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***Antitrust Law and Economics* (Edward Elgar
Publishing, Keith N. Hylton, ed.), Forthcoming**

**George Mason University Law and Economics
Research Paper Series**

08-37

This paper can be downloaded without charge from the Social Science
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Antitrust Analysis of Tying Arrangements and Exclusive Dealing

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Forthcoming in 2009

**THE LAW AND ECONOMICS OF ANTITRUST
(Keith Hylton ed., Edward Elgar Publishing Ltd.)**

Abstract

This chapter surveys the legal and economic literatures on the antitrust analysis of tying arrangements and exclusive dealing contracts. We review the analytical framework applied under U.S. antitrust law to tying, bundling and exclusive dealing arrangements as well as the existing theoretical and empirical literatures.

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I. INTRODUCTION

Exclusionary conduct is one of the most controversial areas in antitrust. As evidenced by the Federal Trade Commission and Department of Justice Joint Hearings on Single Firm Conduct, antitrust jurisprudence is still in the process of identifying what conduct a firm with market power can engage in without creating the risk of antitrust liability. Two areas of significant concern involving potentially exclusionary conduct are tying (and bundling) and exclusive dealing. Both tying and exclusive dealing have the potential to harm competition and generate anticompetitive effects under certain conditions which may be difficult to identify in practice. Further, both tying and exclusive dealing contracts are prevalent in markets without significant antitrust market power and have a number of pro-competitive uses. The key question for antitrust policy is how to design optimal antitrust rules under these conditions when the costs of finding liability for an efficient practice significantly outweigh the costs of failing to condemn an anticompetitive practice.

In this Chapter, we consider the legal framework applied to tying, bundling, and exclusive dealing arrangements and survey the relevant economic literature.

II. TYING AND BUNDLING ARRANGEMENTS

A tying arrangement occurs when, through a contractual or technological requirement, a seller conditions the sale or lease of one product or service on the customer's agreement to take a second product or service.¹ The term "tying" is most often used by economists when the proportion in which the customer purchases the two products is not fixed or specified at the time of purchase, as in a "requirements tie-in" sale.² A bundled sale typically refers to a sale in which the products are sold only in fixed proportions (for example, one automobile and one radio; one pair of shoes and one pair of shoe lace; or a newspaper, which can be viewed as a bundle of topic-specific sections, such as sports, national news, local news, and entertainment). Bundling may

¹ DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 319 (4th ed. 2005).

² A "requirements tie-in" sale occurs when a seller requires customers who purchase one product from the seller (e.g., a printer) also to make all their purchases of another product from the seller (e.g., ink cartridges). Such tying allows the seller to charge customers different amounts depending on their product usage. *Id.* at 321-22.

also be referred to as a “package tie-in.”³ Case law in the United States sometimes uses the terms “tying” and “bundling” interchangeably.⁴

A. LEGAL ANALYSES OF TYING AND BUNDLING

The treatment of tying has undergone a major transformation in American law. At first tying was treated as an inherently anticompetitive, *per se* unlawful practice.⁵ In 1947, in *International Salt Co. v. United States*, the Supreme Court stated that “it is unreasonable, *per se*, to foreclose competitors from any substantial market,”⁶ and in 1949, in *Standard Oil Co. v. United States*, the Court opined that “[t]ying agreements serve hardly any purpose beyond the suppression of competition.”⁷

Since that time, however, although U.S. courts have continued to state that tying is *per se* unlawful,⁸ they have allowed many tying arrangements to escape automatic condemnation by establishing conditions that must be met before the *per se* category applies. Beginning with its landmark “*Fortner II*” decision in 1977,⁹ the Supreme Court began to require substantial proof of market power in

³ *Id.* “Pure bundling” occurs when consumers can purchase only the entire bundle (e.g., when customers are allowed to purchase only a fixed price meal that includes all courses). “Mixed bundling” occurs if the components also are sold separately, with a discount for purchasing the bundle (e.g., restaurant menus that include both à la carte items and complete meals). *See id.* at 324.

⁴ *See, e.g., United States v. Loew’s, Inc.*, 371 U.S. 38 (1962) (analyzing the licensing of feature films only in blocks (or bundles) as tying). *See also* F. Andrew Hanssen, *The Block Booking of Films Reexamined*, 43 J.L. & ECON. 395 (2000); Roy W. Kenney & Benjamin Klein, *How Block Booking Facilitated Self-Enforcing Film Contracts*, 43 J.L. & ECON. 427 (2000); Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 J.L. & ECON. 497 (1983); George J. Stigler, *United States v. Loew’s, Inc.: A Note on Block-Booking*, 1963 S. CT. REV. 152 (1963).

⁵ Business practices merit treatment as *per se* illegal if “their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable.” *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

⁶ *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947).

⁷ 337 U.S. 293, 305-06 (1949).

⁸ ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 177-79 (5th ed. 2002) [hereinafter ANTITRUST LAW DEVELOPMENTS].

⁹ *United States Steel Corp. v. Fortner Enterprises*, 429 U.S. 610 (1977).

the tying product before the *per se* rule would be applied. Although the Court's 1984 *Jefferson Parish* majority opinion continued to give lip service to a *per se* analysis¹⁰ -- while reemphasizing that market power in the tying product was a requirement for *per se* illegality¹¹ -- four of the nine Justices issued a separate opinion supporting application of a case-by-case rule of reason to tying.¹² Later that same year, the Court explained that the application of the *per se* rule to tying had evolved to incorporate a market analysis:

[T]here is often no bright line separating *per se* from Rule of Reason analysis. *Per se* rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct. For example, while the Court has spoken of a "*per se*" rule against tying arrangements, it has also recognized that tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis.¹³

Consistent with this approach, the Supreme Court recently acknowledged that, in contrast to its "historical distrust of tying arrangements,"¹⁴ there are "[m]any tying arrangements . . . [that] are fully consistent with a free, competitive market."¹⁵ Indeed, the test that lower courts use to determine whether to apply the *per se* rule to a particular alleged tie "increasingly resembles

¹⁰ "It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable '*per se*.'" *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 9 (1984).

¹¹ *Jefferson Parish*, 466 U.S. at 9-18.

¹² *Jefferson Parish*, 466 U.S. at 32-47.

¹³ *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 104 n.26 (1984) (citation omitted).

¹⁴ *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281, 1288 (2006). See also ¹⁴ See Joshua D. Wright, *Missed Opportunities in Independent Ink*, 5 CATO SUP. CT. REV. 333 (2006); Bruce H. Kobayashi, *Spilled Ink or Economic Progress? The Supreme Court's Decision in Illinois Tool Works v. Independent Ink*, forthcoming ANTITRUST BULL. (2008), working paper version available at SSRN: <http://ssrn.com/abstract=1084475>

¹⁵ *Illinois Tool*, 126 S. Ct. at 1292.

a rule of reason inquiry.”¹⁶ Although the elements of a *per se* tying violation have been articulated differently, courts generally require that: “(1) two separate products or services are involved, (2) the sale or agreement to sell one is conditioned on the purchase of the other, (3) the seller has sufficient economic power in the market for the tying product to enable it to restrain trade in the market for the tied product, and (4) a not insubstantial amount of interstate commerce in the tied product is affected.”¹⁷ For other *per se* violations, such as naked agreements to fix price, plaintiffs are not required to define the relevant product markets or show that the defendant has market power in the market for the tying product. In addition, some courts have shown a willingness to consider business justifications for the alleged tie,¹⁸ and some courts have required proof that the tie has anticompetitive effects.¹⁹

The limited scope and shaky underpinnings of the *per se* rule against tying were dramatically underscored in the U.S. Court of Appeals for the D.C. Circuit’s landmark 2001 decision in *United States v. Microsoft*.²⁰ That decision refused to apply the *per se* rule to “platform software,”²¹ thereby creating a “technology

¹⁶ ANTITRUST LAW DEVELOPMENTS at 178; 1 HOVENKAMP ET AL., IP AND ANTITRUST § 21.5, at 21-113 to -15.

¹⁷ ANTITRUST LAW DEVELOPMENTS at 179 & n.998 (citing cases).

¹⁸ *United States v. Jerrold Elecs. Corp.*, 187 F. Supp. 545, 557-58 (E.D. Pa. 1960), *aff’d per curiam*, 365 U.S. 567 (1961) (concluding that a tie was justified for a limited time in a new industry to assure effective functioning of complex equipment); *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1348-51 (9th Cir. 1987) (upholding verdict for defendant because the tie may have been found to be the least expensive and most effective means of policing quality); *Dehydrating Process Co. v. A.O. Smith Corp.*, 292 F.2d 653, 655-57 (1st Cir. 1961) (affirming a judgment of a district court that directed a verdict in favor of the defendant because a tie was necessary to assure utility of two products when separate sales led to malfunctions and widespread customer dissatisfaction).

¹⁹ *Wells Real Estate, Inc. v. Greater Lowell Bd. of Realtors*, 850 F.2d 803, 815 (1st Cir. 1988) (“The tying claim must fail absent any proof of anti-competitive effects in the market for the tied product.”); *Fox Motors, Inc. v. Mazda Distribs. (Gulf), Inc.*, 806 F.2d 953, 958 (10th Cir. 1986) (declining to apply the *per se* rule to a tie that “simply does not imply a sufficiently great likelihood of anticompetitive effect”).

²⁰ *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

²¹ *Microsoft*, 253 F.3d at 95. In deciding a tying patent misuse claim, the U.S. Court of Appeals for the Federal Circuit recently rejected a *per se* approach and applied tying case law to find that a package license combining alleged “essential” with “nonessential” patents did not constitute patent misuse because there was no separate demand for the “nonessential” patents, and, thus,

exception” to that rule.”²² The court reasoned that application of traditional *per se* analysis in the “pervasively innovative” platform software industry risks condemning ties that may be welfare-enhancing and procompetitive.²³ Certain leading antitrust commentators have opined that “the rationale [that the court] articulated for abandoning *per se* condemnation applies well beyond just the software industry,” notwithstanding “the court’s protestations to the contrary.”²⁴

Courts have sometimes analyzed bundling under the rubric of tying. In *United States v. Loew’s*,²⁵ for example, the Supreme Court found the practice of licensing feature films to television stations only in blocks (or “bundles”) containing films the stations did not want to license constituted unlawful tying in violation of section 1 of the Sherman Act.²⁶ Nonetheless, in explaining its tying analysis in *Jefferson Parish*, the Supreme Court noted the fact that “a purchaser is ‘forced’ to buy a product he would not have otherwise bought even from another

no separate product market in which competition could have been foreclosed. *U.S. Philips Corp. v. Int’l Trade Comm’n*, 424 F.3d 1179, 1193-97 (Fed. Cir. 2005). The court rejected a *per se* approach “[i]n light of the efficiencies of package patent licensing and the important differences between product-to-patent tying arrangements and arrangements involving group licensing of patents” *Id.* at 1193.

²² See, e.g., Warren S. Grimes, *The Antitrust Tying Law Schism: A Critique of Microsoft III and a Response to Hylton and Salinger*, 70 ANTITRUST L.J. 199, 202 (2002) (“[C]iting the novelty of the issues and the possibility of procompetitive effects, [the D.C. Circuit] imposed a rule of reason to measure Microsoft’s software bundling practices.”); William J. Kolasky, GE/Honeywell: *Continuing the Transatlantic Dialogue*, 23 U. PA. J. INT’L ECON. L. 513, 532 & n.66 (2002) (citing *Microsoft*, 253 F.3d at 84-97, to support a statement that technological ties “are generally evaluated under the rule of reason”).

²³ *Microsoft*, 253 F.3d at 93.

²⁴ This opinion was put forth in 2002 at joint Federal Trade Commission - Justice Department hearings on the intersection between intellectual property and antitrust law [hereinafter IP-ANTITRUST HEARINGS]. Jonathan M. Jacobson & Abid Qureshi, *Did the Per Se Rule on Tying Survive ‘Microsoft’?* (May 14, 2002 Hr’g R.) at 1, <http://www.ftc.gov/opp/intellect/020514jacobson2.pdf>. See also Herbert Hovenkamp, *IP Ties and Microsoft Rule of Reason*, 47 ANTITRUST BULL. 369, 413 (“[W]hile developing a rule of reason for OS/application is laudable, the court’s rationale for distinguishing such ties from the general run of tying arrangements cannot be supported.”).

²⁵ *United States v. Loew’s, Inc.*, 371 U.S. 38 (1962).

²⁶ *Loew’s*, 371 U.S. at 41-43 (noting the blocks contained as many as 754 separate titles); *id.* at 44, 49-50 (treating block booking as tying).

seller” does not imply an “adverse impact on competition.”²⁷ This later statement suggests that bundling would not constitute unlawful tying if the purchaser simply desires to purchase less than the entire bundle of products offered for package sale at a reduced price. Rather, to prevail on an unlawful tying claim, the plaintiff would have to show an exclusionary effect on other sellers as a result of plaintiff’s thwarted desire to purchase substitutes for one or more items in the bundle from other sources that harms competition in the market for the tied product.

More recently, courts have examined bundling in the context of loyalty discounts. For example, in *LePage’s, Inc. v. 3M*,²⁸ the defendant 3M offered a “bundled discount” on its Scotch brand tape and a variety of other products provided the retailer met a target for purchases of private label tape from 3M as well). The en banc court affirmed the trial court’s denial of judgment for defendant as a matter of law.²⁹ The Antitrust Modernization Committee sharply criticized *LePage’s* on the grounds that it offered “no clear standards by which firms can assess whether their bundled rebates are likely to pass antitrust muster” and is “likely to discourage firms from offering procompetitive bundled discounts and rebates to consumers.”³⁰

The Antitrust Modernization Committee proposed an alternative three pronged standard which would require the plaintiff to demonstrate the following in order to establish a violation of Section 2 in addition to the

²⁷ *Jefferson Parish*, 466 U.S. at 16.

²⁸ 324 F.3d 141 (3d Cir. 2003) (en banc).

²⁹ *But see* Brief for the United States as Amicus Curiae, *LePage’s*, 542 U.S. 953 (2004) (No. 02-1865), *denying cert. to* 324 F.3d 141, *available at* <http://www.usdoj.gov/atr/cases/f203900/203900.pdf> (urging the Supreme Court to deny review but criticizing the Third Circuit’s en banc decision for providing little guidance on how section 2 should be applied to bundled rebates, failing to explain why 3M’s conduct was unlawful, and perhaps encouraging challenges to—and therefore chilling the adoption of—procompetitive bundled rebate programs); *see also Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996) (finding “package price” discounts that covered both competitive markets and markets in which defendant had a monopoly did not violate section 2, because plaintiff did not show that either: (1) defendant priced below its average variable cost; or (2) plaintiff was at least as efficient a producer as defendant in competitive product lines, but defendant’s pricing made it unprofitable for plaintiff to continue to compete).

³⁰ ANTITRUST MODERNIZATION COMMITTEE REPORT AND RECOMMENDATIONS 94 (April 2007).

conventional requirements: (1) after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses; and (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.³¹

Consistent with the evolution in legal thinking by the courts, the U.S. federal antitrust agencies (the Justice Department and Federal Trade Commission) in effect endorsed a structured rule of reason for intellectual property tying and bundling in the 1995 Antitrust Guidelines for the Licensing of Intellectual Property (“Antitrust-IP Guidelines”). The Antitrust-IP Guidelines recognize that “[c]onditioning the ability of a licensee to license one or more items of intellectual property on the licensee’s purchase of another item of intellectual property or a good or a service has been held in some cases to constitute illegal tying,”³² but also state that “[a]lthough tying arrangements may result in anticompetitive effects, such arrangements can . . . result in significant efficiencies and procompetitive benefits.”³³ Pursuant to the Antitrust-IP Guidelines, the Agencies consider both the anticompetitive effects and the efficiencies attributable to a tie, and would be likely to challenge a tying arrangement if: “(1) the seller has market power in the tying product,” which the Agencies will not presume necessarily to be conferred by a patent, copyright, or trade secret; “(2) the arrangement has an adverse effect on competition in the relevant market for the tied product; and (3) efficiency justifications for the

³¹ *Id.* at 99. Antitrust Modernization Committee Commissioner Dennis Carlton expressed concern that the first prong of the proposed “AMC” test would fail to protect pro-competitive bundling because common pricing strategies involving price discrimination, such as bundling razors and razor blades, would satisfy the first prong of the test but not threaten competitive injury. See Separate Statement of Dennis Carlton, *id.* at 398-99. Recently, the Ninth Circuit endorsed a modified version of the AMC test which embraced the first prong only but reasoned that the recoupment requirement and proof of an anti-competitive effect were either inappropriate in the bundling context or unnecessary. See *Cascade Health Solutions v. PeaceHealth*, 2007 U.S. App. LEXIS 21075 (9th Cir. 2007).

³² U.S. DEP’T OF JUSTICE & FEDERAL TRADE COMM’N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 5.3 & n.34 (1995), *available at* <http://www.usdoj.gov/atr/public/guidelines/ipguide.htm> [hereinafter ANTITRUST-IP GUIDELINES] (citing *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 156-58 (1948) (copyrights); *Int’l Salt*, 332 U.S. 392 (patent and related product)).

³³ *Id.* § 5.3; *see supra* notes 54-66 and accompanying text (discussion of efficiencies).

arrangement do not outweigh the anticompetitive effects.”³⁴ If a package license constitutes tying,³⁵ the Agencies will evaluate it pursuant to the same rule of reason principles they use to analyze other tying arrangements.

In sum, U.S. courts and federal antitrust enforcement agencies increasingly focus on the actual economic effects of particular tying and bundling arrangements in assessing their legality. The ostensible *per se* prohibition on tying remains applicable only under a limited set of conditions. There is good reason to believe that the Supreme Court will formally reject the *per se* rule and hold that the antitrust rule of reason applies to tying and bundling, if and when presented with the opportunity to do so.³⁶

B. ECONOMIC ANALYSIS OF TYING AND BUNDLING

The shift by courts and enforcers toward a more detailed fact-specific market analysis of tying and bundling arrangements is consistent with the economics literature. That literature suggests that the potential for anticompetitive harms may vary based on surrounding circumstances and that tying and bundling will often generate efficiencies. Whether tying and bundling increase or decrease consumer welfare will depend on the factual circumstances accompanying their use.³⁷ Nevertheless, many economists believe that, in

³⁴ ANTITRUST-IP GUIDELINES § 5.3 (footnotes omitted); *see also id.* § 2.2 (“[The] Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner.”).

³⁵ The Antitrust-IP Guidelines describe package licensing as “the licensing of multiple items of intellectual property in a single license or in a group of related licenses,” which “may be a form of tying . . . if the licensing of one product is conditioned upon the acceptance of a license for another, separate product.” *Id.* § 5.3.

³⁶ This conclusion is supported not only by the tone of the Supreme Court’s decision in *Illinois Tool*, *see text accompanying notes 14-15, infra*, but by the Court’s willingness (in light of economic analysis) to jettison the ninety-five year old *per se* prohibition on minimum resale price maintenance in its 2007 *Leegin* holding. *See Leegin Creative Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007).

³⁷ For surveys on the economic effects of bundling, *see* Bruce H. Kobayashi, *Does Economics Provide A Reliable Guide to Regulating Commodity Bundling By Firms?: A Survey of the Economic Literature*, 1(4) J. COMP. L. & ECON. 707 (2005); Patrick Rey, Paul Seabright & Jean Tirole, *The Activities of a Monopoly Firm in Adjacent Competitive Markets: Economic Consequences and Implications for Competition Policy* (Institut d’Economie Industrielle, Universite de Toulouse, Working Paper No. 132, 2002), *available at* <http://idei.fr/doc/wp/2001/sctivities2.pdf>.

general, tying and bundling are much more likely to be procompetitive than anticompetitive.³⁸

1. THEORIES OF COMPETITIVE HARM

The early economic literature on tying identified two reasons to question whether tying and bundling are likely, as a general matter, to be useful tools for leveraging monopoly power in one market into monopoly power in a second market. First, “tying rarely gives the producer of the tying product a monopoly position in the market for the tied product. . . . A new entrant would have no difficulty in procuring in the open market the requisite cards or ink or salt to supply together with its business machines, duplicating equipment, or salt machinery.”³⁹ Second, a firm with a monopoly in the tying product may be unable to increase its profits by seeking to collect rents from a complementary product. Under the “one monopoly profit argument,” if the same consumers are buying both products in fixed proportions, it is the *total* price that determines consumer sales and the monopolist’s pricing decisions. Consequently, a monopolist would have to lower the price on the tying product to keep the total price unchanged at the profit-maximizing level.⁴⁰ As such, the principal motives for the tie would not be exclusionary conduct aimed at monopolizing the market for the tied product in order to raise its price. Rather, the firm could be using the tie for some other purpose, such as price discrimination or reducing costs.⁴¹

Further analysis has demonstrated that these conclusions rely on some restrictive assumptions, e.g., that the same consumers are buying both products in fixed proportions,⁴² and that the tied good market has a competitive, constant

³⁸ See, e.g., David Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE J. ON REG. 37 (2005).

³⁹ RICHARD A. POSNER, ANTITRUST LAW 202 (2d ed. 2001) (footnote omitted).

⁴⁰ *Id.* at 199.

⁴¹ *Id.* at 199-200; see also Patrick DeGraba, *Why Lever into a Zero-Profit Industry: Tying, Foreclosure, and Exclusion*, 5 J. ECON. & MGMT. STRATEGY, 433-47 (1996).

⁴² As early as the 1950’s, Ward Bowman and others noted this limit on the theoretical conclusions discussed above. See Ward S. Bowman, Jr., *Tying Arrangements and the Leveraging Problem*, 67 YALE L.J. 19 (1957); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837, 837-38 (1990).

returns-to-scale structure. By relaxing those assumptions, some economists have identified exclusionary motives for tying, as well as strategic reasons for bundling and tying.⁴³

One such line of analysis suggests that, under certain cost and demand conditions, a tying arrangement can enable a monopolist in a tying market to reduce demand for rival products in a second, imperfectly competitive, tied market, thus injuring competition.⁴⁴ A commitment by the monopolist of the tying product to sell the tying and tied products only as a package enables the monopolist to commit to aggressive pricing of the tied product. If the monopolist raises its price for the tied product, the commitment to tying means that it loses not only some tied product sales, but also some sales in the profitable, monopolized tying product market. In effect this enables the monopolist to commit itself to a low implicit price for the tied product.⁴⁵ When the market for the tied product exhibits scale economies and therefore is oligopolistic, committing to a low price may reduce competitors' sales and force them to exit.⁴⁶ Consumer harm may occur because "when tied market rivals exit, prices may rise and the level of variety available in the market necessarily falls."⁴⁷ While providing a potential motivation for exclusion, the analysis points

⁴³ See Gregory Vistnes, *Bundling and Tying: Antitrust Analysis in Markets with Intellectual Property* (May 14, 2002 session of IP-ANTITRUST HEARINGS) (slides) at 3-5, <http://www.ftc.gov/opp/intellect/020514vistnesppt2.pdf>; see also Whinston, 80 AM. ECON. REV. at 839; Dennis W. Carlton & Michael Waldman, *Tying, Upgrades, and Switching Costs in Durable-Goods Markets* (Nat'l Bureau of Econ. Research, Working Paper No. 11407, 2005), available at <http://www.nber.org/papers/w11407>.

⁴⁴ See generally Whinston, 80 AM. ECON. REV. 837; Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 194 (2002); José Carbajo, David de Meza & Daniel Seidmann, *A Strategic Motivation for Commodity Bundling*, 38 J. INDUS. ECON. 283 (1990).

⁴⁵ For example, if (contrary to fact) a monopolist in DVD players (the tying product) committed to sell both its DVD player and a CD player (the tied product) only as a bundle for \$300, a customer willing to pay \$250 for a DVD player would obtain the CD player for \$50, because the consumer already was willing to pay \$250 for the DVD player. Thus, the commitment to bundle would set an implicit low price for the tied product, the CD player.

⁴⁶ Whinston, 80 AM. ECON. REV. at 839.

⁴⁷ *Id.* Although originally presented in the context of goods with independent demand, this analysis can also apply to complements.

out that “the impact of this exclusion on welfare is uncertain.”⁴⁸

Another line of analysis shows that tying may be used to preserve an insecure monopoly in the tying product.⁴⁹ Consider a firm that is a monopolist in a primary market and also sells in a duopoly market for a complementary product. In addition, the primary and complementary products must be used together to provide value to consumers. The rival seller in the complementary product market can enter the primary market after incurring an entry cost. To deter the rival in the complementary product market from entering the primary market, the monopolist will tie the primary product with its version of the complementary product. By selling only the combination of products, the monopolist is committing to a low price in the complementary market, just as in the model described in the previous paragraph. This practice can deny the rival seller in the complementary product market enough sales so that it is not worthwhile for the rival to incur the cost of entering the primary market.⁵⁰

Yet another explanation for the monopoly tying of complementary products posits that under certain conditions the tie allows a monopolist to capture some of the profits of the producer of the complementary good.⁵¹ According to this explanation, “the monopolist sometimes ties a product that winds up not being used by consumers . . . in order to extract surplus from, but not exclude, a rival producer. Specifically, the tying improves the monopolist’s position in the pricing game that follows and, in this way, serves to shift profits from the rival to the monopolist.”⁵² Although “this type of tying is frequently inefficient because, for example, consumers do not use the tied good in

⁴⁸ *Id.* at 855-56.

⁴⁹ See Carlton & Waldman, 33 RAND J. ECON. 194 (2002).

⁵⁰ See, e.g., *Microsoft*, 253 F.3d at 60 (“Microsoft’s effort to gain market share in one market (browsers) served to meet the threat to Microsoft’s monopoly in another market (operating systems) by keeping rival browsers from gaining the critical mass of users necessary to attract developer attention away from Windows as the platform for software development.”).

⁵¹ Dennis W. Carlton, Joshua S. Gans, and Michael Waldman, *Why Tie a Product Consumers Do Not Use?* (unpublished manuscript, August 2007), available at <http://www.mbs.edu/home/jgans/papers/Carlton-Gans-Waldman-07-08-09.pdf>.

⁵² *Id.* at 4.

equilibrium,”⁵³ this social inefficiency arguably does not justify antitrust intervention. That is because, as the authors note, the tie “has nothing to do with harming the competitive process in the sense of creating additional market power” (rivals are not excluded and consumer do not pay a higher total price).⁵⁴

As already indicated, tying or bundling intended to gain share at rivals’ expense need not imply consumer harm. Tying may allow for price discrimination, resulting in higher prices for some consumers than would prevail absent a tie, but lower prices for others. Even in the simplest examples, without price discrimination, tying may either raise or lower prices to customers and raise or lower output. Non-monopolists may both gain market share and reduce prices to consumers through tying or bundling.⁵⁵ A firm that sells two complementary products has an incentive to lower the price of one to increase sales of the other. Under this theory, the first firm to act in this manner enjoys a huge market-share gain over its uncoordinated rivals. Moreover, those rivals do not respond by offering bundles of their own, because that would serve only to intensify the competition and leave the rivals worse off. In this scenario, bundling can reduce all prices, because consumer prices are lower when one firm that bundles competes against firms that sell single components independently than when no firms bundle.⁵⁶

2. PROCOMPETITIVE EFFICIENCIES

⁵³ *Id.*

⁵⁴ *Id.* at 26.

⁵⁵ Barry J. Nalebuff, *Competing Against Bundles*, in INCENTIVES, ORGANIZATION & PUBLIC ECONOMICS: PAPERS IN HONOR OF SIR JAMES MIRRELES 323, 324 (Peter Hammond & Garth Mayles eds., 2000) [hereinafter Nalebuff, *Competing Against Bundles*]. The point also holds true for tying. Tying and bundling differ in that “bundling” refers to cases in which the tying and tied products are sold in fixed proportions, whereas “tying” has traditionally referred to cases in which consumers choose the quantity of the tied product they purchase. See CARLTON & PERLOFF, MODERN INDUSTRIAL ORGANIZATION at 319. Thus a producer can use tying to meter usage of the tying product, so as to price discriminate among consumers according to their purchases of the tied product. For example, printers for personal computers often involve a technological tie between the printer and the type of ink cartridge the printer can use. Consumers who do more printing thus pay more to the producer overall than those who print less. Such a tie, however, can result in lower printer prices for consumers. *Id.* at 321.

⁵⁶ Nalebuff, *Competing Against Bundles* at 329-31.

Theoretical work in economics suggests that tying or bundling may often generate efficiencies. Economists postulate that tying and bundling can enhance consumer welfare through a variety of means, such as economies of joint sales, quality assurance and protection of goodwill, and cheating on a cartel price. Economies of joint sales, for example, are present throughout the economy, as in the case of shoes and shoelaces and indeed virtually every manufactured product. Quality assurance may be achieved by tying sales of products to sales of services (warranty repair) or consumables (fast-food franchisees may be required to buy critical ingredients from the franchisor). Cheating on a cartel price may be accomplished by bundling the cartelized product with valuable extras that act as a secret price discount on the cartelized product. In addition, price discrimination, such as through metering, can allow markets to be served that would not be served under single-price monopoly. For example, light and heavy users of printers may both be served if they can buy a manufacturer's printer at a low price and its ink cartridges at a price above marginal cost.⁵⁷ Metering theories, of course, are a consideration only when products can be purchased in variable proportions.

Some of the potential efficiencies result from joining the products in a single bundle. Empirical work on tying and bundling in competitive markets is consistent with the theory that such practices can reduce production costs. For example, consumers can purchase cold tablets that bundle active ingredients to relieve coughs, congestion, and headaches at a significantly lower effective price than if the consumer purchased each of those remedies individually because the incremental cost of adding one more active ingredient to a tablet that already is being produced is negligible.⁵⁸ When the incremental cost of bundling separate goods is small, competition often will result in firms offering the goods both separately and in a bundle, which can improve consumer welfare.⁵⁹ Moreover,

⁵⁷ CARLTON & PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* at 319-22; see also Marius Schwartz & Gregory J. Werden, *A Quality-Signaling Rationale for Aftermarket Tying*, 64 *ANTITRUST L.J.* 387 (1996); William F. Baxter & Daniel P. Kessler, *The Law and Economics of Tying Arrangements: Lessons for the Competition Policy Treatment of Intellectual Property*, in *COMPETITION POLICY AND INTELLECTUAL PROPERTY RIGHTS IN THE KNOWLEDGE-BASED ECONOMY* 137, 142-43 (Robert D. Anderson & Nancy T. Gallini eds., 1998) (discussing beneficial effect of tying as a "metering" device).

⁵⁸ Evans & Salinger, 22 *YALE J. ON REG.* at 66-71.

⁵⁹ Evans & Salinger, 22 *YALE J. ON REG.* 37. The authors note that offering both a bundle and each component separately can involve additional fixed costs. When these fixed costs are sufficiently large, a firm may choose not to bundle and instead to offer only individual components, or may

competition can cause much of the cost savings from bundling to accrue to consumers, making consumers better off than if there were no bundling.⁶⁰

Providing choice may be costly, however. It may not be efficient to provide one of the products separately if only a few consumers prefer it. For example, such a high proportion of consumers want to buy both the left and right shoe as a bundle that the remaining customers do not justify selling them separately. Limiting the combinations of options can simplify production, which lowers costs and presumably prices to consumers.⁶¹ Thus, although Ford Motor Company has offered many options on its Ford Taurus, it has offered them only in certain combinations or packages of options, so that not all possible combinations of options have been available to consumers.⁶² Limiting combinations of options can save fixed costs associated with a full range of product offerings, and it can foster product-specific cost reductions.⁶³

Consistent with this reasoning, the bundling of so-called information goods, such as copyrighted music, programming, and other online content on the Internet, may prove welfare-superior to selling such goods on an individual basis, a study by two economists found.⁶⁴ The study noted that the marginal cost of adding additional units of an information good to a bundle of other information goods typically is very low, and that the demand for bundles of goods across customers can be more homogeneous than the demand for the

choose only to bundle and not to offer any component separately. *Id.* at 65.

⁶⁰ *See id.* at 83 (“Tying is common in competitive markets. It results in lower costs for producers—which get passed onto consumers—or greater convenience, which benefits consumers directly.”). Even a monopolist will pass through to consumers a significant share of the cost savings from bundling. Paul Yde & Michael Vita, *Merger Efficiencies: The “Passing-On” Fallacy*, *ANTITRUST*, Summer 2006, at 59, 59 (“A monopolist that failed to expand output and reduce price in response to a cost reduction would be no less irrational than a monopolist that failed to exercise its market power.”).

⁶¹ Evans & Salinger, 22 *YALE J. ON REG.* at 75-76.

⁶² *Id.* at 75-82.

⁶³ *Id.* at 41-42.

⁶⁴ *See* Yannis Bakos & Eric Brynjolfsson, *Bundling and Competition on the Internet: Aggregations Strategies for Information Goods*, 19 *MARKETING SCI.* 63 (2000); Yannis Bakos & Eric Brynjolfsson, *Bundling Information Goods: Prices, Profits, and Efficiency*, 45 *MGMT. SCI.* 1613 (1999).

individual components. In such circumstances, it can be more profitable to offer such goods only in a bundle. The study also found that competition between two firms that each offer sufficiently large bundles can make consumers better off,⁶⁵ and bundling by a firm facing no competition can increase total welfare but increase or decrease consumer welfare.⁶⁶

3. EMPIRICAL EVIDENCE

A full understanding of the effect of any particular tie or bundle requires a careful analysis of the circumstances surrounding the practice at issue. That likely competitive effects will be fact-dependent creates difficulties for attempts to craft statements of general application about the likely competitive effects of tying and bundling. Even an apparently benign statement such as “offering consumers choice is better than not offering choice” may not be correct. Offering consumers more choices can be costly for firms; if the costs of providing more choice exceed the benefits to consumers, more choice can make consumers worse off.⁶⁷

Thus, economists caution against confusing the “theoretical possibility of harm with an empirical demonstration of such a harm.”⁶⁸ One economist has observed that the difficulty of identifying market settings in which tying and bundling might have exclusionary effects, and the fact that bundling can serve a purely efficiency-enhancing role in some market settings, “make[] the specification of a practical legal standard [for tying and bundling] extremely difficult.”⁶⁹

⁶⁵ Bakos & Brynjolfsson, 19 *MARKETING SCI.* at 71-74 (showing that customers are able to purchase goods from competing firms selling large enough bundles at a lower effective per unit price than the price they would pay for each good if all goods are sold separately).

⁶⁶ *Id.* at 72. The intuition behind this result is that bundling allows the monopolist to sell more units to customers which increases total welfare, but also allows the monopolist to charge higher average prices which extracts surplus from customers. Depending on the parameters of the model, the latter effect could be either greater or less than the former effect.

⁶⁷ *Id.* at 84.

⁶⁸ Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries* 31 (Nat'l Bureau of Econ. Research, Working Paper No. 6831, 1998).

⁶⁹ Whinston, 80 *AM. ECON. REV.* at 856.

A former chief economist of the Federal Trade Commission has argued that documented instances of anticompetitive tying are extremely rare and may not exist.⁷⁰ Other economists have made this point about vertical restraints (which include tying and bundling, among other practices) in general.⁷¹ Noting the paucity of empirical support for the proposition that vertical restraints harm consumers (based on a literature review), they argue that one should infer that vertical restraints are likely to be benign or welfare enhancing.⁷²

In short, the very limited empirical evidence that exists suggests that tying and bundling are unlikely to be anticompetitive. This supports the trend of the U.S. courts to refuse to condemn these practices absent case-specific evidence of actual anticompetitive effects.

III. EXCLUSIVE DEALING

Exclusive dealing contracts involve a supplier conditioning its sale on the buyer's commitment not to purchase from the supplier's rivals.⁷³ While this technical definition of exclusive dealing requires the buyer to forego all purchases from the rival supplier, one can imagine contracts involving "partial" exclusivity which involve the buyer committing a fixed quantity of purchases or percentage of its total purchases to the supplier in lieu of a "full exclusive." The menu of contracts implicating exclusive dealing is even more general than full and partial exclusives. For instance, the economic and legal issues concerning exclusive dealing contracts are also involved in the analysis of "loyalty discounts" and other forms of "compensated exclusion," where the supplier

⁷⁰ Michael A. Salinger, *Business Justifications in Tying Arrangements* (2005), in ISSUES IN COMPETITION LAW AND POLICY (Wayne D. Collins ed. 2006).

⁷¹ See James C. Cooper, Luke M. Froeb, Dan O'Brien, and Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005).

⁷² See *id.*

⁷³ We adopt this definition from Louis Kaplow and Carl Shapiro, *Antitrust* in THE HANDBOOK OF LAW AND ECONOMICS (Shavell and Polinsky, eds., Elsevier 2008), who provide a survey of the exclusive dealing literature discussed throughout this article. The leading antitrust treatise adopts a similar definition. PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1800a (2d ed. 2002) ("an exclusive dealing arrangement is a contract between a manufacturer and a buyer forbidding the buyer from purchasing the contracted good from any other seller, or requiring the buyer to take all of its needs in the contracted good from the manufacturer").

commits to a discount, usually non-linear in nature, if the retailer purchases a certain quantity or percentage of total purchases from the supplier.⁷⁴ Exclusive dealing and exclusionary contracts more generally involve a broad spectrum of contracts in our modern economy. These contracts present a number of important antitrust issues requiring principled distinctions to be drawn between pro-competitive exclusive dealing and arrangements that might threaten competition and harm consumers.

We begin by discussing antitrust analysis of exclusive dealing contracts with reference to a number of recent legal decisions and conclude by summarizing the economics of exclusive dealing including their possible anticompetitive effects, pro-competitive explanations, and empirical evidence.

A. LEGAL ANALYSIS OF EXCLUSIVE DEALING

Exclusive dealing contracts have never generated a substantial amount of suspicion under the law. Prior to the passage of the Sherman Act in 1890, and in the early days of Sherman Act jurisprudence, exclusive dealing contracts “continued to be upheld routinely except in rate instances involving actual monopolization.”⁷⁵ Hostility to exclusive dealing increased after the passage of the Clayton Act in 1914, as the first challenges to the practice under Section 3 of the Clayton Act resulted in the Supreme Court holding unlawful the arrangements in *Standard Fashion Co. v. Magrane-Houston Co.*⁷⁶ and *United Shoe Machinery Corp. v. United States*.⁷⁷ In 1949, the Court analyzed the exclusive dealing arrangements between gasoline refiners and service stations in *Standard Stations*,⁷⁸ introducing quantitative foreclosure analysis and condemning the contracts at issue because they foreclosed 49% of the market. In 1951, the Court

⁷⁴ See, e.g., Willard K. Tom, David A. Balto & Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615 (2000).

⁷⁵ See Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L.J. 311, 316 (2002). Jacobson informatively traces the evolution of antitrust analysis of exclusive dealing from the pre-Sherman Act era to the present. *Id.* at 314-328.

⁷⁶ 258 U.S. 346 (1922).

⁷⁷ 258 U.S. 451 (1922).

⁷⁸ *Standard Oil Co. (Cal.) v. United States*, 337 U.S. 293 (1949).

again condemned exclusive dealing contracts in *Lorain Journal Co. v. United States*⁷⁹ under Section 2 of the Sherman Act.

A decade later in *Tampa Electric Co. v. Nashville Coal Co.*,⁸⁰ the Court ushered in a new era of exclusive dealing jurisprudence in its last exclusive dealing case. The Court articulated that the plaintiff would be required to show that “the competition foreclosed by the contract must be found to constitute a substantial share of the relevant market.”⁸¹ The Court refused to condemn the exclusive dealing contracts at issue in that case on the grounds that the coal supply contract between Tampa Electric and Nashville Coal was found to be less than one percent of the coal supplied from the Appalachian area.⁸²

Since *Tampa Electric*, the evolution of antitrust jurisprudence concerning exclusive dealing has been limited to lower courts with the exception of the Supreme Court’s tying decision in *Jefferson Parish* which held that a 30% foreclosure would not be sufficient to support a claim. One commentator summarizes modern treatment of the foreclosure analysis in exclusive dealing cases as “routinely sustain[ing] the legality of exclusive dealing arrangements with foreclosure percentages of 40 percent or less.”⁸³

Despite the occasional hostility to exclusive dealing and exclusionary contracts, antitrust jurisprudence has generally acknowledged that competition for contract is “a vital form of rivalry . . . which the antitrust laws encourage rather than suppress.”⁸⁴ Acknowledging the potential consumer benefits that flow from exclusivity, modern antitrust analysis insists that plaintiffs make a

⁷⁹ 342 U.S. 141 (1951). See also Kenneth L. Glazer & Abbott B. Lipsky, Jr., *Unilateral Refusals to Deal Under Section 2 of the Sherman Act*, 63 ANTITRUST L.J. 749 (1995).

⁸⁰ 365 U.S. 320 (1961). See also Benjamin Klein, *Exclusive Dealing as Competition for Distribution on the Merits*, 12 GEO. MASON. L. REV. 119, 140-41 (2003) (discussing the economic forces motivating the long-term exclusive dealing contract in *Tampa Electric*).

⁸¹ 365 U.S. at 328.

⁸² *Id.* at 330-31, 333.

⁸³ *Id.* at 362.

⁸⁴ *Menasha Corp. v. News Am. Mktg. In-Store, Inc.*, 354 F.3d 661, 663 (7th Cir. 2004). See also *Paddock Publ’ns., Inc. v. Chicago Tribune Co.*, 103 F.3d 42, 45 (7th Cir. 1996).

prima facie showing of a number of necessary conditions for consumer harm before shifting the burden to the defendant to establish efficiency justifications for their conduct. While this showing includes foreclosure analysis, it also includes a broader inquiry into the potential for the exclusive contracts at issue to harm competition rather than merely disadvantage rivals. This analysis is fairly constant whether the arrangements are challenged under Sections 1 and 2 of the Sherman Act, or Section 3 of the Clayton Act.

The modern “rule of reason” analysis evaluating exclusive dealing contracts focuses on a number of factors, including: the defendant’s market power, the degree of foreclosure, entry conditions, the duration of the contracts at issue, whether exclusivity has the potential to raise rivals’ costs, the presence of actual or likely anticompetitive effects, and business justifications. Areeda and Hovenkamp articulate the prima facie case for exclusive dealing claims as follows:

In order to succeed in its claim of unlawful exclusive dealing a plaintiff must show the requisite agreement to deal exclusively and make a sufficient showing of power to warrant the inference that the challenged agreement threatens reduced output and higher prices in a properly defined market . . . Then it must also show foreclosure coverage sufficient to warrant an inference of injury of competition . . . depending on the existence of other factors that give significance to a given foreclosure percentage, such as contract duration, presence or absence of high entry barriers, or the existence of alternative sources or resale.⁸⁵

A leading exclusive dealing case involving Philip Morris (“PM”) and its “Retail Leaders” program provides a useful illustration of modern antitrust analysis.⁸⁶ Retail Leaders, introduced in October 1998, involved four different “participation levels” corresponding to both the magnitude of PM payments and the amount of advantageous display space provided to PM. At the highest two levels of Retail Leaders, PM not only made promotional payments to retailers but also granted retailers an “industry fixture” that would occupy a specified

⁸⁵ AREEDA & HOVENKAMP, *supra* note __, ¶ 1821.

⁸⁶ R.J. Reynolds Tobacco Co. v. Philip Morris Inc., 199 F. Supp. 2d 362 (M.D.N.C. 2002) (“RJR II”); *aff’d per curiam*, 67 Fed. Appx. 810 (4th Cir. 2003). The analysis of RJR herein relies on a previous discussion in Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 YALE J. REG. 169 (2006).

percentage of total display space for cigarettes. At the highest level, this percentage was 100%. At the mid-level of Retail Leaders, the industry fixture would occupy half of the total category display space, specifying that PM brands were to be allocated proportionately to PM's market share (otherwise known as a "space-to-sales" allocation). The other half of category space was to be divided between a "prime fixture" constituting approximately 25% of category space and promoting only PM brands and a "retailer's choice fixture" which would occupy the remaining 25% of the space and contain competing brands and signage.⁸⁷

Several other details of the Retail Leaders program warrant mention. First, PM paid retailers with per unit discounts known as retail display allowances ("RDAs").⁸⁸ Second, it was undisputed that Retail Leaders contracts were terminable at will without penalty upon thirty days' notice.⁸⁹ Third, under each Retail Leaders level of participation, retailers were never required to grant PM more than "space-to-sales," or a greater percentage of shelf space than its market share.⁹⁰

Several tobacco companies challenged Retail Leaders under both Sections 1 and 2 of the Sherman Act. The court, after initially issuing a preliminary injunction in favor of the plaintiffs, granted Philip Morris' motion for summary judgment, dismissing the case on the grounds that PM did not have market power, and, alternatively, that the Retail Leaders program did not sufficiently foreclose rivals from the market. Specifically, the court found that Retail Leaders foreclosed only 34% of the market, that plaintiffs successfully competed against PM for premium shelf space and signage, and retailers were able to terminate agreements at will.⁹¹

Competition between tobacco manufacturers for valuable shelf space resulted in a boon to consumers as RDAs were passed on in the form of lower

⁸⁷ 199 F. Supp. 2d at 370.

⁸⁸ *Id.* at 369-70.

⁸⁹ *Id.* at 371.

⁹⁰ *Id.* at 370.

⁹¹ *Id.* at 391 ("because Retail Leaders agreements are terminable at will with thirty days notice, retail product and display space are subject to uninterrupted competitive bidding, and Plaintiffs are not substantially foreclosed from the relevant market").

prices.⁹² While anticompetitive foreclosure is a viable concern, the key policy requirement is that the competitive process for distribution is left “open,” meaning that rival manufacturers have the opportunity to bid for shelf space. This condition is clearly satisfied where contracts are of short duration and easily terminable like those in the Retail Leaders program.⁹³ In fact, it appears that PM’s relative prices fell after the implementation of Retail Leaders, suggesting that the program was pro-competitive.⁹⁴

As *RJR II* illustrates, the duration of exclusive dealing contracts, in addition to foreclosure analysis, is an important component of modern antitrust analysis. Exclusive dealing contracts covering shares of the market sufficient to otherwise trigger liability under a standard foreclosure analysis are routinely upheld where the contracts involve short-term commitments, thereby permitting rivals to compete for distribution.⁹⁵ Taken together, *RJR II* illustrates the standard framework in modern exclusionary distribution cases which requires a demonstration of the defendant’s market power, substantial foreclosure, contracts of sufficient duration to prohibit meaningful competitive bidding by rivals, and an analysis of actual or likely competitive effects.

⁹² RJR’s economic expert conceded this point during the litigation. 199 F. Supp. 2d at 369-370. The fact that PM paid significant promotional payments is consistent with the very high margins on tobacco products, giving tobacco manufacturers the incentive to pay for premium shelf space and signage that might induce incremental sales. For an economic analysis providing a pro-competitive basis for understanding shelf space payments, see Benjamin Klein and Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & ECON. ___ (2007).

⁹³ The court made exactly such a finding. *Id.* at 391. Whether short-term agreements do not have substantial anticompetitive effects as a matter of law is an open issue subject to debate across the circuits. See cases cited *infra* n. ___.

⁹⁴ See Peter Bronsteen et al., *Price Competition and Slotting Allowances*, 50 ANTITRUST BULLETIN 267 (2005).

⁹⁵ A number of courts have held that exclusive contracts of one year or less are presumptively lawful. See, e.g., *Roland Mach. Co. v. Dresser Indus.*, 749 F.2d 380, 392-95 (7th Cir. 1984); *Concord Boar Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1059 (8th Cir. 2000); *Omega Env’tl. Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1163-64 (9th Cir. 1997); *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 596 (1st Cir. 1993); *CDC Techs., Inc. v. IDEXX Labs, Inc.*, 186 F.3d 74 (2^d Cir. 1999); *Thompson Everett, Inc. v. Nat’l Cable Adver.*, 57 F.3d 1317, 1325 (4th Cir. 1995); *Paddock Publications, Inc. v. Chicago Tribune Co.*, 103 F.3d 42, 47 (7th Cir. 1996) (“the FTC and the Supreme Court concluded that even exclusive dealing contracts are lawful if limited to one year’s duration”). Similarly, some commentators have argued in favor of *per se* legality for such short-term contracts. See, e.g., Joshua D. Wright, *Antitrust Law and Competition for Distribution*, at ___.

B. ECONOMIC ANALYSIS OF EXCLUSIVE DEALING

The primary anticompetitive concern with exclusive dealing contracts is that a monopolist might be able to utilize exclusivity to fortify its market position and ultimately harm consumers. As a general matter, these concerns also extend to other contracts, such as loyalty and market-share discounts, which we discuss separately in Section III.C.

1. THEORIES OF COMPETITIVE HARM

The most common scenario of antitrust relevance involving exclusive dealing contracts concerns an upstream supplier, *S*, entering into an exclusive dealing contract with retailers, *R*, who in turn, sell the product to final consumers. The potentially anticompetitive motivation associated with exclusive dealing contracts is clearly related to the limitation placed by that contract on *R*'s ability to sell rival products to final consumers. The possibility of anticompetitive exclusion arising out of these types of contracts generally arises only if *S* is able to foreclose rival suppliers from a large enough fraction of the market to deprive *S*'s rivals of the opportunity to achieve minimum efficient scale.⁹⁶

The well known critique of this line of reasoning comes from the Chicago School argument that *R* will not have the incentive to agree to contracts that facilitate monopolization upstream because they will then suffer the consequences of facing that monopolist in their chain of distribution.⁹⁷ As a general matter, one can think of this criticism as drawing the analogy of to a conspiracy among retailers, *R*, organized by the monopolist *S* to exclude *S*'s

⁹⁶ This anticompetitive strategy using exclusive contracts belongs to the more general class of strategies analyzed in the raising rivals' costs literature. See Thomas Krattenmaker & Stephen C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 234 (1986); Stephen C. Salop & David T. Scheffman, *Raising Rivals' Costs*, 73 AM. ECON. REV. 267 (1983).

⁹⁷ This line of reasoning is conventionally associated with Robert Bork. See, e.g., Robert A. Bork, *THE ANTITRUST PARADOX* 309 (1978) ("A seller who wants exclusivity must give the buyer something for it. If he gives a lower price, the reason must be that the seller expects the arrangement to create efficiencies that justify the lower price. If he were to give a lower price simply to harm his rivals, he would be engaging in deliberate predation by price cutting, and that, as we have seen in Chapter 7, would be foolish and self-defeating behavior on his part").

rivals from access to distribution.⁹⁸ Like any other conspiracy, it is generally the case that each R has the incentive to deviate and remain outside the agreement by contracting with S's rivals and expanding output at the expense of rival retailers.⁹⁹ In other words, retailers have the incentive to avoid entering agreements that will ultimately harm them and S will generally not be able to compensate retailers enough to enter into the anticompetitive exclusive contract.¹⁰⁰ The critique goes on to argue that if observed exclusive dealing contracts must generate efficiencies rather than anticompetitive effects.

The economic literature has grown in recent years to include a series of theoretical models contemplating scenarios where S can sufficiently compensate retailers to join and remain within the conspiracy and therefore accomplish an anticompetitive purpose. These anticompetitive theories of exclusive dealing generally assume that S supplies a product that is essential to R's viability and that there are substantial economies of scale in manufacturing.

One such theory considers the case where the monopolist S adopts exclusive contracts rather than merely collecting its monopoly profit from the sale of the essential product and relies on the existence of dynamic economies of scale such as network effects.¹⁰¹ Under this dynamic theory of exclusion, S's exclusive contracts prevent S's rivals or potential entrants that might develop into future rivals, in order to protect future market power. Because S's rivals must operate at a cost disadvantage that drives out S's rivals and prevents entry, S is able to increase the duration and scope of its market power.¹⁰²

⁹⁸ This analogy is explored and used to derive the economic conditions necessary for exclusive contracts to cause anticompetitive effects in Benjamin Klein, *Exclusive Dealing as Competition for Distribution On the Merits*, 12 GEO. MASON. L. REV. 119, 122-28 (2004).

⁹⁹ See Elizabeth Granitz & Benjamin Klein, *Monopolization by "Raising Rivals' Costs": The Standard Oil Case*, 39 J.L. & ECON. 1 (1996).

¹⁰⁰ Douglas Bernheim & Michael Whinston, *Exclusive Dealing*, 106 J. POL. ECON. 64 (1998), formally derive this result.

¹⁰¹ See Dennis W. Carlton & Michael A. Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 194 (2002).

¹⁰² An alternative, but related, theory of exclusion operates by driving out competing retailers and allowing S to monopolize distribution and collect its monopoly price on the distribution of rival products. See Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837 (1990). This alternative theory also requires substantial economies of scope or scale in the supply

A second set of models explores the possibility that coordination problems between buyers prevent the foiling of S's anticompetitive use of exclusive dealing contracts. There is a substantial industrial organization literature analyzing the conditions under which these types of coordination problems between buyers generate the possibility of anticompetitive exclusion. The seminal article of this type is by Rasmussen, Ramseyer and Wiley ("RRW"),¹⁰³ later refined by Segal and Whinston ("SW"),¹⁰⁴ and expanded on by others.¹⁰⁵ The central logic of these models is that the potential entrant (or current rival) must attract a sufficient mass of retailers to cover its fixed costs of entry, but S's exclusive contracts with retailers prevent the potential entrant from doing so. Significant economies of scale in distribution militate against exclusion because in that case a potential entrant may need to attract only a single buyer in order to achieve minimum efficient scale. Similar logic suggests that a small number of buyers will be able to coordinate in order to support the excluded rival. Further, the exclusionary equilibrium in this model appears relatively fragile because an alternative equilibrium in which buyers reject exclusivity also exists.¹⁰⁶

Finally, the most recent strand of the exclusive dealing literature involves an analysis of the relationship between downstream competition at the retail level and exclusion. Fumagalli and Motta consider the role of retail competition in the RRW-SW framework and demonstrate that the incentives to exclude can disappear in this setting as one buyer becomes large enough to support the entry

of distribution services. Economies of scope in distribution may be present if, for example, S's product is essential to the economic viability of R.

¹⁰³ Eric B. Rasmussen, Mark J. Ramseyer, & John Shepherd Wiley, Jr., *Naked Exclusion*, 81 AM. ECON. REV. 1137 (1991).

¹⁰⁴ Ilya R. Segal & Michael D. Whinston, *Naked Exclusion: Comment*, 90 AM. ECON. REV. 296 (2000).

¹⁰⁵ See, e.g., Chiara Fumagalli & Massimo Motta, *Exclusive Dealing and Entry, When Buyers Compete*, 96 AM. ECON. REV. 785 (2006); John Simpson & Abraham L. Wickelgren, *Exclusive Dealing and Entry, When Buyers Compete: Comment* (mimeo, June 2005); Joseph Farrell, *Deconstructing Chicago on Exclusive Dealing*, 50 ANTITRUST BULLETIN 465 (2005).

¹⁰⁶ But see Segal & Whinston, *supra* note __, and Michael D. Whinston, *LECTURES ON ANTITRUST ECONOMICS* (MIT Press, 2006), for arguments that the ability to make discriminatory or sequential offers to buyers increases the support for exclusion.

or viability of a rival.¹⁰⁷ Simpson and Wickelgren take the opposite position, arguing that downstream competition enhances the incentive to exclude. They contend that the incentive to exclude increases because the benefits to a single buyer of resisting exclusion are minimal if all retailers are equally disadvantaged because retail competition will allow retailers to pass those costs on to consumers.¹⁰⁸

The development of this literature has increased our knowledge about the potential impact of exclusive dealing contracts. The models generating anticompetitive exclusion generally rely on strict assumptions concerning the existence of significant economies of scale, barriers to entry, and absence of efficiency justifications. Where the necessary conditions of those models are satisfied, they demonstrate that exclusive dealing contracts may harm consumers where those necessary conditions are satisfied and thus are an appropriate subject for antitrust scrutiny and further analysis.

2. PROCOMPETITIVE EFFICIENCIES

Exclusive dealing arrangements are often efficient and result from the normal competitive process. Exclusive dealing contracts are often observed between firms lacking any meaningful market power, implying that there must be efficiency justifications for the practice. Indeed, the economics literature is replete with pro-competitive explanations for exclusives.¹⁰⁹

The standard pro-competitive account of exclusive dealing contracts involves preventing dealer free-riding on manufacturer-supplied investments in the form of utilizing those investments to promote rival products.¹¹⁰ For example, a manufacturer may make investments including purchasing display fixtures or salesperson training. Dealer free-riding on these investments involves using these investments to promote rival brands. The classic example of this

¹⁰⁷ Fumagalli & Motta, *supra* note __.

¹⁰⁸ Simpson & Wickelgren, *supra* note __.

¹⁰⁹ A description of other commonly accepted justifications for exclusive dealing is presented in Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L. J. 311, 357-60 (2002).

¹¹⁰ Howard Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982).

type of free-riding in the antitrust context is *Ryko Mfg. Co. v. Eden Servs.*,¹¹¹ where a manufacturer of car wash equipment used exclusive territories and exclusive dealing contracts to prevent its dealers from switching consumers to other brands. By facilitating dealer performance, the exclusive dealing contract allows manufacturers to collect a return on their investments and increase output.

A recent article by Benjamin Klein and Andres Lerner expands our understanding of the use of exclusive dealing by demonstrating how exclusivity minimizes free-riding in cases where there are no manufacturer supplied investments: (1) free-riding on manufacturer paid-for promotion to sell rival products, and (2) free-riding in the form of failing to supply the promotion paid for by the manufacturer altogether, even in the absence of dealer switching.¹¹² First, because manufacturers often compensate retailers for the provision of promotional services such as premium shelf space,¹¹³ dealers have the incentive to use these additional promotional efforts to switch consumers to other products upon which the dealer earns a greater profit. Exclusive dealing can be used to prevent this type of free-riding in an analytically identical manner to the way it prevents free-riding on manufacturer supplied promotion.¹¹⁴

A second type of free-riding examined by Klein and Lerner also involves manufacturer paid-for promotion. Because dealers are being compensated for promotional effort on the basis of total sales (both marginal and infra-marginal), and non-performance is costly to detect, dealers have the incentive not to supply the agreed upon promotional inputs.¹¹⁵ Exclusive dealing mitigates the incentive to free-ride in this way by increasing the dealer's incentive to promote the

¹¹¹ 823 F.2d 1215 (8th Cir. 1987). See also Benjamin Klein and Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 72 ANTITRUST L.J. 473, 481-83 (2007) (discussing *Ryko* as an example of this type of free-riding).

¹¹² Benjamin Klein and Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 72 ANTITRUST L.J. 473 (2007).

¹¹³ See Benjamin Klein and Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & ECON. 421 (2007), which extends the original analysis of inadequate dealer incentives to promote and the use of vertical restraints in solving this dealer incentive problem in Benjamin Klein and Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265 (1988).

¹¹⁴ Klein and Lerner, *supra* note __, at 497-502.

¹¹⁵ *Id.* at 502-504.

manufacturer's product. Courts have recognized this somewhat intuitive justification for the use of exclusive dealing in *Joyce Beverages*¹¹⁶ and *Roland Machinery*, noting the incentive effects of "dedicated" or "loyal" distribution.¹¹⁷ Klein and Lerner provide an economic basis for understanding the mechanism by which dealers more actively promote the manufacturer's product in this case and consider whether *Dentsply's* "dealer loyalty" justification for its use of exclusive dealing was improperly rejected.¹¹⁸

Outside of the expanded analysis of dealer free-riding, there are other efficient uses of exclusive dealing. One such use involves the role of exclusive dealing by individual retailers, including those without any market power, to intensify competition by manufacturers for their business and to improve purchase terms. By offering manufacturers access to the retailer's loyal customer base, a retailer is able to commit a substantial fraction of its customers' purchases to the "favored" supplier and thereby dramatically increase each supplier's perceived elasticity of demand by making rival products highly substitutable.¹¹⁹ Wright extends this analysis to explain the use of category management contracts where the particular quantity and type of shelf space devoted to the manufacturer's products is not contractually set by the retailer, but is flexibly determined over time by the category captain.¹²⁰ In contrast to the case where

¹¹⁶ *Joyce Beverages v. Royal Crown Co.*, 555 F. Supp. 271, 276-77 (S.D.N.Y. 1983). See also *Hendricks Music Co. v. Steinway, Inc.*, 689 F. Supp. 1501 (N.D. Ill. 1988) ("it is perfectly legitimate and, in fact, pro-competitive, for manufacturers to insist that their dealers devote undivided loyalty to their products and not use those of their competitors").

¹¹⁷ *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380 (7th Cir. 1984).

¹¹⁸ Klein and Lerner, *supra* note __, at 507-518. See generally *United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d 387 (D. Del. 2003), *rev'd*, 399 F.3d 181 (3d Cir. 2005), *cert. denied*, 126 S. Ct. 1023 (2006). Klein and Lerner conclude that creating "undivided dealer loyalty" was a plausible justification in *Dentsply*, but that "we do not know if a more complete analysis would have found the net effect of *Dentsply's* exclusive dealing to be procompetitive or anticompetitive" and "what is clear is that further analysis of the undivided loyalty rationale for exclusive dealing should have been undertaken." Klein and Lerner, *supra* note __, at 518.

¹¹⁹ See Benjamin Klein and Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L. J. (forthcoming 2008). This explanation is related to, and provides the economic basis for, the argument that exclusives "instigated" by customers should enjoy a presumption of legality. See Richard M. Steuer, *Customer Instigated Exclusive Dealing*, 68 ANTITRUST L. J. 239 (2000).

¹²⁰ Joshua D. Wright, *Antitrust Analysis of Category Management: Contwood Co. v. United States Tobacco*, 19 SUP. CT. ECON. REV. __ (2009).

the optimal shelf space commitments are stable, well known, easily specified by contract, and non-performance is easily detected by the manufacturer, category management contracts offer increased flexibility where such commitments are imprecise and change over time.

3. EMPIRICAL EVIDENCE

As discussed, the theoretical literature focuses on the question of whether exclusive dealing contracts limit competition or are a pro-competitive element of the competitive contracting process designed to solve incentive conflicts between manufacturers and retailers over the supply of promotional services. If the anticompetitive theories are correct, one expects that exclusive dealing contracts will increase prices and decrease output. Conversely, if the pro-competitive theories are correct, prices and output should increase. Thus theory generates ambiguous predictions regarding the effects of exclusive dealing on output.

Existing empirical evidence of the impact of exclusive dealing is scarce but generally favors the view that exclusive dealing is output-enhancing. Heide et al. conducted a survey of managers responsible for distribution decisions and found that the incidence of exclusive dealing was correlated with the presence of “free-ridable” investments.¹²¹ Both Asker and Sass separately examine the welfare consequences of exclusive dealing in the beer market by observing the effect of exclusive dealing on total market output, as well as the output and prices of rival distributors, concluding that exclusive dealing is output increasing and does not generate foreclosure.¹²²

C. LOYALTY DISCOUNTS¹²³

¹²¹ Jan B. Heide et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 J.L. & ECON. 387 (1988).

¹²² See John Asker, *Diagnosing Foreclosure Due to Exclusive Dealing* (unpublished working paper, 2004); Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the U.S. Beer Industry*, 23 INT’L J. INDUS. ORG. 203 (2005).

¹²³ A comprehensive survey of the legal and economic issues associated with loyalty discounts appears in Bruce H. Kobayashi, *The Economics of Loyalty Discounts and Antitrust Law in the United States*, 1(2) COMPETITION POLICY INT’L 115 (2005). See also Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 Minn. L. Rev. 1688 (2005).

Loyalty discounts are a form of non-linear pricing in which the buyer's discount increases after a buyer-specific minimum threshold requirement is satisfied. One such discount is known as an "all units" discount which applies the per unit rebate to all units purchased by the buyer if and only if it satisfies the threshold. A similar form of rebate is a "market-share discount," which requires a buyer to commit a specified share of its purchases to the seller in order to qualify for the discount. The relationship between loyalty discounts and exclusive dealing contracts is relatively straightforward as the latter involves the special case where the discounts are granted if and only if the threshold commitment requires the buyer to commit 100% of its purchases from the supplier. I will refer to these loyalty rebate programs such as market share discounts and all-units discounts which require less than full exclusivity as "partial exclusives" and reserve use of "full exclusive" to specify 100% exclusivity.

Loyalty discounts and "partial exclusives" have generated a substantial amount of antitrust scrutiny in recent history, and in particular, after the *LePage's* decision which involved a multi-market or "bundled discount."¹²⁴ In this Section, we will focus on single-product loyalty discounts alleged to have exclusionary effects similar to exclusive dealing.¹²⁵ Single product partial exclusives have been involved in a number of recent antitrust cases, including *FTC v. McCormick*,¹²⁶ *RJR II*,¹²⁷ *Barry Wright*,¹²⁸ *Concord Boat*,¹²⁹ and *Brooke Group*.¹³⁰

¹²⁴ The reader is referred to Kobayashi, *supra* note __, at 137-46, for discussion of multi-product discounts.

¹²⁵ See, e.g., Tom, Balto & Averitt, *supra* note __ (analyzing market share discounts as a form of de facto exclusive dealing).

¹²⁶ Federal Trade Commission v. McCormick (FTC Dkt. No. C-3939) (2000). (FTC File No. 961-0050).

¹²⁷ R.J. Reynolds Tobacco Co. v. Philip Morris Inc., 199 F. Supp. 2d 362 (M.D.N.C. 2002) ("*RJR II*"); *aff'd per curiam*, 67 Fed. Appx. 810 (4th Cir. 2003).

¹²⁸ Barry Wright v. ITT Grinnell, 724 F.2d 227 (1st Cir. 1983).

¹²⁹ Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000).

¹³⁰ Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

In each of these cases, the supplier offered dealers “loyalty discounts” in the form of partial exclusives. Many of these rebates were “all units discounts,” meaning that they were applied to all of the dealer’s purchases once the minimum threshold was satisfied, including those in *Barry Wright* and *Concord Boat*, and possibly the discounts at issue in *Brooke Group*.¹³¹ The partial exclusives in *McCormick* and *RJR II* likely did not involve this “all units” feature, but increased upon the commitment of a specific share of shelf space to the supplier’s product. For example, in *McCormick*, which ultimately resulted in a settlement, the Complaint alleged that the slotting contracts included provisions that “typically demand that the customer allocate the large majority of the space devoted to spice products – in some case 90% of all shelf space devoted to packaged spices, herbs, seasonings and flavorings of the kinds offered by McCormick – to McCormick.”¹³²

McCormick did not offer a pro-competitive justification for these contracts, and specifically, the restrictions on distributing rival products. While Philip Morris’ shelf space arrangements survived the antitrust challenge from R.J. Reynolds to its Retail Leaders program in *RJR II* because the contracts were of short duration and therefore could not sufficiently foreclose rivals from access to distribution, the court did not find that the contracts had any persuasive pro-competitive business justification.

While partial exclusives may generate the same type of “raising rivals’ costs” concerns as full exclusives, the important question is whether these contracts are capable of producing harm to competition. As a general matter, antitrust analysis of these partial exclusives correctly proceeds by exploring whether the necessary conditions for competitive harm are satisfied, including substantial foreclosure and sufficient duration to prevent competitive bidding for distribution. Unfortunately, because the pro-competitive function of partial exclusives is less well understood than full exclusives, courts may be tempted to conclude that partial exclusives do not have any redeeming efficiencies and more likely to find that any potential anticompetitive effect sufficient to find an antitrust violation.

¹³¹ See Kobayashi, *supra* note __ (Figure 1).

¹³² Complaint, ¶ 10. *McCormick* is analyzed in Wright, *supra* note __, at 113-15, and Klein and Murphy, *Exclusive Dealing Intensifies Competition for Distribution* (unpublished working paper, 2007).

As discussed above, Klein and Murphy present an analysis of the pro-competitive use of full and partial exclusives that may explain the prevalence of these contracts in retail settings.¹³³ Klein and Murphy consider the role of exclusive dealing and partial exclusives in the setting where consumers choose retailers on the basis of both average retail price and product variety. In essence, while adopting an exclusive imposes some costs on consumers in the form of preventing those consumers from satisfying their preferences for a particular brand, those costs are outweighed by the increase in consumer welfare generated by the retailer acting as a competitive bargaining agent for its customers which results in lower wholesale prices. This pro-competitive justification extends to the case of partial exclusives which give the retailer the flexibility to satisfy the preferences of consumers with a clear preference for a rival brand, thereby avoiding a large fraction of the consumer welfare losses associated with failing to stock a product highly demanded by some subset of consumers, while still extracting some benefits of the exclusivity in the form of increased ex ante competition for all consumers. Klein and Murphy apply this explanation to explain a number of partial exclusive contracts, including those in *McCormick*, the category management shelf space contract in *El Aguila Food Products v. Gruma*¹³⁴ and the restrictive promotion contracts adopted in *Coca-Cola v. Harmar*¹³⁵ and *RJR II*.¹³⁶ Wright applies this partial exclusive analysis to the case of category management contracts where the retailer dedicates, without contractual discretion, a significant portion of its shelf space by allowing the category captain to determine or influence shelf space allocation and stocking decisions.¹³⁷

IV. CONCLUSION

¹³³ Klein and Murphy, *supra* note __.

¹³⁴ *El Aguila Food Products v. Gruma Corp.*, 301 F.Supp. 2d 612 (S.D. Tex. 2003), *aff'd*, 131 Fed. Appx. 450 (5th Cir. 2005).

¹³⁵ *Coca-Cola Co. v. Harmar Bottling Co.*, 50 Tex. Sup. Ct. J. (October 20, 2006) (No. 03-0737), *rev'g*, 111 S. W. 3d 287 (Tex. App.-Texarkana, 2003).

¹³⁶ *R. J. Reynolds Tobacco Co. v. Philip Morris, Inc.*, 199 F. Supp. 2d 362 at 388, 390 (M.D.N.C. 2002), *aff'd per curiam*, 67 Fed. Appx 810 (4th Cir. 2003).

¹³⁷ Joshua D. Wright, *Antitrust Analysis of Category Management: Contwood Co. v. United States Tobacco*, 19 SUP. CT. ECON. REV. __ (2009).

A large number of antitrust investigations in the United States involve tying, bundling, and exclusive dealing contracts. These practices have much in common from the standpoint of economic analysis. For instance, the potential efficiencies associated with both tying and exclusive dealing, and the fact that both are prevalent in markets without significant antitrust market power, lead most commentators to believe that they are generally pro-competitive and should be analyzed under some form of rule of reason analysis. Further, the anticompetitive theories applied to both tying and exclusive dealing generally involve “raising rivals’ costs” and the potential for the practice to foreclose rivals or acquire monopoly power in a second market. Despite these similarities, the legal analysis of these two practices remains remarkably divergent with the modified per se approach still applied to tying practices and a more sophisticated rule of reason analysis emphasizing potential consumer welfare effects applied to exclusive dealing. While developments in economic theory generally take some time to generate corresponding changes in competition policy, our analysis of these practices suggests that the adoption of a rule of reason for tying and presumptions of legality for both practices under certain conditions may be long overdue.