No. 15-706

In The
Supreme Court of the United States

McWANE, INC.,

Petitioner,

v.

FEDERAL TRADE COMMISSION,

Respondent.

**On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eleventh Circuit**

**BRIEF FOR *AMICI CURIAE* PROFESSORS
OF ANTITRUST LAW AND ECONOMICS
IN SUPPORT OF PETITIONER**

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TABLE OF CONTENTS

	Page
INTERESTS OF *AMICI CURIAE*	1
SUMMARY OF THE ARGUMENT	1
ARGUMENT	2
I. Economic Analysis Has Shown that Exclusive Dealing, While Potentially Anticompetitive, is Usually Procompetitive	2
A. Exclusive Dealing May Result in Anticompetitive Harm Only Under Certain Sets of Circumstances	3
B. Exclusive Dealing May Provide a Number of Procompetitive Benefits	6
II. Supreme Court Precedent on Vertical Restraints Has Evolved to Require Proof of Harm to the Competitive Process, Not Merely Harm to a Competitor Except in Regards to Exclusive Dealing	14
III. The Economic Coherence of Modern Antitrust Law Requires Economic Proof of Actual Harm in Exclusive Dealing Cases	19
A. A Lack of Economic Content in Exclusive Dealing Law Precludes Consistent Application of Antitrust Law With a Consumer Welfare Focus	20
B. Liability Should Not Rest on Hypothetical or Presumed Effects	23

TABLE OF CONTENTS – Continued

Page

IV. The Supreme Court Needs to Revisit this Area of Law to Give Clear Guidance to the Lower Courts 24

CONCLUSION... 27

APPENDIX

List of *Amici Curiae* ....App. 1

TABLE OF AUTHORITIES

Page

CASES

Albrecht v. Herald Co., 390 U.S. 145 (1968) 19

Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988) 18

Continental T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977) ....*passim*

Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911) 18, 19

Leegin Creative Leather Products v. PSKS, Inc., 127 S. Ct. 2705 (2007) 18, 19, 24, 27

McWane, Inc. v. FTC, 783 F.3d 814 (11th Cir. 2015) 26

Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984) 18

Reiter v. Sonotone Corp., 442 U.S. 330 (1979) 3

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

State Oil Co. v. Khan, 522 U.S. 3 (1997) 19, 24

Taggart v. Rutledge, 657 F. Supp. 1420 (D. Mont. 1987) 3

Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961) ....*passim*

United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) 18

TABLE OF AUTHORITIES – Continued

Page

Virgin Atl. Airways Ltd. v. British Airways PLC, 257 F.3d 256 (2d Cir. 2001)............................26

ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254 (3d Cir. 2012)..26

OTHER AUTHORITIES

Leah Brannon & Douglas H. Ginsburg, *Antitrust Decisions of the U.S. Supreme Court 1967 to 2007*, 3 COMPETITION POL'Y INT'L 1 (2007)..19, 20

James C. Cooper, et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005)..13

Jan B. Heide, et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 J.L. & ECON. 387 (1998)......................13

Katherine Ho, Justin Ho & Julie Holland Mortimer, *Analyzing the Welfare Impacts of Full-Line Forcing Contracts*, 60 J. INDUS. ECON. 468 (2012) 12

Katherine Ho, Justin Ho & Julie Holland Mortimer, *The Use of Full-Line Forcing Contracts in the Video Rental Industry*, 102 AM. ECON. REV. 686 (2012)...12

HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION (2005).........7, 9, 10, 15, 27

TABLE OF AUTHORITIES – Continued

Page

Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311 (2002) 17

Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 J.L. & ECON. 497 (1983) 12

Benjamin Klein & Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 74 ANTITRUST L.J. 473 (2007) 7

Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433 (2008) 8

Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707 (2005) 12

William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. ECON. PERSP. 43 (2000) 19

Thomas Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power Over Price*, 96 Yale L.J. 209 (1986) 23

TABLE OF AUTHORITIES – Continued

Page

Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy* in HANDBOOK OF ANTITRUST ECONOMICS (Paolo Buccirossi ed., 2008) 13

Howard P. Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982) 7

Daniel O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems* in THE PROS AND CONS OF VERTICAL RESTRAINTS (2008) 13

ROBERT S. PINDYCK & DANIEL S. RUBINFELD, MICROECONOMICS (6th ed. 2008) 4

Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the U.S. Beer Industry*, 23 INT'L J. INDUS. ORG. 203 (2005) 13

HAL R. VARIAN, INTERMEDIATE ECONOMICS (1987) 4

Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 Geo. MASON L. REV. 1163 (2012) 5

Joshua D. Wright, *The Supreme Court Should Grant Certiorari in* FTC v. McWane (December 21, 2015), *available at* http://ssrn.com/abstract=2706859 ....*passim*

INTERESTS OF *AMICI CURIAE*[1]

Amici Curiae are law professors and economists at U.S. accredited law schools, business schools, and university economics departments who specialize in antitrust law and economics. They share a common view that antitrust law should not penalize vertical agreements unless they are shown to harm competition under this Court's jurisprudence. They are concerned that the decisions below could chill beneficial competition and have adverse effects for consumer welfare. The full list of *amici* appears in the attached Appendix.

SUMMARY OF THE ARGUMENT

In the past forty years, since the decision in *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), this Court has ushered in an era of modern antitrust jurisprudence that moves away from rules of *per se* illegality and focuses on the economic impact of certain practices. In doing so, it has helped to establish clear guidance for the lower courts and businesses so that firms can compete aggressively. One outlier is the area of exclusive dealing law which

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[1] No counsel for a party authored this brief, in whole or in part, and no person or entity, other than *amici* and their counsel, has made a monetary contribution to the preparation or submission of this brief. Counsel for *amici* gave counsel for the parties timely notice of intent to file this brief, and their consents are enclosed.

is still governed by the pre-economic revolution ruling *Standard Oil Co. of Cal. v. United States* [hereinafter *Standard Stations*], 337 U.S. 293 (1949), and dicta from *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961).

The result has been a mess. Without adequate guidance, the lower courts have analyzed exclusive dealing using the foreclosure test from *Standard Stations*, the price-cost test from predatory pricing law, and have even formed a hybrid of both bodies of law. Many rulings, such as the one in this case, have diverged from modern economic scholarship, which has extensively studied exclusive dealing and has generally reached a consensus that such activity generally produces procompetitive benefits, and that anticompetitive concerns only exist in limited circumstances. These studies show no reason why exclusive dealing should remain outside the *GTE Sylvania* line of cases.

The Supreme Court should grant certiorari in this case in order to update the law of exclusive dealing in light of the economic revolution in antitrust law enacted by the *GTE Sylvania* line of cases, and to give guidance to the lower courts.

ARGUMENT

I. Economic Analysis Has Shown that Exclusive Dealing, While Potentially Anticompetitive, is Usually Procompetitive

Exclusive dealing occurs when one party to a contract agrees to execute transactions of a certain

type with only its counterparty. A contract in which a buyer promises to purchase all its requirements of some product from a single seller, for example, is an exclusive dealing contract. *See*, *e.g.*, *Taggart v. Rutledge*, 657 F. Supp. 1420, 1443-45 (D. Mont. 1987). So is an agreement in which an independent retailer, such as a gasoline service station or franchised ice cream shop, commits to distribute only one brand of a product. *See*, *e.g.*, *Standard Stations*, 337 U.S. 293 (1949). As these examples demonstrate, exclusive dealing arrangements are ubiquitous.

The courts have struggled with the treatment of exclusive dealing. Antitrust law – a "consumer welfare prescription," *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) – aims to ensure market competition, which in turn promotes increased provision of goods and services at lower prices and of higher quality. Most exclusive dealing arrangements facilitate some sort of cost-reduction that intensifies competition among producers and thereby enhances overall market output. Under certain limited circumstances, however, exclusive dealing arrangements may injure consumers.

A. Exclusive Dealing May Result in Anticompetitive Harm Only Under Certain Sets of Circumstances

Exclusive dealing may harm competition when it is used to reduce overall market output or increase prices. Most notably, a dominant firm may employ

exclusive dealing arrangements to saddle its rivals with a cost disadvantage that renders them less competitive.

Most markets exhibit economies of scale at certain levels of output. This means that producers operating at lower output levels may often reduce their average costs of production by making additional units. *See* ROBERT S. PINDYCK & DANIEL S. RUBINFELD, MICROECONOMICS 237 (6th ed. 2008). But economies of scale do not go on forever. As the inputs required for continued production get scarcer and costlier, the incremental (or "marginal") cost of producing an additional unit eventually grows so high that the average cost of production begins to rise. The output level at which average production costs are minimized is termed "minimum efficient scale" ("MES"). *See* HAL R. VARIAN, INTERMEDIATE ECONOMICS 428 (1987). A firm that has not yet reached such scale could lower its average cost of production by making more units; upon achieving MES, however, continued growth would not reduce, and would eventually increase the firm's average production cost. When a firm operates at MES it exerts the maximum competitive constraint possible upon its rivals.

In light of this fact, exclusive dealing may offer a way for dominant firms to squelch competition from their smaller rivals under certain conditions. Because a producer cannot profitably expand its output if it cannot find buyers for its wares, a dominant firm may limit its rivals' total output by persuading buyers of

its product to purchase exclusively from it. If the dominant firm's exclusive dealing arrangements foreclose a large enough share of available sales outlets, its rivals may not be able to expand their production to the level of MES. If rivals cannot reach that level of production, their per-unit costs will be higher than they otherwise would be. Facing higher costs, rivals become less able to impose pricing discipline on the dominant firm. *See generally* Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1166-71 (2012) (discussing economics of market foreclosure). When the injury to the dominant firm's rivals also results in reduced market output (and higher prices), which is not always the case, it constitutes a harm to *competition itself* and not merely harm to competitors.

For such anticompetitive harm to result, at least three circumstances must exist. First, the degree of foreclosure occasioned by the perpetrator's exclusive dealing must be substantial enough to drive (or hold) at least some rivals below MES. *Id*. at 1166 ("A consensus has emerged that a necessary condition for anticompetitive harm arising from allegedly exclusionary agreements is that the contracts foreclose rivals from a share of distribution sufficient to achieve [MES]."). Second, it must be impracticable for foreclosed rivals to bypass the buyers subject to the exclusive dealing arrangements and sell to others by, for example, integrating forward into distribution, selling through newly entering distributors, or selling to distributors unaffected by the exclusive deal.

Finally, output-reducing exclusive dealing is unlikely absent significant barriers to entry in the producer market. If market power created by foreclosure-inducing exclusive dealing could be easily undermined by new firms entering the producer market in response to supracompetitive prices, producers (who generally have to "pay" something to induce exclusivity) would be unlikely to attempt monopolization via exclusive dealing, and even if they did so, consumer harm would be unlikely.

B. Exclusive Dealing May Provide a Number of Procompetitive Benefits

Exclusive dealing is pervasive in the modern economy and can be found in many industries, including ice cream parlors, automobile sales, gas stations, and beer distribution. As the prevalence of exclusive dealing arrangements in highly competitive markets suggests, many uses of exclusive dealing strengthen competition and enhance market output. One way they may do so is by eliminating "interbrand free-riding." To win sales from their rivals, producers aim to make their offerings more attractive, often by investing in their distributors. A manufacturer of gasoline, for example, may try to increase its sales by providing the independent retailers that carry its brand with attractive signage, good lighting, and free items for customers (e.g., roadmaps). If such a retailer were also to carry gasoline produced by another manufacturer that did not provide similar retailer investments (and thus bore less cost, permitting it to

charge lower wholesale prices), many of the additional sales resulting from the amenities provided by the investing producer would inure to its non-investing, lower-cost rival. By assuring investing producers that their retailer investments will not inure to the benefit of their rivals, exclusive dealing may encourage producers to make consumer-friendly, output-enhancing investments in the distributors that carry their brands. *See generally* Howard P. Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1, 6-11 (1982); HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 440 (2005).

Free-riding may occur, and exclusive dealing may thus be warranted, even absent producer investment in distributors. *See* Benjamin Klein & Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 74 ANTITRUST L.J. 473 (2007). Professors Benjamin Klein and Andres Lerner found that "[d]ealers often have an insufficient incentive to supply the quantity of brand-specific promotion that maximizes manufacturer profitability because they earn less profit than the manufacturer on their promotional efforts." *Id.* at 477. This is primarily because brand-specific promotion causes consumers to shift their purchasing behavior among brands, rather than dealers. *Id.* Exclusive dealing can better align incentives between the dealer and the manufacturer and also prevent situations where dealers are incentivized to free-ride on the manufacturer. *Id.* at 477-80.

A second way exclusive dealing may enhance competition and benefit consumers is by intensifying competition for distribution. To induce retailer exclusivity and the heightened sales it will generate, producers often lower their wholesale prices in exchange for exclusive dealing. Competition among retailers for customers, then, ensures that those wholesale price-savings are passed on to consumers in the form of lower retail prices. Those lower retail prices, in turn, more than make up for any welfare loss occasioned by reduced consumer choice. By intensifying the competition for access to a retailer, exclusive dealing may therefore confer a net benefit on consumers. *See generally* Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433 (2008).

Exclusive dealing may also enhance consumer welfare by reducing the costs associated with uncertain supply and demand. Distributors may find exclusive dealing contracts to be the optimal way to assure a steady source of supply. A gasoline retailer, for example, will want to ensure adequate gasoline supplies for the busy summer months. It could contract in advance to purchase some fixed quantity of gasoline from a producer, but it would run the risk that consumer demand may either soften, leaving it with a glut of gasoline, or spike, leaving it without sufficient gasoline and forcing it to find other suppliers. The retailer's lowest cost option for assuring an adequate, but not excessive, supply of gasoline may well be to enter a requirements contract under which

it promises to buy all its requirements from a single gasoline producer in exchange for that producer's promise to supply all that is required. *See Standard Stations*, 337 U.S. at 306 (exclusive dealing "may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand"); HOVENKAMP, *supra*, at 439.

On the producer side, exclusive dealing may reduce uncertainty and thereby lower costs (and ultimately prices) by assuring producers of a steady source of demand for their output. A producer that has entered exclusive dealing contracts with a number of distributors can be assured of sales reflective of their collective requirements, a sum that is likely more predictable than is abstract demand for the producer's output. *See Standard Stations*, 337 U.S. at 306-07 (exclusive dealing "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"); HOVENKAMP, *supra*, at 439-40.

By making it easier for producers to forecast demand for their products, exclusive dealing may encourage producers to expand their productive facilities, thereby enhancing market output. Consider, for example, a gasoline producer that is deciding whether to build a new refinery and, if so, at what

scale. If the producer builds a large and expensive refinery but then encounters soft demand for its output, it may be forced to reduce its gasoline prices to levels that would not permit it to recoup its construction costs. In light of this possibility, the producer may construct a smaller facility or not build at all. This problem may be particularly acute where information about other market participants is poor. For example, if the producer does not know whether competing producers are contemplating new refineries, it may fear excess refining capacity and hold back on expansion. Long-term exclusive dealing contracts guaranteeing demand for its products could alleviate the producer's uncertainty and encourage output expansion. *See generally* HOVENKAMP, *supra*, at 440.

Exclusive dealing may be particularly helpful for encouraging the production of "systems" involving multiple disparate components. Many systems utilize multiple parts that are similar in design, have comparable fixed costs of production, and are used together but not in fixed proportions. A home plumbing system, for example, involves pipes, joints, and valves of multiple shapes and sizes. The parts are manufactured using comparable technologies and therefore have similar fixed costs of production. The parts are used together, but some parts are utilized and replaced more frequently than others. There are also economies in distributing and producing the products together: consumers will benefit if they can purchase all their plumbing parts from a single distributor, and distributors can reduce transaction costs (and thus

charge lower prices) if they acquire all complementary parts from a single producer. Both consumers, who need easy access to multiple complementary parts, and producers, who will find each part to be more highly valued if its complements are easy to obtain, benefit from having all parts readily available. Taken together, these facts suggest that efficiencies may result when the same producer provides all the parts in the system.

But a producer that provides the full line of complementary parts will incur costs that makers of a narrower line of parts may avoid. Because the fixed cost of producing each of the various parts is similar but the incidence of their usage varies, a producer that makes only frequently used parts will have lower average per-unit costs than will a producer that makes the full line of parts. Facing lower costs, the partial line producer – which benefits from the full line maker's production of obscure parts – could charge lower prices on the narrower line of parts it makes. But if the partial line producer undersells and thus wins business from the full line producer on popular parts, the full line producer may be weakened or go out of business, making obscure parts less readily available. Such a development would injure not just the full line producer but also both consumers, who need easy access to obscure parts, and partial line producers, whose products will be valued less if the full line of complementary parts is less readily available.

To protect itself *and* avoid the consumer harm that will result if the system it makes becomes less valuable, a system producer will want to avoid "cherry-picking" by partial line producers. It could do so by utilizing a form of exclusive dealing in which it requires distributors of its parts to carry only its parts, not those of partial line producers who are ultimately free-riding on its full line production. *See* Roy W. Kenney & Benjamin Klein, *The Economics of Block Booking*, 26 J.L. & ECON. 497 (1983); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMP. L. & ECON. 707 (2005); Katherine Ho, Justin Ho & Julie Holland Mortimer, *The Use of Full-Line Forcing Contracts in the Video Rental Industry*, 102 AM. ECON. REV. 686 (2012); Katherine Ho, Justin Ho & Julie Holland Mortimer, *Analyzing the Welfare Impacts of Full-Line Forcing Contracts*, 60 J. INDUS. ECON. 468 (2012).

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In sum, exclusive dealing may enhance consumer welfare by reducing interbrand free-riding, intensifying competition for distribution, cutting costs by guaranteeing sources of supply for distributors and demand for producers, and eliminating value-destructive cherry-picking by producers of partial lines of system components. Given that exclusive dealing has these many procompetitive uses and is likely to occasion anticompetitive harm in only a narrow set of circumstances, it should come as no

surprise that empirical studies generally find most instances of exclusive dealing to enhance, rather than reduce, competition. *See* James C. Cooper, et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 658 (2005) (observing that although "some studies find evidence consistent with both pro- and anticompetitive effects . . . virtually no studies claim to have identified instances where vertical practices were likely to have harmed competition"); Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy* in HANDBOOK OF ANTITRUST ECONOMICS 391 (Paolo Buccirossi ed., 2008) ("[I]t appears that when manufacturers choose to impose restraints, not only do they make themselves better off but they also typically allow consumers to benefit from higher quality products and better service provision."); Daniel O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems* in THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 72-73 (2008) (observing that "with few exceptions, the literature does not support the view that [vertical restraints] are used for anticompetitive reasons"); Jan B. Heide, et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 J.L. & ECON. 387, 387 (1998) (finding that "firms are more likely to use exclusive dealing when there is a potential that other manufacturers can free ride on the services they provide" and that "when manufacturers are concerned about the costs that exclusive dealing imposes on end customers, such arrangements are less likely"); Tim R. Sass, *The Competitive*

Effects of Exclusive Dealing: Evidence from the U.S. Beer Industry, 23 INT'L J. INDUS. ORG. 203 (2005) (concluding that exclusive dealing in the beer market increases market output).

II. Supreme Court Precedent on Vertical Restraints Has Evolved to Require Proof of Harm to the Competitive Process, Not Merely Harm to a Competitor Except in Regards to Exclusive Dealing

This is not merely a petition to correct the errors of a lower court. Review of this case by the Supreme Court will necessarily require the update of exclusive dealing law, an area of law that has been unaddressed since before the economic revolution in antitrust law. Exclusive dealing law has not been touched since the Supreme Court's decisions in *Standard Stations* and *Tampa Electric*, neither of which are consistent with modern antitrust jurisprudence. Joshua D. Wright, *The Supreme Court Should Grant Certiorari in* FTC v. McWane at 4 (December 21, 2015), *available at* http://ssrn.com/abstract=2706859.

In *Standard Stations*, the Supreme Court focused on whether the defendant's exclusive dealing arrangements caused harm to its competitors, not to competition itself. The Court further suggested that market foreclosure is a sufficient, not merely a necessary, condition to antitrust liability. *See Standard Stations*, 337 U.S. at 314. Subsequent Supreme Court decisions have clarified both that harm to competition

is a prerequisite to liability for exclusive dealing and that market foreclosure generally will not, by itself, create antitrust liability.

The exclusive dealing in *Standard Stations* involved requirements by a gasoline producer that the independent retailers selling its brand carry its fuel exclusively. *Id*. at 295-96. Such arrangements were common in the gasoline industry. *Id*. at 314. Finding that the defendant's exclusive dealing arrangements foreclosed its rivals from 6.7 percent of available distribution outlets, the district court imposed antitrust liability. It barred evidence concerning "the economic merits or demerits of the present system," and refused to consider whether the number of dealers had increased or decreased since the exclusive dealing contracts had come into existence. *Id*. at 298. In affirming the district court, the Supreme Court appeared to endorse a rule of *per se* liability for exclusive dealing arrangements foreclosing a "substantial" percentage of sales opportunities for the defendant's rivals. *See* HOVENKAMP, *supra*, at 441.

A dozen years later, the Supreme Court rethought that "quantitative foreclosure" approach. In *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961), the Court reversed a decision condemning an arrangement in which a Florida utility had promised to purchase its coal exclusively from a single producer for a 20-year period. The key part of the *Tampa Electric* decision was the Court's ruling on how to define the relevant market, a ruling that

reduced the foreclosure occasioned by the challenged arrangement to an insubstantial percentage (less than one percent). *Id*. at 329-33. That ruling was enough to warrant reversing the lower court's decision. In a bit of influential dicta, however, the Court ventured beyond the market definition issue and asserted that the mere *quantity* of sales opportunities foreclosed by an exclusive dealing arrangement should not determine the arrangement's legality. Rather, a reviewing court should inquire further into the *competitive effect* of the exclusive dealing arrangement – i.e., whether it enhances or reduces market output from what it otherwise would be. The Court explained:

> To determine substantiality [of market foreclosure] 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 preemption of that share of the market might have on effective competition therein*. *Id*. at 329 (emphasis added).

Tampa Electric's effects-based, "qualitative foreclosure" approach properly reflects economic insights about exclusive dealing's ability to enhance market output even when it forecloses sales opportunities for

a defendant's rivals.[2] The Court's emphasis on the competitive effects of foreclosure suggests that a court assessing the legality of an exclusive dealing arrangement should first consider, in addition to any evidence on the degree of foreclosure, whether the arrangement at issue occasioned an actual change in market output – i.e., a significant change in the number of units sold, their quality, or the prices charged.

However, this is as far as the law on exclusive dealing has progressed and *Tampa Electric* is still pre-economic revolution. *Tampa Electric* did little to advance the law on exclusive dealing outside of the dicta discussed above, and that dicta is insufficient to properly guide the lower courts towards a cohesive economics-based analysis of exclusive dealing restraints. The law on other vertical restraints, in contrast, have enjoyed the benefit of the economic revolution through a series of landmark cases. These cases incorporated valuable economic learning in order to properly recognize procompetitive benefits of vertical restraints.

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[2] Commentators generally refer to the approach prescribed in *Tampa Electric* as a "qualitative," as opposed to "quantitative," foreclosure approach because the Court there clarified that the percentage of sales opportunities foreclosed by an exclusive dealing arrangement, while relevant, is not the touchstone for liability. *See* Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311, 322 (2002). Instead, liability should turn on the arrangement's actual or likely effect on competition – i.e., on market output.

The modernization of vertical restraint law began with the decision in *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). *GTE Sylvania* overruled *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), by finding that vertical nonprice restrictions are to be judged under the rule of reason. *GTE Sylvania*, 433 U.S. at 58-59. In doing so, the Court stated that "we do make clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than – as in *Schwinn* – upon formalistic line drawing." *Id.*

After *GTE Sylvania*, the Supreme Court went to work on limiting the reach of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which ruled that minimum price fixing agreements are considered *per se* illegal. First, *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), "required that antitrust plaintiffs alleging a § 1 price-fixing conspiracy must present evidence tending to exclude the possibility a manufacturer and its distributors acted in an independent manner." *Leegin Creative Leather Products v. PSKS, Inc.*, 127 S. Ct. 2705, 2722 (2007) (citing *Monsanto*, 465 U.S. at 764). Then, *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), further narrowed the scope of Dr. Miles by holding "that the *per se* rule applied only to specific agreements over price levels and not to an agreement between a manufacturer and a distributor to terminate a price-cutting distributor." *Id.* (citing *Business Electronics*, 485 U.S. at 726-27).

The Court then overturned *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), which made maximum price fixing agreements *per se* illegal, in *State Oil Co. v. Khan*, 522 U.S. 3 (1997). The Court finally overturned *Dr. Miles*, the last bastion of *per se* treatment of vertical restraints, in the landmark case *Leegin Creative Leather Products v. PSKS, Inc.*

The vertical restraint of exclusive dealing has so far been left out of this important line of cases that have been updating vertical restraint law since *GTE Sylvania* in 1977.

III. The Economic Coherence of Modern Antitrust Law Requires Economic Proof of Actual Harm in Exclusive Dealing Cases

The Supreme Court's decision in *GTE Sylvania* was a pivotal point in antitrust jurisprudence because the Court "emphasized that the analysis of economic effects provided the proper basis for evaluating conduct under the antitrust laws." William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. ECON. PERSP. 43, 53 (2000). *GTE Sylvania* signaled the beginning of the economic revolution in antitrust law. A study of antitrust cases from 1967 to 2007 found that the Supreme Court cited to modern economic thought only 30 percent of the time in the decade beginning with 1967. Leah Brannon & Douglas H. Ginsburg, *Antitrust Decisions of the U.S. Supreme Court 1967 to 2007*, 3 COMPETITION POL'Y INT'L 1 (2007). However,

in the decade beginning in 1977, the year *GTE Sylvania* was decided, the percentage of cases citing to modern economic thought jumped to 60 percent and increased further to 78 percent in the decade following. *Id.* at 21.

Supreme Court cases following *GTE Sylvania* have required antitrust claims to make economic sense in order to be successful. Joshua D. Wright, *The Supreme Court Should Grant Certiorari in* FTC v. McWane at 1 (December 21, 2015), *available at* http://ssrn.com/abstract=2706859. As such, there should be substantial economic evidence of actual harm to competition in order to find a violation of antitrust laws. Such economic evidence can be provided through proof of direct effects, indirect inference through proof of foreclosure and barriers to entry, or other means.

A. A Lack of Economic Content in Exclusive Dealing Law Precludes Consistent Application of Antitrust Law With a Consumer Welfare Focus

The particular requirement to show real economic evidence of actual harm results in greater consumer benefits. Antitrust law applied with a focus on economic evidence leads to consistent enforcement that targets behaviors which cause consumer welfare loss without punishing behaviors that have net consumer welfare gains. This objective view of business behaviors avoids many pitfalls, including overly

relying on contemporaneous documents that, while helpful, do not on their own make out a case for harm to competition. The line of cases following in the wake of *GTE Sylvania* have created a system of modern, economic evidence focused antitrust law that is no longer "at war with itself" as Robert Bork described. *Id.*

The instant case is a sound vehicle for addressing what economic content is necessary to meet the burden of proof necessary to show harm to competition. The case below was deficient in several critical respects. As Professor Joshua Wright, former-Commissioner of the Federal Trade Commission during the *McWane* case, states:

> Complaint Counsel made no effort to establish harm to competition directly, such as by demonstrating that McWane's conduct had a deleterious effect on price or output in the domestic fittings market. The data were available to do so. Instead, Complaint Counsel and the Commission relied upon – and the Eleventh Circuit accepted as sufficient to establish liability – indirect evidence including market share estimates and imprecise estimates regarding how much the Full Support Program "foreclosed" Star from access to distributors.
>
> This evidence is only indirectly relevant to establishing the Full Support Program harmed competition in the Domestic Fittings market because it requires a number of inferences to be drawn and assumptions to be

> made to establish such a connection. Indeed, the most probative indirect evidence in the record is evidence of Star's successful entry in the Domestic Fittings market and its growing market share. If the challenged conduct that occurred in 2009 and 2010 harmed competition, Complaint Counsel ought to be able to prove it with evidence that *consumers of domestic pipe fittings are worse off as a result of McWane's conduct*. The record is clear that there is no such proof. Joshua D. Wright, *The Supreme Court Should Grant Certiorari in* FTC v. McWane at 48-49 (December 21, 2015), *available at* http://ssrn.com/abstract=2706859 (citations omitted).

Exclusive dealing liability should not be so easy to establish. As discussed above, economics has taught that although exclusive dealing may sometimes occasion anticompetitive harm, several prerequisites must be in place before such harm can occur. Moreover, exclusive dealing can achieve a number of procompetitive benefits and is quite common in highly competitive markets. The Supreme Court should grant certiorari in order to instruct courts on the economic content necessary to successfully make out a claim of unlawful exclusive dealing.

B. Liability Should Not Rest on Hypothetical or Presumed Effects

In exclusive dealing, the critical economic issue is "[w]hether the exclusionary rights arrangement will so limit remaining supply available to rivals that it

will lead them to bid up the price of that supply, thereby increasing their costs to the point that the purchaser obtains power over price." Thomas Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power Over Price*, 96 YALE L.J. 209, 259 (1986). Professor Joshua Wright states that:

> [E]xclusive dealing cannot result in the acquisition or maintenance of market power and harm competition unless the contracts foreclose a rival from access to a critical input necessary to achieve minimum efficient scale (MES). In other words, a coherent theory of exclusion involving exclusive dealing contracts requires an analytical link between the contracts and the MES of production. Joshua D. Wright, *The Supreme Court Should Grant Certiorari in* FTC v. McWane at 16-17 (December 21, 2015), *available at* http://ssrn.com/abstract=2706859 (citations omitted).

This analytical link should be shown through economic direct or indirect evidence and not through hypothetical or presumed effects in order to be in line with the economics evidence based approach introduced into antitrust law through the *GTE Sylvania* line of cases. This standard is not overly burdensome. As Professor Wright points out, Complaint Counsel in the case below could have substantiated its theory of harm through: "(1) direct evidence that the Full Support Program reduced output or increased price or (2) indirect evidence that the agreement foreclosed

Star by preventing it from achieving minimum efficient scale for a substantial period of time." *Id.* at 18.

Instead, Complaint Counsel fixated on whether Star could justify the purchase of a foundry under McWane's alleged exclusive dealing, without presenting "enough evidence to compel the conclusion that MES in the domestic fittings industry was the scale necessary to justify the purchase of a foundry." *Id.* at 18. All complaint counsel showed was that production costs would be lower with a foundry, and that some customers were reluctant to purchase from Star because it did not own its own foundry. This left the lynchpin of the Federal Trade Commission's case untested and unproven through economic examination.

IV. The Supreme Court Needs to Revisit this Area of Law to Give Clear Guidance to the Lower Courts

The modernization of vertical restraint law that occurred between 1977 and 2007 has entirely passed over exclusive dealing law. It is telling that the important vertical restraint cases *GTE Sylvania*, *State Oil*, and *Leegin* were not once mentioned in the Eleventh Circuit's opinion. However, the Eleventh Circuit cited *Standard Stations*, which appeared to endorse *per se* liability, as good law.[3] App. 36a-37a.

[3] In contrast to *Standard Stations*, the post-economic revolution line of cases from *GTE Sylvania* to *Leegin* overturned

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The Eleventh Circuit only commented that *Standard Stations* had been amended by *Tampa Electric* to "open[ ] the door to a broader analysis." *Id.*

Professor Joshua Wright's criticism of *Standard Stations* is helpful:

> The Court's error in *Standard Stations* was focusing its attention away from the most significant question in virtually all cases involving unilateral conduct – whether the conduct in question harmed competition – and focusing instead upon an issue that is, at best, weakly relevant to answering that most significant question in exclusive dealing cases – whether the contract results in substantial foreclosure. Since *Standard Stations*, courts in exclusive dealing cases have been attempting to rationalize the law while maintaining fidelity to Court's erroneous preoccupation with substantial foreclosure. Joshua D. Wright, *The Supreme Court Should Grant Certiorari in* FTC v. McWane at 37 (December 21, 2015), *available at* http://ssrn.com/abstract=2706859.

This confusion in reconciling *Standard Stations* with modern, economics focused antitrust law has led to a circuit split in respect to the tests used to analyze exclusive dealing or partial exclusive dealing agreements. *Id.* at 51-58. This is primarily seen in exclusive

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per se liability for vertical restraints. This line of cases is widely viewed as a success for consumers.

dealing law concerning conditional pricing, where courts are torn between analyzing such agreements "under exclusive dealing law, predatory pricing law, or an alternative approach recently embraced by the Third Circuit." *Id.* at 51-52.

The Eleventh Circuit's decision in *McWane, Inc. v. FTC*, 783 F.3d 814 (11th Cir. 2015), which involved a discount conditioned upon exclusivity, follows the exclusive dealing approach. *Id.* at 55. However, the Third Circuit's decision in *ZF Meritor, LLC v. Eaton Corp.* follows a different approach altogether. 696 F.3d 254 (3d Cir. 2012). The Third Circuit analyzed the case under both sets of law, stating "a plaintiff's characterization of its claim as an exclusive dealing claim does not take the price-cost test off the table."[4] *Id.* at 275. The Third Circuit, however, rules that price-cost tests are not relevant to analysis when "price itself [is] not the clearly predominant mechanism of exclusion." *Id.* at 277. Other courts have analyzed conditional pricing under predatory pricing law using the price-cost test. *See*, *e.g.*, *Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256 (2d Cir. 2001) (using the Brooke Group test where plaintiff had alleged below-cost pricing).

These differing analysis of exclusive dealing show that the lower courts need better guidance than *Standard Stations* and *Tampa Electric* afford. This is especially true considering *Standard Stations*

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[4] The price-cost test is relevant in predatory pricing analysis.

appeared to endorse a rule of *per se* liability, which would make it the only law on vertical restraints that still has such a rule. *See* HOVENKAMP, *supra*, at 441. *Tampa Electric* was decided based on a relevant market issue, and therefore has nothing to contribute to exclusive dealing law accept in dicta. *Tampa Electric*, 365 U.S. at 329-33. The evolution of vertical restraint law should not stop with *Leegin* but should continue to include current gaps in the law including exclusive dealing.

CONCLUSION

This Court should grant certiorari in order to close important gaps in vertical restraint law that have yet to be addressed in the post-economic revolution line of cases that began with *GTE Sylvania*.

Respectfully submitted,

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