HANDLER, *ANTI-TRUST IN PERSPECTIVE* 29-48 (1957).

³¹ *FTC v. Brown Shoe, Inc.*, 384 U.S. 316 (1966).

³² *Brown Shoe Co.*, 62 F.T.C. 679, 714 (1963), *rev'd*, 339 F.2d 45 (9th Cir. 1964), *rev'd*, 384 U.S. 316, 319 (1966).

Court observed that the Federal Trade Commission had broad powers to prevent practices "which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws."³³ *Brown Shoe* has not been widely applied, although the FTC did follow it in a few cases decided in the late 1960s and early 1970s.³⁴

The Supreme Court's decision in *Tampa Electric Co. v. Nashville Coal Co.*,³⁵ decided under the Clayton Act five years before *Brown Shoe*, has been more influential. In *Tampa Electric*, the Court rejected the quantitative substantiality test and announced what has become known as the rule of "qualitative substantiality." This rule places less emphasis on raw market share data and gives more weight to "the probable effect of the contract on the relevant area of effective competition."³⁶ *Tampa Electric* involved an end-user rather than a distributor, but the standard the Court formulated constitutes an important part of the test applicable to distributors. The exclusive dealing arrangement at issue was an electric utility's twenty-year requirements contract, which bound it to purchase all of its coal requirements from one supplier. The contract covered \$128 million worth of coal, but foreclosed only 0.77% of the relevant market to other coal suppliers.

The Court held that exclusive dealing is not illegal unless "the competition foreclosed by the contract [is] found to constitute a substantial share of the relevant market. That is to say, the opportunities for other traders to enter into or remain in that market must be significantly limited"³⁷ The Court went on to explain that

[t]o 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

³³ 384 U.S. at 321. The Court remarked that *Brown Shoe*'s program "obviously conflicts with the central policy of both § 1 of the Sherman Act and § 3 of the Clayton Act against contracts which take away freedom of purchasers to buy in an open market." *Id.* The Court added, however, that it was not necessary to prove that the effect of the program might be "to substantially lessen competition or tend to create a monopoly" because the FTC Act can reach "restraints in their incipency without proof that they amount to an outright violation of § 3" *Id.* at 321-22.

³⁴ *Adolph Coors Co.*, 83 F.T.C. 32, *aff'd*, 497 F.2d 1178 (10th Cir.), *cert. denied*, 419 U.S. 1105 (1974); *L.G. Balfour Co. v. FTC*, 442 F.2d 1 (7th Cir. 1971); *Luria Bros. & Co. v. FTC*, 389 F.2d 847 (3d Cir.), *cert. denied*, 393 U.S. 829 (1968).

³⁵ 365 U.S. 320 (1961). *Tampa Electric* is analyzed at length in Bok, *supra* note 23.

³⁶ 365 U.S. at 329.

³⁷ *Id.* at 328.

dollars is ordinarily of little consequence.³⁸

The lower courts have applied this standard in a number of subsequent cases, largely displacing the *Standard Stations* approach.³⁹

B. *Beltone*

The most significant recent decision on exclusive dealing in the context of distribution is the Federal Trade Commission's opinion in *Beltone Electronics Corp.*⁴⁰ The Commission upheld the legality of exclusive dealing and territorial restrictions that Beltone, a manufacturer of hearing aids, imposed on seven to eight percent of the retail dealers in the country. The restrictions affected approximately sixteen percent of total hearing aid sales.

The *Beltone* decision signals a departure from the former practice of applying the Federal Trade Commission Act as expansively as possible, as in *Brown Shoe*, and adheres rather strictly to Clayton Act standards.⁴¹ In effect, *Beltone* represents the coalescence of *Tampa Electric's* "qualitative substantiality" standard, *Sylvania's* framework for analyzing vertical restraints,⁴² and "Chicago School" economics.⁴³

³⁸ *Id.* at 329. The Court also noted that if an exclusive dealing arrangement "does not fall within the broader proscription of § 3 of the Clayton Act" it is not forbidden by §§ 1 or 2 of the Sherman Act. *Id.* at 335.

³⁹ See *Pitchford v. PEPI, Inc.*, 531 F.2d 92, 99-100 (3d Cir. 1975), *cert. denied*, 426 U.S. 935 (1976); *Smith v. Scrivner-Boogaart, Inc.*, 447 F.2d 1014, 1017 (10th Cir. 1971), *cert. denied*, 404 U.S. 1059 (1972); *Cornwell Quality Tools v. C.T.S. Co.*, 446 F.2d 825 (9th Cir. 1971), *cert. denied*, 404 U.S. 1049 (1972); *Joyce Beverages v. Royal Crown Cola Co.*, 555 F. Supp. 271 (S.D.N.Y. 1983); *Refrigeration Eng'g Corp. v. Frick Co.*, 370 F. Supp. 702, 708-09 (W.D. Tex. 1974); *Curly's Dairy, Inc. v. Dairy Coop. Ass'n*, 202 F. Supp. 481, 484-85 (D. Ore. 1962). See also *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291 (9th Cir.) (considering aggregate pattern of conduct in relevant market), *cert. denied*, 103 S. Ct. 364 (1982); *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230 (3d Cir. 1975) (discussing economic justifications for exclusive dealing clause); *Timken Roller Bearing Co. v. FTC*, 299 F.2d 839, 842 (6th Cir.), *cert. denied*, 371 U.S. 816 (1962); *Borman, Inc. v. Great Scott Super Markets, Inc.*, 1975-1 Trade Cas. (CCH) ¶ 60,321 (E.D. Mich. 1975) (considering effects of exclusive dealing arrangements on other distributors); *Precision Dynamics Corp. v. American Hosp. Supply Corp.*, 241 F. Supp. 436, 440, 447 (S.D. Cal. 1965); ABA ANTITRUST SECTION, *supra* note 18, at 86 n.430 (1982) (citing cases using *Tampa Electric* standard).

⁴⁰ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,934 (F.T.C. 1982).

⁴¹ *Beltone* is especially significant because it was a unanimous decision. The opinion was written by Commissioner Clanton and joined in by both Chairman Miller and Commissioner Pertschuk, who failed to agree in two other important distribution cases decided at almost the same time: *General Motors Corp.*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,931 (F.T.C. 1982) and *Russell Stover, Inc.*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) ¶ 21,933 (F.T.C. 1982), *rev'd*, 1983-2 Trade Cas. (CCH) ¶ 65,640 (8th Cir. 1983). Commissioner Bailey filed a separate concurring statement, which is described below.

⁴² See *supra* note 9.

⁴³ The Commission relied in particular on R. BORK, *THE ANTITRUST PARADOX* 288 (1978) and Posner, *The Next Step in the Antitrust Treatment of Restrictive Distribution: Per Se Legality*, 48 U. CHI. L. REV. 1 (1981). The Commission also discussed the analysis contained in Williamson, *Assessing Vertical Market Restraints: Antitrust Ramifications of the Transactions Cost Approach*, 127 U. PA. L. REV. 953 (1979).

The Commission made three significant holdings in *Beltone*. First, the Commission held that the degree to which competitors, including new entrants, are foreclosed is only one element to be considered in assessing the reasonableness of an exclusive dealing arrangement. The trier of fact must also consider any "reasonable justifications" that exist for the restraint, as well as the "duration" of the agreement. This goes beyond the *Tampa Electric* formulation and incorporates the types of considerations that played a prominent role in *Sylvania*. Second, the Commission held that the availability of less restrictive alternatives is not determinative; it would be error to prohibit a supplier from imposing an exclusive dealing arrangement merely on the ground that this would not be the least restrictive means for achieving the supplier's marketing goals.⁴⁴ Third, the Commission held that in order to carry the burden of proving that an exclusive dealing agreement or other vertical restraint is unreasonable, it is necessary to prove not only a loss of intrabrand competition, but also a "probable adverse effect on interbrand competition."⁴⁵ This holding applies more directly to territorial restraints than to exclusive dealing, because exclusive dealing alone never diminishes intrabrand competition. Nonetheless, the language is significant for purposes of exclusive dealing because it appears to reject *Brown Shoe* and the entire notion that under the FTC Act a violation can be shown without proving a truly "probable" effect upon interbrand competition.

Beltone's analysis of exclusive dealing begins with a review of the prior authorities. The Commission noted that "since the earliest cases" the emphasis has been on market foreclosure, but added that more recently courts have begun to employ a "fuller rule-of-reason analysis, which takes into account not only the market share of the firm but the dynamic nature of the market in which the foreclosure occurs."⁴⁶ This apparently was intended to refer to *Tampa Electric* and its progeny.

The Commission then described all of the major exclusive dealing cases decided by the Supreme Court, the lower courts, and the Commis-

⁴⁴ The Commission's conclusion is based on the Third Circuit's opinion in *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1248-49 (3d Cir. 1975), and is consistent with a number of other recent decisions that have limited the least restrictive alternative requirement to per se cases. See, e.g., *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 381 (5th Cir. 1977). Courts, however, have sometimes considered less restrictive alternatives as bearing upon reasonableness in the context of a rule of reason inquiry, at least where some anticompetitive effect has been shown. See *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 303 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980); *Smith v. Pro Football, Inc.*, 593 F.2d 1173, 1187-88 (D.C. Cir. 1978); *Foster v. Maryland State Sav. & Loan Ass'n*, 590 F.2d 928, 933-35 (D.C. Cir. 1978), cert. denied, 439 U.S. 1071 (1979); *Hennessey v. National Collegiate Athletic Ass'n*, 564 F.2d 1136, 1153 (5th Cir. 1977).

⁴⁵ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,393; accord *Mendlovitz v. Adolph Coors Co.*, 1982-83 Trade Cas. (CCH) ¶ 65,090 (5th Cir. 1982); *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982).

⁴⁶ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,387.

sion, pointing out that the degree of foreclosure in these cases has been as little as one percent, as in *Brown Shoe*. The Commission appeared critical of *Brown Shoe*, remarking that the decision seemed a "departure from the *Tampa Electric* Section 3 test," and had to be considered "ambiguous" because the Commission was influenced at that time by a trend toward vertical integration in the shoe industry and by a contemporaneous Supreme Court condemnation of a Brown Shoe merger.⁴⁷

In *Beltone* the Commission also criticized of another pertinent FTC authority, *Adolph Coors Co.*⁴⁸ It stated that in *Coors* "the Commission dispensed with finding the percentage of outlets foreclosed," and that the court of appeals affirmed, citing "only" *Brown Shoe*.⁴⁹ The Commission also remarked that *Coors* and two other Commission cases decided at about the same time⁵⁰ added "[l]ittle further precision . . . to the concept of 'substantial foreclosure.'" ⁵¹ This is highly significant, because, as noted above,⁵² *Brown Shoe* and *Coors* had come to stand for the proposition that under section 5 of the FTC Act an exclusive dealing violation could be found if a significant number of outlets were foreclosed, without any showing of the extent of actual foreclosure in the relevant market as a whole.⁵³

On the basis of its historical survey, the Commission rejected foreclosure as the only pertinent criterion. It stated that the foreclosure standards "are not well settled," and that even if they were, under the newer *Sylvania* standard foreclosure must be considered as "only one of several variables to be weighed."⁵⁴ The Commission noted that under *Sylvania* there must be close examination of the "dynamics" of the market: "More specifically, a proper analysis of exclusive dealing arrangements should take into account market definition, the amount of foreclosure in the relevant markets, the duration of the contracts, the extent to which entry is deterred, and the reasonable justifications, if any, for the exclusivity."⁵⁵

Applying these criteria to the facts of *Beltone*, the Commission found that despite *Beltone's* having bound seven to eight percent of the dealers, who accounted for sixteen percent of the sales, the exclusive dealing restraints were reasonable because they fostered *Beltone's* ability to compete with other brands in the market. The Commission was im-

⁴⁷ *Id.* at 22,390; see *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

⁴⁸ 83 F.T.C. 32, *aff'd*, 497 F.2d 1178 (10th Cir.), *cert. denied*, 419 U.S. 1105 (1974).

⁴⁹ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,390.

⁵⁰ See *L.G. Balfour Co. v. FTC*, 442 F.2d 1 (7th Cir. 1971); *Luria Bros. & Co. v. FTC*, 389 F.2d 847 (3d Cir.), *cert. denied*, 393 U.S. 829 (1968).

⁵¹ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,390.

⁵² See *supra* notes 48-50 and accompanying text.

⁵³ See, e.g., *Handler*, *supra* note 13, at 97-98.

⁵⁴ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,394.

⁵⁵ *Id.* at 22,391.

pressed with both Beltone's interest in stimulating the marketing efforts of its dealers and Beltone's interest in assuring the effectiveness of its own marketing efforts.

Beltone had devoted considerable resources to identifying potential customers for its distributors and was instrumental in generating demand through national and local advertising, but it wanted assurance that its distributors would meet this demand with Beltone products. The Commission indicated that the supplier's interest in protecting these investments provided a legitimate reason for imposing exclusive dealing. The Commission stated that the exclusive dealing arrangement had a "rational and efficient connection" to the supplier's objective of "protect[ing] its investment" in national and local promotional activity.⁵⁶

In concluding that the arrangement was lawful, the Commission also relied on the fact that Beltone's market share was falling, that the restraints were terminable upon thirty days' notice, and that new entrants had experienced little difficulty in finding other distributors.⁵⁷

Commissioner Bailey filed a separate statement criticizing the Commission for even bothering to scrutinize the justifications Beltone proffered for its restraints. According to Commissioner Bailey, once the Commission found "an essentially competitive interbrand market . . . not adversely affected by Beltone's system of intrabrand restraints," its analysis should have ended.⁵⁸ In Commissioner Bailey's view, "additional analysis of Beltone's 'justifications' for its system of intrabrand restraints was unnecessary."⁵⁹

Beltone constitutes a significant step in assembling a framework for analysis of exclusive dealing. In itself, the decision might not be considered a breakthrough, because the same framework could be strung together from other cases, including *Tampa Electric* and *Sylvania*. What is significant, however, is that this analysis came out of the Federal Trade Commission, against the largely antithetical background of *Brown Shoe* and *Coors*, which, but for *Beltone*, would remain the leading authorities under the FTC Act.

⁵⁶ *Id.* at 22,398. This theme is echoed in a recent article, discussed *infra* in the text accompanying note 120, which argues that the real procompetitive effect of exclusive dealing is not that it encourages dealers to increase their marketing efforts, but that it permits the supplier to provide greater support to its dealers, safe in the knowledge that those dealers will not be using this support to sell someone else's competing products. See Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982).

⁵⁷ The Commission noted, but did not place special emphasis on, the fact that none of the other suppliers in the industry employed exclusive dealing arrangements. Interestingly, such arrangements had been outlawed a number of times by previous FTC consent decrees. [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,395.

⁵⁸ *Id.* at 22,401.

⁵⁹ *Id.*

II

ANALYZING THE EFFECTS OF EXCLUSIVE DEALING

To delineate the standard that should be applied to exclusive dealing, or even to characterize the standard, is no simple matter. In enacting section 3 of the Clayton Act, Congress intended to supersede the rule of reason that the Court had announced a few years earlier⁶⁰ and to replace it with a new standard, interdicting practices "which may . . . substantially lessen competition or tend to create a monopoly." It is not clear, however, how the two standards differed.⁶¹

In tying cases, the Supreme Court shaped the section 3 standard into a per se rule of illegality, on the theory that tying contracts "serve hardly any purpose beyond the suppression of competition."⁶² In exclusive dealing cases, however, the Court recognized that certain exclusive arrangements "may well be of economic advantage" to buyers, sellers and the consuming public alike,⁶³ and it developed the standard of "qualitative substantiality."⁶⁴ This standard is being interpreted today as indistinguishable from the rule of reason, at least partly in response to *Sylvania's* indication that the rule of reason should apply generally to nonprice vertical restraints.⁶⁵ In *Beltone*, for example, the Commission explicitly professed to be undertaking a "rule of reason" inquiry into the legality of the exclusive dealing provisions.⁶⁶ Likewise, in a recent amicus curiae brief filed with the Supreme Court, the Department of Justice took the position that courts are to assess exclusive dealing arrangements under the rule of reason.⁶⁷

⁶⁰ See *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

⁶¹ See M. HANDLER, *supra* note 30, at 31 ("[P]recisely how this new test differed, if at all, from the [rule of reason], neither its words nor history disclose."); E. KINTNER, *supra* note 16, at 997-1000; Handler, *Recent Antitrust Developments*, 71 YALE L.J. 75, 84-87 (1961); Lockhart & Sacks, *supra* note 6, at 938; Note, *supra* note 14, at 74.

⁶² *Standard Oil Co. v. United States*, 337 U.S. 293, 305-06 (1949); *accord* *Northern P. Ry. v. United States*, 356 U.S. 1, 5 (1958).

⁶³ 337 U.S. at 306.

⁶⁴ See *supra* notes 35-39 and accompanying text.

⁶⁵ *Sylvania*, 433 U.S. at 59. Note that *Sylvania* arguably did not disturb the per se rule against tying because it relied on *Northern P. Ry. v. United States*, 356 U.S. 1 (1958), which applies this rule.

⁶⁶ The Commission observed that in the more recent exclusive dealing cases, "the courts have employed a fuller rule-of-reason analysis . . ." *Beltone*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,387. Later the Commission described *Sylvania* as "returning to a rule of reason analysis for non-price vertical restraints . . ." *id.* at 22,391, and proceeded to balance the procompetitive and anticompetitive effects of *Beltone's* exclusive dealing arrangement. See also *White & White Inc. v. American Hosp. Supply Corp.*, 540 F. Supp. 951, 1027 (W.D. Mich. 1982).

⁶⁷ Brief for the United States as Amicus Curiae at 7, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, No. 82-1031 (U.S., filed May 14, 1983) (supporting Petition for Certiorari). The government argued that a hospital's exclusive contract for anesthesia services should have been treated as an exclusive dealing arrangement and assessed under the rule of reason, rather than being treated as a per se illegal tying arrangement. *Hyde v. Jefferson Parish Hosp. Dist. No. 2*, 686 F.2d 286 (5th Cir. 1982).

In any event, whether the inquiry mandated by the Supreme Court is properly labeled a "rule of reason" inquiry or something else, it is apparent that because exclusive dealing arrangements have been recognized as serving legitimate purposes, courts must balance their procompetitive and anticompetitive effects. Regardless of the terminology applied to this balancing, an analysis of the type undertaken in *Beltone* is imperative, both to satisfy the qualitative substantiality standard of *Tampa Electric*, and to perform the economic evaluation required by *Sylvania*.

This does not mean, however, that the *Beltone* approach cannot be improved. The Commission in *Beltone* was too quick to combine its examination of exclusive dealing with its economic appraisal of the territorial restraints that were also at issue. After separately describing the leading precedents on territorial restraints and exclusive dealing, the Commission launched into a unitary assessment headed "Analysis of Competitive Effects" and subheaded "Exclusive Dealing and Territorial Restraints."⁶⁸

The two should not be combined so readily. Although the Commission may have reached the proper result, its analysis leaves the impression that the appropriate avenues of inquiry for territorial restrictions and exclusive dealing are essentially the same. For example, at one point the Commission erroneously remarked: "All vertical restraints, of course, by their very nature occasion some reduction in intrabrand competition"⁶⁹ Exclusive dealing, as explained earlier, does not have this effect by itself. At another point the Commission reviewed the economic literature on vertical restraints, but failed to draw any distinction between the economic effects of resale restraints and the economic effects of exclusive dealing.⁷⁰ Other cases decided since *Sylvania* have suffered from the same failure to differentiate.⁷¹

⁶⁸ See *Beltone*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,391, 22,394.

⁶⁹ *Id.* at 22,397.

⁷⁰ *Id.* at 22,392-94.

⁷¹ See, e.g., *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291 (9th Cir.) (exclusive concession franchise contract for events at major baseball stadium), *cert. denied*, 103 S. Ct. 364 (1982); *Gilbuilt Homes, Inc. v. Continental Homes*, 667 F.2d 209 (1st Cir. 1981) (termination of dealership); *Barnosky Oils, Inc. v. Union Oil Co.*, 665 F.2d 74 (6th Cir. 1981) (horizontal customer and territorial allocations and exclusive dealing arrangements); *Bob Maxfield, Inc. v. American Motors Corp.*, 637 F.2d 1033 (5th Cir.) (termination of franchise dealership), *cert. denied*, 454 U.S. 860 (1981); *Perington Wholesale, Inc. v. Burger King Corp.*, 631 F.2d 1369 (10th Cir. 1979) (exclusive dealing contract and tying arrangement), *on remand*, 554 F. Supp. 708 (D.C. Colo. 1982); *Dillon Materials Handling, Inc. v. Albion Indus.*, 567 F.2d 1299 (5th Cir.) (former exclusive stocking distributor sued manufacturer), *cert. denied*, 439 U.S. 832 (1978); *Brown v. Hansen Publications, Inc.*, 556 F.2d 969 (9th Cir. 1977) (exclusive concession contract for sheet music and music books); *White & White, Inc. v. American Hosp. Supply Corp.*, 540 F. Supp. 951, 1026-32 (W.D. Mich. 1982) (dictum) (exclusive dealing and group boycott in medical surgical supplies business); *Sapienza v. New York News, Inc.*, 481 F. Supp. 671 (S.D.N.Y. 1979) (territorial restraints in home delivery of newspapers); *Optivision, Inc. v. Syracuse Shopping Center Assoc.*, 472 F. Supp. 665

Although certain similarities exist among the various vertical restraints, it is misleading to suggest that all vertical restraints have the same procompetitive and anticompetitive effects, and that all may be justified under a single economic equation. A proper analysis of exclusive dealing must use a different approach from that used in analyzing territorial and other resale restraints, because exclusive dealing creates significantly different procompetitive and anticompetitive effects.⁷²

Sylvania illustrates the analysis of resale restraints. The Court there weighed the limitation of intrabrand competition arising from one type of territorial limitation—a location clause—against the promotion of interbrand competition stimulated by the resulting elimination of the “free rider” effect. By restricting each dealer to reselling only from a specified location, the supplier in *Sylvania* prevented any individual dealer from taking a free ride on the marketing efforts of dealers in other locations. This encouraged each dealer to compete against other brands in its own area, rather than against dealers of the same brand in other areas. The territorial restriction at issue in *Belton* had essentially the same effects.

The effects on competition in exclusive dealing, however, are decidedly different, and the analysis should reflect these differences. Exclusive dealing promotes interbrand competition by encouraging intensive market penetration and “demand-generating activities.”⁷³ On the surface these appear to be the same effects as those of the location clause in

(N.D.N.Y. 1979) (exclusivity clause in lease of space in shopping center challenged by competitor).

⁷² Normally, there can be no liability for asking that a distributor enter into an exclusive dealing arrangement—there must be an actual agreement. Courts have refused to find illegality where a supplier merely sought to persuade a distributor to handle its brand exclusively, or unilaterally terminated a distributor for failure to do so. *See* *Ron Tonkin Gran Turismo, Inc. v. Fiat Distribs., Inc.*, 637 F.2d 1376, 1388-89 (9th Cir.) (mere offer to enter into exclusive dealing arrangement not violative of Clayton Act), *cert. denied*, 454 U.S. 831 (1981); *Dillon Materials Handling, Inc. v. Albion Indus.*, 567 F.2d 1299, 1306 (5th Cir.), *cert. denied*, 439 U.S. 832 (1978); *Amplex of Md., Inc. v. Outboard Marine Corp.*, 380 F.2d 112, 115 (4th Cir. 1967) (unilateral refusal to sell not actionable), *cert. denied*, 389 U.S. 1036 (1968); *Timken Roller Bearing Co. v. FTC*, 299 F.2d 839, 842 (6th Cir.) (manufacturer may lawfully terminate jobbers who deal in competitive products), *cert. denied*, 371 U.S. 861 (1962); *McElhenny Co. v. Western Auto Supply Co.*, 269 F.2d 332, 337-39 (4th Cir. 1959) (carrying out threat to discontinue selling products to retailer who handled goods of competitor not unlawful); *Elliot & Frantz, Inc. v. Raygo, Inc.*, 379 F. Supp. 498, 501-02 (E.D. Pa. 1974) (mere refusal by manufacturer to deal with retailer who should not enter into exclusive dealing arrangement not unlawful); *Carbon Steel Prods. Corp. v. Alan Wood Steel Co.*, 289 F. Supp. 584, 588 (S.D.N.Y. 1968) (refusal to deal with distributor who handles competitive products does not violate antitrust laws); *Alpha Distrib. Co. v. Jack Daniel's Distillery*, 207 F. Supp. 136, 138 (N.D. Cal. 1961) (manufacturer has right to free selection of distributors and may refuse to deal with one who handles closely competitive products), *aff'd per curiam*, 304 F.2d 451 (9th Cir. 1962).

⁷³ This language is from the *Belton* description of economic justifications for vertical restraints. *Belton*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,392.

Sylvania, the territorial restraint in *Beltone*, or any resale restraint. The mechanics, however, are wholly distinct.

With territorial and other resale restraints, the free rider effect that the restraint eliminates may be defined more precisely as an "intra-brand free rider effect"; dealers compete more vigorously against other brands because they need not worry that other dealers of the same brand will capitalize upon their efforts by "skimming the cream" of their customers. Exclusive dealing promotes interbrand competition in two ways. First, it encourages distributors to promote the brand more vigorously simply because they have no other brands to sell. Second, it encourages the *supplier itself* to give the distributors more support by eliminating what may be called the "interbrand free rider effect"; suppliers will strengthen their distributors because other *brands* cannot take a "free ride" on the supplier's investment by selling through the same distributors.⁷⁴ Thus, although exclusive dealing promotes interbrand competition, the forces generating this effect are discrete from those at work in the case of territorial and other resale restraints.

It is also important to bear in mind that unlike resale restraints, exclusive dealing in no way limits intra-brand competition. Exclusive dealing is a restraint on purchasing rather than on selling. Because it does not limit intra-brand competition, exclusive dealing also does nothing to limit the *intra-brand* free rider effect. Distributors of one brand of a product all may be bound by exclusive dealing arrangements, but this will not prevent them from poaching on the marketing efforts of their brethren, unless they are also bound by other restraints. Therefore, the elimination of the *intra-brand* free rider effect is not one of the procompetitive effects of an exclusive dealing arrangement. Nevertheless, exclusive dealing still can be expected to have the procompetitive effects of focusing the efforts of each distributor on one brand, and of eliminating the *interbrand* free rider effect by preventing other brands from syphoning off part of each distributor's efforts.

One other critical distinction should be made in analyzing exclusive dealing. Unlike resale restraints, which restrict intra-brand competition but ordinarily promote interbrand competition,⁷⁵ exclusive dealing

⁷⁴ See *Marvel*, *supra* note 56, at 6-11; *Bok*, *supra* note 23, at 310.

That the free rider effect has several dimensions beyond the intra-brand free rider effect presented in *Sylvania* is illustrated by *USM Corp. v. SPS Technologies, Inc.*, 1982-83 Trade Cas. (CCH) ¶ 65,077, at 71,032 (7th Cir. 1982) (free riding threatened against licensor), and *United States Trotting Ass'n v. Chicago Downs Ass'n, Inc.*, 665 F.2d 781, 789 (7th Cir. 1981) (free riding among group of horizontal competitors).

The "interbrand free rider effect" does not apply to the efforts of the distributors—as distinguished from the investments of suppliers—because competing suppliers cannot be said to be taking a "free ride" on the investments of the distributors who are, after all, in the business of distributing and who may want to carry as many brands as possible.

⁷⁵ Whether this is true of one resale restraint, resale price maintenance, has been the subject of heated debate. *Compare, e.g., Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S.

both inhibits and promotes interbrand competition at the same time. The inhibition is the foreclosure effect, described earlier, which was once virtually the entire focus of exclusive dealing analysis.⁷⁶ Thus, unlike the inquiry that territorial and customer restraints require, in which the factfinder must balance intrabrand and interbrand effects, the analysis for exclusive dealing requires balancing the reduction of interbrand competition resulting from the foreclosure effect against the stimulation of that same interbrand competition.

Striking that balance, however, is not easy. "Foreclosure" is not nearly as simple a concept in the context of distribution as it is where end-users are the buyers, or as it might appear from earlier cases which merely relied on percentages. Encouragement of interbrand competition is likewise difficult to measure properly in the context of exclusive dealing, and is far more complex than the cases suggest. The proper considerations for assessing both the anticompetitive effects and the procompetitive effects of exclusive dealing in the context of distribution are in need of substantial refinement. Specific recommendations are offered below.

A. The Anticompetitive Effect—Foreclosure

Beltone held that the degree of market foreclosure is only one consideration in judging the legality of an exclusive dealing arrangement. Nonetheless, foreclosure of competitors continues to be a principal factor for judicial inquiry⁷⁷ because it remains the primary anticompetitive effect of exclusive dealing. Measuring foreclosure, however, is not yet an exact science. Although courts in the past concentrated on finding the percentage of available distributors who have been foreclosed or the percentage of total sales those distributors accounted for, both *Tampa Electric* and *Beltone* instruct that these measures alone are no longer an adequate measure of foreclosure. Market "dynamics" must also be considered. The cases provide little guidance, however, as to what these "dynamics" are or how they are to be determined.

When an exclusive dealing arrangement involves an end-user, the

36, 51 n.18 (1977) and Gerhart, *The "Competitive Advantages" Explanation for Intrabrand Restraints: An Antitrust Analysis*, 1981 DUKE L.J. 417 with Posner, *supra* note 43, at 15-17; see also Brief of the Department of Justice as Amicus Curiae, *Spray-Rite Serv. Corp. v. Monsanto Co.*, No. 82-914 (U.S., filed Jan. 3, 1983) (supporting Petition for Certiorari). See generally ABA ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 78-84 (1977). In the case of nonprice resale restraints such as territorial and customer restrictions, most courts have accepted this proposition. See, e.g., *Sports Center, Inc. v. Riddell, Inc.*, 673 F.2d 786, 791 (5th Cir. 1982) ("Unless decidedly unreasonable, vertical restrictions upon product distribution are permissible and even desirable.").

⁷⁶ See *supra* notes 46-47 and accompanying text.

⁷⁷ It also seems clear that a very low percentage of foreclosure will continue to provide something of a "safe harbor" under *Tampa Electric*, regardless of any other features of a particular exclusive dealing arrangement.

foreclosure effect is straightforward; sales to the end-user are foreclosed. In *Tampa Electric*, for example, sales to the utility were foreclosed to any other suppliers of coal. When distributors are involved, however, this kind of one-to-one analysis is not reliable. Although courts have concentrated on finding the percentage of available distributors foreclosed or the percentage of total sales accounted for, the most meaningful way to determine the foreclosure effect is to examine the extent to which competing suppliers actually have been foreclosed from reaching the ultimate "market," the consumers of their product.⁷⁸

Percentages provide a starting point for measuring foreclosure, but the practical effect of binding a certain percentage of distributors to exclusive dealing contracts depends on a number of factors. Merely to find that one supplier has signed twenty-five percent of the existing distributors of a product to exclusive dealing contracts, or has signed distributors who historically have accounted for twenty-five percent of total sales, does not indicate enough about foreclosure to provide the basis for a sound judgment as to the legality of the arrangement. The arrangement may foreclose other suppliers from reaching twenty-five percent of the potential consumers of the product, fifty percent of them, or none of them at all. This would be the case even if other suppliers in the same industry have foreclosed another twenty-five percent of the existing distributors with exclusive dealing contracts of their own.⁷⁹ Moreover, evidence that an exclusive dealing arrangement has bound twenty-five percent of the *number* of distributors in an area means even less than evidence that the arrangement has bound distributors who historically have accounted for twenty-five percent of total sales. Twenty-five percent of the *number* of distributors may have accounted for ten percent of total sales or ninety percent of total sales during a prior period, and the percentage of total sales they will account for in the future is even less clear.

A meaningful analysis of the impact of exclusive dealing must recognize that the true foreclosure effect of binding any particular percentage of distributors to exclusive dealing contracts can vary dramatically, depending upon a number of important variables: (1) Are the distributors wholesalers or retailers? (2) Is the product a "shopping" product or

⁷⁸ See Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 HARV. L. REV. 50, 72 (1958) ("Distributors are merely channels to the ultimate market."); see also *Standard Oil Co. v. United States*, 337 U.S. 293, 323 (1949) (Jackson, J., dissenting) ("[T]he retailer . . . is only a conduit . . . to get the business of the ultimate consumer . . .").

⁷⁹ In the *Standard Stations* case the Supreme Court placed considerable emphasis upon the fact that exclusive dealing arrangements were prevalent in the oil industry. It invalidated an exclusive dealing arrangement entered into by a supplier, having a market share of 23%, with 16% of the independent service stations in the area (accounting for 6.7% of gasoline sales), where the supplier's six major competitors, accounting for another 42%, all employed similar arrangements. 337 U.S. at 295. In *Bellone*, the respondent was the only supplier in the entire industry that was imposing exclusive dealing restrictions.

a "convenience" product—durable or perishable, expensive or inexpensive? (3) Are alternative methods of distribution available to suppliers? (4) Can other suppliers establish new distributors of their own? Any analysis of exclusive dealing should factor-in each of these variables. Each variable will be considered below.

1. *Level of Distribution*

The level of distribution at which exclusive dealing is imposed can have an enormous effect upon the degree of foreclosure. Although an exclusive dealing arrangement binding twenty-five percent of the end-users in a market plainly forecloses twenty-five percent of the "market," with retailers and wholesalers the relationship is seldom one-to-one. They do not consume, and they may or may not have much influence over those who do.

Beltone, like *Brown Shoe* and *Standard Stations*, dealt with an arrangement imposed upon retailers.⁸⁰ Few cases have dealt with exclusive dealing restrictions placed upon wholesale distributors or other such intermediaries. Yet wholesalers can differ as significantly from retailers as retailers do from end-users. Foreclosure of wholesalers normally will have less of an effect on competing suppliers than foreclosure of either end-users or retailers.

a. *Retailers*. Measuring foreclosure when an exclusive dealing arrangement is imposed upon a retailer requires an examination of consumer loyalty. An exclusive dealing arrangement with a retailer may foreclose other brands from almost all of that retailer's customers or from almost none of them, depending upon how loyal the customers are to the retailer. Certain types of outlets, because of their location, services, or personnel, can command more loyalty than the brands they sell, and foreclosure of those types of retailers may genuinely foreclose that part of the ultimate market. A neighborhood tavern, for example, may begin selling only one brand of draft beer, or may switch from one exclusive brand to another without a significant loss of patronage.⁸¹ Similarly, a neighborhood shoe store may switch exclusive brands of shoes without losing many customers,⁸² or a neighborhood service station may

⁸⁰ The dealers in *Beltone* should be considered retailers because they sold directly to consumers. The supplier shipped directly to these dealers without using intermediary wholesalers.

⁸¹ Compare *Adolph Coors Co. v. FTC*, 497 F.2d 1178 (10th Cir. 1974) (where Coors' control over its distributors was held to violate Sherman Act because it forced distributors to control retailers), *cert. denied*, 419 U.S. 1105 (1975) with *Dawson, Unconscionable Coercion: The German Version*, 89 HARV. L. REV. 1041, 1088-96 (1976) (analysis of "shackling" of beer retailers in Germany).

⁸² Cf. *Brown Shoe Co.*, 62 F.T.C. 679 (1963) (agreements with independent retailers to stock only Brown shoes held illegal), *rev'd*, 339 F.2d 45 (9th Cir. 1964), *rev'd*, 384 U.S. 316 (1966).

switch exclusive brands of spark plugs without loss.⁸³ In these cases, an exclusive dealing arrangement with retailers accounting for twenty-five percent of each product's sales may well foreclose roughly twenty-five percent of total sales in the market, because these retailers can be expected to "deliver" their following of customers.⁸⁴

The most extreme example of foreclosure at the retail level is the retail monopolist. For example, if a dress pattern company were to enter into an exclusive dealing arrangement with the only general store in a small, isolated town, the store might be able to deliver every potential dress pattern customer in the area. This was a real concern in *Standard Fashion*. Today it is less common, although in the case of certain specialized retailers local retail monopolies can still exist. If a town has only one commercial bank, for example, a check printing company that enters into an exclusive dealing contract with that bank could foreclose other suppliers from the town's entire demand for checks. If a neighborhood has only one shoe repair shop, a replacement heel manufacturer that enters into an exclusive dealing contract with that shop similarly could foreclose all other suppliers from area residents.⁸⁵

Not every retailer, however, has captive or even particularly loyal patrons. A department store may lose sales if it switches from one exclusive brand of shoes or spark plugs to another, because customers may delay purchasing these items until they find their favorite brand at another outlet. Customers of a neighborhood shoe store or service station, in contrast, are more likely to rely on their local merchant's choice of merchandise. Many department stores command relatively little loyalty because their customers frequent numerous other retailers that offer essentially the same types of goods. The hypothetical department store may sell more shoes or spark plugs of the one brand it does carry than it would if it carried several brands because some of its customers will be indifferent to brand names or will be sufficiently loyal to the store to trust the store's judgment in selecting superior merchandise. The de-

⁸³ Cf. *Atlantic Ref. Co. v. FTC*, 381 U.S. 357 (1965) (agreement between Atlantic and Goodyear whereby Atlantic pressured its retailers to stock only Goodyear products held illegal); *Champion Spark Plugs*, 50 F.T.C. 30 (1953) (agreements with distributors to deal solely with Champion Spark Plugs held illegal).

⁸⁴ Professor Porter distinguishes between "convenience outlets" and "non-convenience" outlets. M. PORTER, *supra* note 18, at 23. Convenience outlets are defined as outlets that provide little or no sales assistance and that are densely spaced. Nonconvenience outlets are defined as outlets that provide sales assistance and that are widely spaced, such as automobile dealerships.

⁸⁵ See generally D. BOWERSOX, M. COOPER, D. LAMBERT & D. TAYLOR, *MANAGEMENT IN MARKETING CHANNELS* 272-73 (1980) [hereinafter cited as *MANAGEMENT*].

Of course, a local monopolist may have sufficient economic power to resist efforts by suppliers to require exclusive dealing. Cf. *United States v. Griffith*, 334 U.S. 100 (1948) (use of monopoly power in one market to gain power in second market held illegal); *United States v. Crescent Amusement Co.*, 323 U.S. 173 (1944) (arrangement between distributors and exhibitors to control showing of motion pictures held illegal).

partment store, however, probably will not be in a position to deliver all of its potential shoe or spark plug customers to the one brand.

Thus, foreclosure of certain retailers can be more significant than foreclosure of others, even where the same product is involved. Although there is no way to measure these differences with mathematical precision, courts should be sensitive to the degree of consumer loyalty that particular retailers command. There will be cases in which this is a matter of considerable speculation and of no evidentiary value, but there will also be cases in which courts can ascertain the degree of consumer loyalty and factor it into the analysis.

b. *Wholesalers.* Foreclosure of wholesalers typically will have less impact on competitors trying to reach the ultimate market than foreclosure of retailers. Although consumers customarily travel to retailers in search of a product, retailers rarely visit the consumer.⁸⁶ In contrast, numerous wholesalers who carry similar products commonly call upon each retailer. Even if a retailer is exceptionally loyal to a particular wholesaler, other wholesalers offering the same products are still likely to approach that retailer. Accordingly, although an exclusive dealing arrangement binding a retailer with loyal customers may well foreclose a segment of the ultimate consumer market to other suppliers, an exclusive dealing arrangement binding a wholesale distributor is considerably less likely to foreclose any segment of the ultimate market to other suppliers. Thus, an exclusive dealing arrangement entered into by a supplier with wholesale distributors accounting for twenty-five percent of sales in a relevant market may not foreclose that market in any way, provided that other distributors carrying competing goods remain available. So long as the arrangement does not foreclose competing suppliers from achieving adequate distribution through other distributors, suppliers will have the opportunity to reach every retailer and consumer in the relevant market.

Some wholesalers will command a certain degree of loyalty because of the services they offer or because of personal relationships, and if they enter into exclusive dealing arrangements they will be able to retain some of their accounts no matter which brand they offer. But wholesalers sell entirely to retailers, who cannot afford to let loyalties take priority over profits. Unless there is little brand differentiation in the particular product, or the product is a relatively unimportant part of a larger line, it is difficult for a wholesaler to have a "captive" account. As

⁸⁶ The exceptions are retailers that make door-to-door sales, such as Amway and Fuller Brush, and retailers that sell directly to consumers through catalogues, such as Sears, Roebuck, L.L. Bean, and some of the newer specialty catalogue companies. Of course, other retailers try to "reach" the consumer at home through advertising in the media.

a general rule, wholesalers cannot expect their customers to remain with them without regard to which brands the wholesalers sell.

Clearly, the level of distribution at which exclusive dealing is imposed can be very significant. In analyzing foreclosure, the percentage of sales accounted for by foreclosed wholesalers or retailers should be discounted by any inability to deliver those sales to an exclusive brand.

2. *Type of Product*

The preclusive effect of exclusive dealing contracts, at least those involving retailers, cannot be fully understood without distinguishing among different types of products. Loyalty to a retailer is as much a function of the type of product as it is a function of the type of retailer. Some products, because they are durable or expensive, or both, are known as shopping products. Before purchasing these products consumers tend to shop around and compare brands and prices.⁸⁷ Other products, because they are perishable or inexpensive, or both, are known as convenience products.⁸⁸ Most consumers tend to buy them where they see them, without much preliminary comparison.⁸⁹

If a product is a shopping product, such as a refrigerator⁹⁰ or a farm tractor,⁹¹ consumers usually engage in fairly extensive "search" activity.⁹² They are likely to compare a number of brands and to compare prices at a number of retail outlets. If an outlet carries only one brand, consumers are likely to look elsewhere. Accordingly, in the case of a shopping product, if one supplier enters into exclusive dealing agreements with retailers who historically have accounted for twenty-five percent of sales in an area, there is no guarantee that the retailers can deliver that twenty-five percent to the particular brand. In fact, there is no assurance that they will make any sales to customers who would not have purchased that brand anyway.

The effect of foreclosing retailers of shopping products is illustrated by *United States v. J.I. Case Co.*⁹³ The defendant, Case, required retailers

⁸⁷ See M. PORTER, *supra* note 18, at 24; F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 5 n.4 (1980); Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 HARV. L. REV. 795 (1962).

⁸⁸ See M. PORTER, *supra* note 18, at 24; F. SCHERER, *supra* note 87; Note, *supra* note 87.

⁸⁹ Naturally, these are generalizations. Some consumers will undertake extensive comparison shopping for items that most consumers consider convenience products. Likewise, certain consumers will devote no effort to comparison shopping for products that most would treat as shopping products. Furthermore, many products do not fit easily into either category.

⁹⁰ *Cf.* Refrigeration Eng'g Corp. v. Frick Co., 370 F. Supp. 702, 709 (W.D. Tex. 1974) (commercial refrigeration equipment distributors have large geographic markets).

⁹¹ See *United States v. J.I. Case Co.*, 101 F. Supp. 856 (D. Minn. 1951).

⁹² MANAGEMENT, *supra* note 85, at 39; M. PORTER, *supra* note 18, at 61, 96-113; F. SCHERER, *supra* note 87.

⁹³ 101 F. Supp. 856 (D. Minn. 1951).

of its farm machinery to deal exclusively with Case for the products it manufactured and to discontinue any other brands they had been carrying. Farm machinery is extremely durable. Consumers shop for it carefully, and may travel substantial distances to comparison shop.⁹⁴ Therefore, the fact that one manufacturer signs a significant number of retailers to exclusive dealing contracts might have little effect upon the opportunities for other manufacturers to reach consumers through different retailers. The court found that there had been "no showing that any farm machinery manufacturer had difficulty in obtaining dealers as outlets"⁹⁵ as a result of Case's exclusive dealing arrangements, and it dismissed the complaint.⁹⁶

Exclusive dealing in convenience products that results in foreclosure of retailers is more likely to cause foreclosure of those retailers' customers. For example, a college bookstore that begins to carry only one brand of looseleaf paper probably will not lose many customers, because most consumers are likely to treat paper as a convenience product. If the store begins to carry only one brand of calculators or typewriters, on the other hand, it is more likely to lose customers because most customers are likely to treat such items as shopping products, and will not confine their search to that outlet.

In the tavern example described earlier, the neighborhood tavern can deliver its customers for draft beer not only because of the type of establishment it is, but because draft beer, being highly perishable and relatively inexpensive, is not a product for which most consumers comparison shop. This ability to deliver customers may help to explain the decision in *Adolph Coors Co. v. FTC*,⁹⁷ where the court held that arrangements requiring retailers to deal exclusively in Coors draft beer were unlawful under the Federal Trade Commission Act.

Likewise, the different results reached in *Coors* and *J.I. Case* are partially reconcilable on the basis of the different types of products involved; draft beer is a convenience product, whereas farm machinery is a shopping product. Foreclosing a percentage of draft beer accounts may well foreclose competitors from that percentage of the ultimate draft beer market, while binding the same percentage of farm machinery dealers may carry far less assurance of foreclosing competitors from a comparable segment of the ultimate farm machinery market. A real problem with the cases, however, is that they fail to articulate these distinctions or to address the underlying economics, leaving the impression

⁹⁴ *Id.* at 862-63.

⁹⁵ *Id.* at 862.

⁹⁶ *Belton*, by comparison, presented a somewhat unique situation because consumers commonly had to be convinced that they needed the product in the first place. The Commission found that there was relatively little comparison shopping. [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,379.

⁹⁷ 497 F.2d 1178 (10th Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975).

that simple formulations will suffice.⁹⁸

The nature of the product becomes unimportant in the case of wholesalers, it should be noted, because retailers purchasing inventory items at wholesale generally purchase with considerable deliberation. There are no convenience products in the eyes of a reseller, and the effect of foreclosing wholesalers accounting for twenty-five percent of the sales of a product will not depend upon whether the ultimate consumers of that product later treat it as a shopping product or a convenience product. The tavern owner will be as discriminating about purchasing beer as the farm equipment dealer will be about buying tractors.

In the case of retailers, however, the nature of the product is significant, and courts should recognize this in evaluating the foreclosure effect of exclusive dealing.⁹⁹

3. *Alternative Channels of Distribution*

Taking account of the level of distribution and the type of product does not end the inquiry when measuring the degree of foreclosure caused by an exclusive dealing arrangement. Another important consideration is the entirely separate channels of distribution that may be available to suppliers. For example, one supplier may have an exclusive dealing agreement with the only wholesaler of a particular product in an area, yet other suppliers may be able to reach retailers by equipping other wholesalers to handle the product, by shipping directly to retail outlets themselves, or by shipping to warehouses owned by retail chains or cooperatives.¹⁰⁰ At the retail level, suppliers can reach consumers through retailers who have never handled the product before, as evidenced by food stores that have begun selling magazines and pantyhose.¹⁰¹ Suppliers also may be able to reach consumers directly through mail order solicitations and door-to-door sales.

Indeed, by developing other channels of distribution, suppliers will be promoting "intertype competition"—competition among different

⁹⁸ Another important problem with *Coors* was that the Tenth Circuit entirely dispensed with finding the percentage of outlets foreclosed. The court stated flatly that "[a]greements foreclosing a competitor's products are unlawful," 497 F.2d at 1187, prompting the Commission in *Beltone* to question the continued viability of *Coors*. [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,390-91.

⁹⁹ Cf. M. PORTER, *supra* note 18, at 61 (arguing that where "shopping" goods are involved, percentage of distributors foreclosed is significant "only in extreme cases").

¹⁰⁰ In *Joyce Beverages v. Royal Crown Cola Co.*, 555 F. Supp. 271 (S.D.N.Y. 1983), the court held that the Seven-Up Company had the "prestige, resources and contacts" to enter the New York market with a new cola even if foreclosed from contracting with one particular bottler that was bound to an exclusive dealing arrangement with another company. The court found that "[t]here are numerous ways in which Seven-Up will be able to enter the New York market." *Id.* at 278.

¹⁰¹ See MANAGEMENT, *supra* note 85, at 203 (referring to this phenomenon as "scrambled merchandising").

modes of distribution.¹⁰² This adds a new dimension to competition by offering customers not only another brand, but another delivery option. In estimating foreclosure, courts should look beyond the particular channel of distribution affected and determine whether competitors can reach the ultimate market through alternative channels.

4. *Establishing New Distributors*

If a supplier has sufficient financial strength, it can establish a network of entirely new distributors to handle its brand.¹⁰³ Increasing the total number of distributors will promote competition more than "piggybacking" onto another supplier's existing distributors, because each distributor will be devoting its full efforts to only one brand.¹⁰⁴ If a supplier is in a position to achieve adequate distribution by creating new distributors, therefore, the degree of foreclosure attributable to any exclusive dealing arrangements between other suppliers and their distributors must be discounted accordingly.

Thus, in any effort to measure foreclosure, the percentage of distributors foreclosed and the percentage of sales volume historically accounted for by those distributors merely provide starting points. These percentages must be examined in light of customer loyalty to the distributors and the brand, as well as the availability of alternative means of distribution. Only after considering all of these variables can the anticompetitive effect of an exclusive dealing arrangement be measured.

B. The Procompetitive Effects

A complete analysis of the impact of exclusive dealing arrangements must also consider the procompetitive effects these arrangements create. Although exclusive dealing, like resale restraints, can promote interbrand competition, its procompetitive effects differ significantly from those of resale restraints. As explained above,¹⁰⁵ exclusive dealing does not discourage *intra-brand* free riding. However, it does encourage distributors to compete more vigorously, and suppliers to assist them in these efforts. It may also have certain procompetitive effects in protecting trade secrets and trademarks. Judicial investigations should consider all of these effects, yet to date the cases have only treated them superficially. The procompetitive effects of exclusive dealing arrangements merit more careful consideration.

1. *Stimulating Distributors*

Confining the efforts of a distributor to a single brand can promote

¹⁰² J. PALAMOUNTAIN, *THE ECONOMICS OF DISTRIBUTION* 38-48 (1955).

¹⁰³ *See, e.g.*, Dictograph Prods., Inc., 50 F.T.C. 281, 294 (1953).

¹⁰⁴ *See infra* notes 106-10 and accompanying text.

¹⁰⁵ *See supra* notes 73-74 and accompanying text.

interbrand competition by encouraging the distributor to devote its maximum effort to the one brand. An exclusive dealing arrangement makes the distributor an advocate rather than a mere conduit. When contacting customers, the distributor can be expected to extol the virtues of that brand because its own success is tied to the brand's success. Customers are likely to perceive the distributor's carrying of only the one brand as an endorsement, even if the distributor does little else to promote the brand.

If a distributor carries a number of brands of the same product, the distributor becomes more like a clearinghouse; so long as its margins remain the same, the distributor is indifferent to which brand its customers buy. It acts less as an active advocate in the competitive arena than as a passive onlooker. By carrying competing brands, a distributor gives the appearance of endorsing them all, and becomes a less credible advocate for any one of them. In addition, a distributor who carries more than one brand will not devote its wholehearted efforts to promote any one brand as vigorously as it would if it dealt in that brand alone. Its loyalties will be divided, and its efforts on behalf of each brand will be diluted.

*Joyce Beverages v. Royal Crown Cola Co.*¹⁰⁶ illustrates this problem. The Seven-Up Company, wishing to introduce a new cola called "Like," contracted with Joyce Beverages, a New York bottler. Joyce, however, already was bottling and distributing another cola, Royal Crown, under what amounted to an exclusive dealing arrangement. Joyce desired to distribute both brands, and sued for a declaratory judgment that its exclusive dealing contract with Royal Crown was anticompetitive and therefore unenforceable. The court rejected this argument, holding that exclusive dealing, which was also being employed by the other major brands in the market, increased competition because it focused the efforts of each bottler on a single brand.

The court cited several examples of how divided loyalties could be expected to dilute Joyce's efforts on behalf of Royal Crown if the exclusive dealing requirement were not enforced:

Joyce will control pricing, placement of local advertisements, special promotions, feature advertising and special displays of the two competitive products. . . . Retailers have been and will be asked to devote a portion of their limited cola budgets and to edge into their shelf space a cola product competitive to Royal Crown. In addition, Joyce will begin seeking and seizing promotional and merchandising opportunities on behalf of LIKE cola. These activities will necessarily dilute Joyce's efforts on behalf of the Royal Crown colas.¹⁰⁷

The court also pointed out that Seven-Up's national advertising cam-

¹⁰⁶ 555 F. Supp. 271 (S.D.N.Y. 1983).

¹⁰⁷ *Id.* at 275.

paign for Like, in which Joyce was expected to participate, claimed that Like was superior to most other colas, including Royal Crown.

The court expressed concern that if Joyce controlled the distribution of two competing brands it would become the arbiter of when each would be promoted or discounted, and for how long and how much. Joyce testified that it would stagger sales promotions, so that it would never promote both brands in the same manner at the same time. Although Joyce would face competition from other brands, it would also be competing against itself, affording the illusion of arm's length competition between Like and Royal Crown even though such competition would not really exist. The court quoted an observation made in *Sulmeyer v. Coca-Cola Co.*,¹⁰⁸ that "[a] bottler with a dual franchise might be hesitant to strongly promote one cola product over the other, with competitive detriment to both syrup manufacturers."¹⁰⁹

The court concluded that competition among Like, Royal Crown, and the two leading colas, Coca-Cola and Pepsi-Cola, would be better served if Joyce distributed only one cola, either Like or Royal Crown:

[T]he arrangement that will arise if Joyce distributes LIKE and Royal Crown uses another distributor or set of distributors, increases rather than forecloses competition, as four distributors would then be distributing four colas. The equivalent will result if Joyce continues to distribute Royal Crown and Seven-Up uses another distributor or distributors. Under either situation, there will be the "fierce" interbrand competition testified to between Coke, Pepsi, Royal Crown and LIKE. If both LIKE and Royal Crown were in the hands of Joyce, these two colas would "never" compete with one another, according to [a Joyce witness].¹¹⁰

Joyce Beverages demonstrates that interbrand competition reaches its maximum level when each distributor is bound to an exclusive dealing arrangement and focuses on only one brand, provided there are enough distributors to go around for every brand and each distributor can stay in business selling a single brand. Although territorial and customer restraints also strengthen interbrand competition between distributors—by removing the distraction of competition with other distributors of the *same* brand—exclusive dealing strengthens those efforts by preventing the distributors from being distracted by *other* brands.

¹⁰⁸ 515 F.2d 835, 840 n.2 (5th Cir. 1975), *cert. denied*, 424 U.S. 934 (1976).

¹⁰⁹ The Federal Trade Commission made a similar observation in *Coca-Cola Co.*, 91 F.T.C. 517, 637 (1978), *vacated*, 642 F.2d 1387 (D.C. Cir. 1981). The Commission referred to piggybacking of several brands by Coca-Cola bottlers as affording only "the image of competition."

Several other cases have also addressed the problem of divided loyalties. *See* *Brattleboro Auto Sales, Inc. v. Subaru, Inc.*, 633 F.2d 649, 651 n.4 (2d Cir. 1980); *Business Equip. Center Ltd. v. De Jur-Amsco Corp.*, 465 F. Supp. 775, 779-80, 785-86 (D.D.C. 1978); *Deltown Foods, Inc. v. Tropicana Prods., Inc.*, 219 F. Supp. 887, 890-91 (S.D.N.Y. 1963).

¹¹⁰ 555 F. Supp. at 279.

2. *Stimulating Suppliers*

Exclusive dealing not only encourages distributors to compete more vigorously, it also encourages suppliers to assist distributors in their marketing efforts. Many suppliers invest substantial amounts of money in strengthening their independent distributors, often providing the capital for initial start-up costs.¹¹¹ They may provide financing,¹¹² technical training,¹¹³ merchandising advice,¹¹⁴ architectural services,¹¹⁵ site selection,¹¹⁶ and customer leads.¹¹⁷ A supplier will be less inclined to provide this type of assistance if it knows that other suppliers could come along and “piggyback” their competing products onto the same distributor, taking a free ride on the investments of the supplier that initially made that distributor an effective marketer.¹¹⁸

Beltone recognizes that providing incentives for suppliers to underwrite the competitive efforts of their distributors is one of the procompetitive effects of exclusive dealing. In *Beltone*, the supplier engaged in extensive “lead generation” through national and local promotional activity aimed at finding potential customers for its distributors. It would not have been anxious to forward these leads to its distributors, however, if the distributors could have offered these customers other brands. The exclusive dealing requirement eased this concern. The Commission found that the exclusive dealing restriction had a “rational and efficient connection” to the supplier’s objective of “protect[ing] its invest-

¹¹¹ See, e.g., *Martin B. Glauser Dodge Co. v. Chrysler Corp.*, 570 F.2d 72 (3d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978); *Coleman Motor Co. v. Chrysler Corp.*, 525 F.2d 1338 (3d Cir. 1975); *Rea v. Ford Motor Co.*, 497 F.2d 577 (3d Cir.), *cert. denied*, 419 U.S. 868 (1974); *England v. Chrysler Corp.*, 493 F.2d 269 (7th Cir.), *cert. denied*, 419 U.S. 869 (1974); *Perma Life Mufflers, Inc. v. International Parts Corp.*, 376 F.2d 692 (7th Cir. 1967), *rev'd on other grounds*, 392 U.S. 134 (1968).

¹¹² See, e.g., *Martin B. Glauser Dodge Co. v. Chrysler Corp.*, 570 F.2d 72 (3d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978); *Melso v. Texaco, Inc.*, 532 F. Supp. 1280 (E.D. Pa.) (financing for retailer’s customers), *aff'd*, 696 F.2d 983 (3d Cir. 1982); *Mt. Lebanon Motors, Inc. v. Chrysler Corp.*, 283 F. Supp. 453 (W.D. Pa. 1968).

¹¹³ See, e.g., *Perma Life Mufflers, Inc. v. International Parts Corp.*, 376 F.2d 692 (7th Cir. 1967), *rev'd on other grounds*, 392 U.S. 134 (1968); *McAlpine v. AAMCO Automatic Transmissions, Inc.*, 416 F. Supp. 1232, 1248-51 (W.D. Mich. 1978).

¹¹⁴ See, e.g., *FTC v. Brown Shoe Co.*, 384 U.S. 316, 318 (1966).

¹¹⁵ See, e.g., *id.*; *Principe v. McDonald’s Corp.*, 631 F.2d 303 (4th Cir. 1980), *cert. denied*, 451 U.S. 970 (1981); *Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965).

¹¹⁶ See, e.g., *Ungar v. Dunkin’ Donuts of Am., Inc.*, 531 F.2d 1211 (3d Cir.), *cert. denied*, 429 U.S. 823 (1976); *Martino v. McDonald’s Sys., Inc.*, 81 F.R.D. 81 (N.D. Ill. 1979); *In re: 7-Eleven Franchise Antitrust Litig.*, 1974-2 Trade Cas. (CCH) ¶ 75,429 (N.D. Cal. 1974).

¹¹⁷ See *Beltone*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,376.

¹¹⁸ The first supplier also may anticipate that the distributor intends to market a competing brand under its own “house” label. See *Deltown Foods, Inc. v. Tropicana Prods., Inc.*, 219 F. Supp. 887, 890-91 (S.D.N.Y. 1963). The problem of divided loyalties is even more aggravated in the case of a distributor’s own brand because the distributor is likely to make greater profits on such products and to show greater loyalty to them.

ment."¹¹⁹

One commentator has argued that encouraging suppliers to invest is the *only* genuine procompetitive effect of exclusive dealing, and that exclusive dealing does not result in more efficient marketing efforts on the part of distributors at all.¹²⁰ This assessment, however, ignores the value of preventing distributors from developing divided loyalties¹²¹ and rests on two questionable assumptions.

First, it assumes that exclusive dealing will result in fewer sales and lower per unit profit for the distributor, forcing the supplier to lower its own price in order to compensate the distributor for this loss. In reality, the distributor's profits may be higher under exclusive dealing, because its promotional efforts are not diluted among a number of brands and its total sales may therefore be greater.

Second, it assumes that if the promotional services of distributors of one brand were superior to those of multiline distributors, distributors would adopt exclusive dealing voluntarily. Exclusive dealing, however, makes the distributor dependent on one supplier, and although it might actually maximize the profits of both the distributor and the supplier, this dependence makes exclusive dealing unappealing to distributors. Although there are notable exceptions, distributors rarely adopt exclusive dealing as a marketing strategy voluntarily. More often exclusive dealing is a function of limited space or facilities—as when a neighborhood delicatessen has room to carry only one brand of ketchup—or a function of the distributor's inability to find more than one supplier willing to grant it distribution rights. If a distributor is newly formed, or if the brand itself is new, the future will be too uncertain for the distributor to forego sales of other brands voluntarily. If the distributor is already established, it probably will consider it too risky to switch to exclusive dealing voluntarily, even though it may achieve more success in the long run by carrying only one brand.

The argument that stimulation of suppliers' efforts is the only procompetitive effect of exclusive dealing cannot be accepted in light of these factors.¹²² Nonetheless, it is correct to point out that the effect of exclusive dealing arrangements on suppliers' efforts can be extremely significant.¹²³ In the absence of exclusive dealing, suppliers are more likely to allow distributors to sink or swim on their own, rather than spend money to strengthen a distributor who can then serve other suppliers who have not made similar investments.

No supplier wants to bankroll a distribution network for its compet-

119 *Bellone*, [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,398.

120 *Marvel*, *supra* note 56, at 4-5.

121 *See supra* notes 107-09 and accompanying text.

122 *See supra* note 120 and accompanying text.

123 *See Marvel*, *supra* note 56.

itors. A supplier who finances and trains a distributor, without requiring that distributor to deal exclusively in its brand, allows a competing supplier to sit back and take a free ride simply by having the distributor add its brand for sale as well. The free-riding supplier can also take a number of affirmative steps to dilute further the distributors promotional efforts on behalf of the original supplier's brand by "buying" the distributor's loyalty. These steps, designed to shift some of the expense of promotion from the distributor back onto the supplier, are the same steps a supplier would take to induce any nonexclusive distributor to push its brand.

First, the free-riding supplier can lower its prices to offer the distributor a higher margin. Distributors will devote more effort to selling brands on which they stand to make a greater profit. Not uncommonly, a supplier in these circumstances will invest in little or no "pull" advertising—advertising designed to pull consumers into the retail outlets in search of that specific brand. Instead, the supplier will keep prices to its distributors low and rely on them to "push" the brand to consumers.¹²⁴

A related technique is the sales contest. These contests do not lower prices to the distributors directly, but instead offer a cash or merchandise bonus to distributors who exceed their sales quotas. Distributors may promote the free-riding supplier's brand over the original supplier's brand in hope of earning the reward. Alternatively, the free-riding supplier may pay a bonus directly to the distributors' sales representatives or sales managers.¹²⁵

Free-riding suppliers can also encourage distributor promotion by paying for it directly through cooperative advertising, promotional payments, or outright provision of promotional materials. Cooperative arrangements encourage the distributor to commit its own funds to promote those brands that provide matching funds. An attractive cooperative arrangement will be difficult to pass up, even though it will require the distributor to spend some of its own money. Direct provision of promotional material is even more likely to be utilized. If a supplier gives a distributor displays, samples, banners, leaflets, signs, videotaped sales presentations, or live demonstrators, the distributor is likely to use these to promote the brand because such promotion requires little or no additional cost.¹²⁶

¹²⁴ This can manifest itself in "bait and switch" sales techniques at the retail level, with the original supplier's lower-margin product as the "bait" and the free riding supplier's higher-margin product as the "switch."

¹²⁵ M. PORTER, *supra* note 18, at 33 n.46.

¹²⁶ Alternatively, a supplier relying on distributors that carry other brands can attempt to overcome the dilemma of nonexclusivity by appealing directly to the distributors' customers through advertising and other means rather than by paying to encourage the distributor to promote. At the wholesale level, a supplier can hire advocates of its own in the form of "detail men," "presellers," or sales representatives of any other name, to try to convince retail-

All these methods help a free-riding supplier to encourage a distributor to devote more effort to promoting its brand and less to promoting other brands. Instead of finding its own distributor—resulting in two faithful advocates for two brands—the free-riding supplier divides the loyalties and promotional efforts of one distributor between the two brands. This discourages the original supplier's assistance to the distributor and probably discourages that supplier from helping to establish other distributors in the future.

One might argue that if a supplier can encourage distributors to promote its brand by employing all of the different incentives described above, it really does not need to impose exclusive dealing in the first place. This overlooks the fact that none of these incentives can totally overcome the impact of divided loyalty. Furthermore, none of them will convince a supplier to give its unqualified support to a distributor in the way that exclusive dealing does. Finally, none of these incentives requires an investment on the part of the supplier in the competitive effectiveness of the distributor itself, rather than the supplier's brand.

Of course, underlying the procompetitive effects of exclusive dealing is the need for enough distributors to serve every supplier. If an exclusive dealing arrangement significantly forecloses other suppliers, the arrangement may inhibit, rather than promote interbrand competition.¹²⁷ On balance, however, if exclusive dealing does not significantly foreclose other brands from reaching the market, one may expect it to increase interbrand competition.

3. *Other Procompetitive Effects*

Wholly apart from the procompetitive effects on distributors' marketing efforts and on supplier support for distributors, exclusive dealing arrangements may also be necessary to protect trade secrets or licensed trademarks. As the Commission emphasized in *Beltone*, any "reasonable justifications" for exclusive dealing must be taken into account.¹²⁸

a. *Protection of Trade Secrets.* Exclusive dealing arrangements can prevent distributors from misappropriating confidential supplier information and using it to market competing brands. Suppliers often give distributors access to a wealth of confidential information including indispensable trade secrets, such as recipes and formulas. Some of the in-

ers to buy its brand from the distributors. This may be a difficult task, because retailers may lack the patience to grant an audience to another species of salesman for the same brand that the distributors carry. At the retail level the supplier can engage in advertising, offer free samples by mail, or use other techniques to build consumer demand directly.

¹²⁷ *See, e.g.,* Standard Fashion Co. v. Margane Houston Co., 258 U.S. 346, 357 (1922) (exclusive dealing arrangement may substantially lessen competition in both large cities and small towns with few outlets).

¹²⁸ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,391.

formation is strategic, such as timetables for new promotional programs, and some instructive, such as technical training information or the results of consumer surveys. In addition, some of it is of immediate value to competitors, such as the actual customer leads described in *Beltone*.¹²⁹

The misappropriation of a supplier's trade secrets for the benefit of other brands is actually a variation of the interbrand free-riding described above.¹³⁰ Although suppliers normally have considerable leeway in deciding how much to spend in assisting distributors to become stronger competitors, most suppliers must share at least some confidential information in order to do any business through a distributor. Accordingly, although a supplier can promote its products directly to consumers and limit its financial support to distributors with divided loyalties, it may have little choice in disclosing confidential information to those distributors. Exclusive dealing arrangements can provide the most reliable method to prevent such information from benefiting competing brands.

In *Joyce Beverages v. Royal Crown Cola Co.*,¹³¹ the court recognized that an example of the conflicts the bottler would face if it tried to distribute both Royal Crown Cola and Like cola was "the need to keep each one's market strategies confidential."¹³² The court concluded that exclusive dealing would prevent this dilemma and upheld the exclusive dealing arrangement at least partially for this reason. Similarly, other cases have suggested that exclusive dealing arrangements can have the long-run procompetitive effect of protecting trade secrets.¹³³

b. *Quality Control.* The Supreme Court specifically pointed out in *Sylvania* that the acceptable justifications for vertical restraints include not only marketing efficiencies, such as eliminating the free-rider effect, but also quality control efficiencies:

Marketing efficiency is not the only legitimate reason for a manufacturer's desire to exert control over the manner in which his products are sold and serviced. As a result of statutory and common-law developments, society increasingly demands that manufacturers assume direct responsibility for the safety and quality of their products.¹³⁴

¹²⁹ See *supra* note 119 and accompanying text.

¹³⁰ See *supra* notes 119-27 and accompanying text.

¹³¹ 555 F. Supp. 271 (S.D.N.Y. 1983).

¹³² *Id.* at 276.

¹³³ *Esposito v. Mister Softee, Inc.*, 1980-1 Trade Cas. (CCH) ¶ 63,089, at 77,422-23 (E.D.N.Y. 1979) (finding exclusive dealing clause unnecessary because franchisor's product not based on secret formula); *cf.* *National Football League v. North Am. Soccer League*, 103 S. Ct. 499, 502 (1982) (Rehnquist, J., dissenting from denial of certiorari) (procompetitive effect of rules prohibiting NFL team owner from owning other sports team "does not appear [to be] . . . outweighed by their negative effects on competition.").

¹³⁴ *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 n.23 (1977); *accord* *Na-*

Even before *Sylvania*, in *Susser v. Carvel Corp.*,¹³⁵ the Second Circuit pointed out that among the "economic justifications" that would satisfy the requirements of *Tampa Electric* was protection of a trademark by a licensor: "Trademark licensing agreements requiring the sole use of the trademarked item have withstood attack under the antitrust laws where deemed reasonably necessary to protect the goodwill interest of the trademark owner" ¹³⁶

Federal law requires a trademark owner that licenses its trademark to exercise control over the quality of the trademarked goods produced and distributed by its licensees.¹³⁷ If a distributor manufactures the licensed product in whole or in part, such as a Carvel soft ice cream store,¹³⁸ a Chock Full O' Nuts coffee shop¹³⁹, or a Dawn Donut Shop,¹⁴⁰ quality control is easier to maintain if the distributor is limited to selling only the one brand. Substitution of unauthorized ingredients presents a continuing concern in such situations;¹⁴¹ if a licensed manufacturer-distributor handles other brands, it will always have a variety of ingredients on hand, making policing more difficult for the licensor.

If an exclusive dealing arrangement provides an effective means for exercising the required quality control, a court or the FTC may uphold it even though it results in a significant foreclosure of competition. Although some trademark owners monitor quality without exclusive dealing clauses, the FTC has held that a supplier need not employ the least restrictive alternative so long as the restraint is reasonable.¹⁴² Courts should recognize that in the context of trademark licensing, the efficiency effects of exclusive dealing can promote long-run interbrand competition even if there is significant foreclosure.¹⁴³

tional Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 688, 696 n.22 (1978); Tripoli Co. v. Wella Corp., 425 F.2d 932, 938 (3d Cir.), *cert. denied*, 400 U.S. 831 (1970).

¹³⁵ 332 F.2d 505, 516 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965).

¹³⁶ *Id.* at 517.

¹³⁷ Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d 358, 365-66 (2d Cir. 1959); *see* Note, *Quality Control and the Antitrust Laws in Trademark Licensing*, 72 YALE L.J. 1171, 1186-93, 1198-99 (1963); *cf.* Pike v. Ruby Foo's Den, Inc., 232 F.2d 683 (D.C. Cir. 1956) (licensor of restaurant name retained revocation rights and ownership of the name by licensing clause in licensing agreement and involvement in maintaining quality at licensee's restaurant); Philip Morris, Inc. v. Imperial Tobacco Co., 251 F. Supp. 362, 379 (E.D. Va. 1965) (antitrust violations and British licensor's lack of involvement with or relation to American licensee justified court order stripping British licensor of trademark rights in United States for trademarks licensed to American manufacturer), *aff'd*, 401 F.2d 179 (4th Cir. 1968) *cert. denied*, 393 U.S. 1094 (1969).

¹³⁸ *Susser v. Carvel Corp.*, 332 F.2d 505, 517 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965).

¹³⁹ Chock Full O' Nuts Corp., 83 F.T.C. 575 (1973).

¹⁴⁰ *See, e.g.*, Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d 358 (2d Cir. 1959).

¹⁴¹ *Id.* at 367.

¹⁴² *See supra* note 44 and accompanying text.

¹⁴³ Where patent licensing is involved instead of trademark licensing, restrictions against a licensed manufacturer producing competing goods comes in for much harsher treatment

c. *Duration*. In *Beltone*, the Commission stated that one other factor that must be considered in an assessment of exclusive dealing is the duration of the agreement.¹⁴⁴ The Commission observed that one of the reasons exclusive dealing has been treated rather leniently under the antitrust laws is that most exclusive dealing arrangements are of relatively short duration and are easily terminable.¹⁴⁵ The Commission referred to Professor Sullivan's assertion that "the longer the exclusive dealing arrangement, the more likely it is that its restrictiveness outweighs any efficiencies or justifications associated with it."¹⁴⁶

This appears to be an overstatement. Naturally, an exclusive dealing arrangement that expires after one year is less restrictive than an otherwise identical agreement which expires after two years. It does not follow, however, that arrangements of longer duration are always likely to be less procompetitive. A one-year foreclosure of a substantial number of end-users, for example, may be far more restrictive of inter-brand competition than a perpetual foreclosure of a limited group of distributors.

CONCLUSION

In *Beltone* the Commission instructed that the "dynamic nature of the market" must be taken into account along with market share data in assessing the legality of an exclusive dealing arrangement. This article has attempted to give some content to the concept of market dynamics in the context of distribution.

The most important dynamic that emerges is loyalty—loyalty of consumers, of distributors, and of suppliers. The anticompetitive effect of foreclosing a particular percentage of distributors will vary significantly with the two factors that influence consumer loyalty—the distribution level and the product type. Other dynamics affecting foreclosure are the availability of alternative channels of distribution and the potential for creating new distributors.

The principal procompetitive dynamics of exclusive dealing are the degree of distributor loyalty to the brand and the degree of supplier loyalty to the distributor. These loyalties are measured by how much more intensely the distributors and the suppliers each compete against other brands as a result of the exclusive dealing arrangement. Exclusive

because the licensor is not required to monitor the quality of products sold under its name. *See, e.g.*, *Stewart v. Mo-Trim, Inc.*, 192 U.S.P.Q. 410 (S.D. Ohio 1975).

¹⁴⁴ [1979-1983 Transfer Binder] TRADE REG. REP. (CCH) at 22,391.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 22,391 n.39 (citing L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 485-86 (1977)); *see also* Bok, *supra* note 23, at 302-03. On the other hand, the Commission also recognized that the restriction in *Tampa Electric* was for 20 years and in *Beltone* itself the restriction had no time limitations, although the dealership contracts were terminable by either party on 30 days' notice.

dealing enhances both. Other market dynamics that generate procompetitive effects involve the safeguarding of confidential information and assurance of quality control in trademark licensing situations.

These market dynamics are far more complex than are simple percentages of distributors or sales volume foreclosed. Only by recognizing and accounting for these dynamics can courts measure the procompetitive and anticompetitive effects of exclusive dealing with any assurance of accuracy. Courts should focus on the percentages of foreclosure as the starting points of any inquiry, but, unless the application of these percentages is tempered with the considerations discussed above, it will not provide an adequate basis for determining legality.