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John H. Shenefield

A SURVEY OF THE ANTITRUST LAW OF EXCLUSIVE AGREEMENTS

*John H. Shenefield**

WITHIN the world of commerce, long-term supply contracts are common. Manufacturers seek to establish dependable customers and consumers hope for the security of a reliable supply. Short of vertical integration no commercial arrangement accomplishes these ends more efficiently than the several varieties of exclusive arrangements.

The extent to which businessmen sign such agreements and operate under the effects of their provisions while unaware of the potential for violation of the antitrust laws is surprising. Part of the reason for this lies in the nature of the relevant legal rules. For nowhere in the evolving area of antitrust law, with all its inherent abstraction and complexity, is the ground more uncertain and the guideposts less helpful. Courts have sought to avoid dealing directly with the core issues raised by the exclusive dealing cases because of their own asserted defects as triers of complex economic facts, and because of the inefficiency of lengthy trials. Even were courts willing to shoulder the burden, insufficient work has been done by economists to analyze the true effects of these arrangements upon competition.

This survey studies the current law and makes some brief suggestions as to how businessmen, lawyers and courts alike could, with both reasonable fairness and efficiency, deal more successfully with the difficult antitrust issues of exclusive agreements of all kinds.

THE APPLICATION OF ANTITRUST LAW TO EXCLUSIVE AGREEMENTS

Exclusive long-term supply agreements raise antitrust questions. To the extent they have a restrictive effect on the operations of purchasers or sellers, they impose the economic costs that antitrust policy associates with the inhibition of the free operation of market forces.

A long-term supply contract may be framed as an agreement by a purchaser to deal exclusively with a seller. Such agreements are gov-

*Member of the Virginia and District of Columbia Bars. A.B., Harvard, 1960; LL.B., Harvard, 1965.

erned, though not necessarily prohibited, by specific provisions of antitrust law, including § 3 of the Clayton Act.[1] Also, supply contracts, though not in form exclusive, may undertake to insure that all or most of the requirements of the purchasers will be supplied by the seller. Frequently, a purchaser will contract for the purchase of the entire output of a seller. These "requirements" or "output" contracts may also come within the scope of the antitrust statutes, including § 3 of the Clayton Act and § 1 of the Sherman Act.[2] In addition, supply contracts in their various forms may raise other antitrust questions, involving price discrimination or even monopolization.[3]

I. Historical Development of Section 3 of the Clayton Act

After the first twenty years of operation of the Sherman Act, the Supreme Court announced a new standard of interpretation in *Standard Oil Co. v. United States*.[4] In the face of the Act's flat prohibition of contracts, combinations or conspiracies in restraint of trade, the Supreme Court decided that under the "rule of reason," only those arrangements in *unreasonable* restraint of trade were in fact touched by the statute.

The reaction to this judicial construction was largely hostile. In the presidential campaign of 1912, platforms of the three major political parties advocated specific legislative definition of business practices to be prohibited, and sought the establishment of a regulatory authority to facilitate enforcement. If enacted, such proposals would, it was thought, avoid the enervating interpretations of a too-cautious Supreme Court.

Congress responded in 1914 with the enactment of the Clayton Act and the Federal Trade Commission Act.[5] The Clayton Act, dealing with price discrimination, stock acquisitions and interlocking directorates, also dealt with exclusive dealing arrangements.

The House of Representatives, after refusing to accept limiting

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1 15 U.S.C. § 14 (1970).

2 15 U.S.C. § 1 (1970).

3 Such contracts may promote price discrimination or even monopolization, and accordingly trigger the Robinson-Patman Act, 15 U.S.C. § 13 (1970) or § 2 of the Sherman Act, 15 U.S.C. § 2 (1970).

4 221 U.S. 1 (1911).

5 Act of Sept. 26, 1914, ch. 311, § 1, 38 Stat. 717 (codified at 15 U.S.C. §§ 41-58 (1970)).

amendments, passed a bill outlawing all types of exclusive arrangements. For its part, the Senate after vigorous debate initially refused to include in its version of the bill any prohibition of exclusive dealing, under the impression that such arrangements would be covered by the unfair competition clause of the Federal Trade Commission Act. Only after the Senate-House Conference Committee produced a compromise version which prohibited only those exclusive dealing arrangements having the prescribed impact upon competition, did both Houses of Congress agree on the final language.[6]

The language of § 3 of the Clayton Act covers at least three types of competitive arrangements: exclusive dealing, requirements contracts and tying arrangements. Exclusive dealing and requirements contracts are treated similarly by the courts, but not identically. Tying arrangements are subject to substantially different legal standards.[7]

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6 Section 3 of the Clayton Act now provides:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or to make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce. 15 U.S.C. § 14 (1970).

The history of the debates is important for at least two reasons. First, the language of the "competitive impact clause" of § 3 of the Clayton Act was at least in part drawn from Addyston Pipe & Steel Co. v. United States, 175 U.S. 211 (1899), which thus provides assistance in exploring the intent of Congress. Second, the Supreme Court in a major exclusive dealing case, Standard Oil Co. v. United States, 337 U.S. 293 (1949) (*Standard Stations*) created much potential for mischief by misreading the legislative history of the Clayton Act.

7 The position of the Supreme Court has been that "[t]ying agreements serve hardly any purpose beyond the suppression of competion," Standard Oil Co. v. United States, 337 U.S. 293, 305-06 (1949), and that as a result they "fare harshly under the laws forbidding restraints of trade." Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 606 (1953). On the other hand, exclusive dealing arrangements are said not to involve automatically the same degree of economic detriment. Accordingly, the standards governing tying arrangements are substantially more restrictive than those governing exclusive dealing arrangements. *See, e.g.*, Brown Shoe Co. v. United States, 370 U.S. 294 (1962). Because the commercial function of tying arrangements is quite different from that of exclusive dealing or other supply contracts, tying will not be discussed further.

A course of dealing comes within § 3 of the Clayton Act if the following requirements are met:

(1) The seller must be engaged in interstate commerce and the practice to be examined must take place in interstate commerce;

(2) There must be a sale, lease or contract for sale;

(3) The agreement must be concerned with goods, wares, merchandise, machinery, supplies or other commodities;

(4) There must be a commitment by the purchaser to deal only in the goods of the supplier; and

(5) The arrangement must produce as a probable result the defined impact on competition.

Of these five requirements, the first four may be termed jurisdictional requirements, and the fifth comprises the substantive requirement of competitive impact.

II. Requirements for Application of Section 3

A. *The "Commerce" Requirement*

Section 3 requires that the seller be "engaged in commerce" and that the agreement occur "in the course of such commerce." Section 1 of the Clayton Act defines "commerce" as used in the Act.[8] In general terms, § 3 governs a seller engaged in interstate or foreign commerce[9] and applies specifically to an agreement reached in the course of such commerce.[10] The language by its terms excepts those engaged in

[8] That section defines "commerce" as:

> . . . trade or commerce among the several States and with foreign nations, or between the District of Columbia or any Territory of the United States and any State, Territory, or foreign nation, or between any insular possessions or other places under the jurisdiction of the United States, or between any such possession or place and any State or Territory of the United States or the District of Columbia or any foreign nation, or within the District of Columbia or any Territory or any insular possession or other place under the jurisdiction of the United States . . . . 15 U.S.C. § 12 (1970).

[9] To simplify the syntax of the following discussion, "interstate commerce" will be used as a substitute term for the convoluted definition of "commerce" in § 1.

[10] Because of the requirement of § 3 that the subject matter of the agreement must be for "use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States," § 3 does not apply to United States export trade.

intrastate commerce, as well as those engaged in interstate commerce who do not use exclusive dealing except in the intrastate portion of their business activity.

The initial analytical step in applying § 3 is to determine if the supplier is in interstate commerce. The courts have required activity in, rather than an effect upon, interstate commerce. "Commerce" in § 3 cases has thus been construed to mean only that business activity "in the flow" of interstate commerce.[11] In *United States v. United Shoe Machinery Co.*[12] the court excluded from the scope of § 3 leases between lessor and lessee in the same state not requiring goods to pass across state lines. Although the possibility exists that this restricted reading of the term "commerce" will be relaxed by inventive federal courts, it is fair to say now that the statutory language governs only those suppliers whose business activity includes commerce flowing between states or otherwise, as defined in § 1 of the Clayton Act.

A second requirement of § 3 of the Clayton Act is that the course of dealing to be evaluated must itself have occurred "in the course of such commerce."[13] Nevertheless, that requirement has been whittled down over the years. For instance, where an interstate business located in one state sells to buyers nationwide, even its sales to buyers within the state of original location have been held to be in interstate commerce. The commerce requirement of § 3 was seemingly rewritten by *Standard Oil Co. v. United States (Standard Stations)*.[14] Although the appellant contended his requirements contracts with California retail dealers were intrastate in nature, the Court concluded the contracts in question inhibited dealings with suppliers in other states as well, thereby affecting competition in both intrastate and interstate commerce.[15]

Further, the provisions of the Unfair Competition Act, 15 U.S.C. §§ 71-77 (1970), enacted in 1916, expressly permit exclusive sales by a foreign supplier to an American agent.

11 This requirement of actual participation in interstate commerce is in contrast to the scope of the Sherman Act which includes those not actually engaged in interstate commerce whose activities nevertheless have an effect upon such commerce. *See, e.g.*, Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219 (1948).

12 264 F. 138 (E.D. Mo. 1920), *aff'd*, 258 U.S. 451 (1922).

13 It goes without saying that satisfaction of this second requirement should automatically result in satisfaction of the first, though the reverse would clearly not necessarily be true.

14 337 U.S. 293 (1949) [hereinafter cited as *Standard Stations*].

15 *Id.* at 314-15.

What the Court seemed to indicate is that a mere impact upon interstate commerce will be sufficient to trigger § 3.[16] It is clear from the language of the statute, however, that something more than an effect upon interstate commerce should be required before § 3 applies. This is not to say that Congress could not have passed a statute such as the Supreme Court in *Standard Stations* appeared to be construing, but only that it did not. Perhaps the most that can now be said confidently, in view of this startling misreading of the statute, is that exclusive dealing in interstate activities is clearly included, and that such a practice, though it be solely intrastate, if it produces an appreciable impact upon interstate commerce, may be included—if the rationale of *Standard Stations* is followed.

In the preferable view, the commerce requirement of § 3 is satisfied if the supplier does some interstate business and the course of conduct under review occurred in the interstate portion of his business.

B. *The Requirement of a "Lease, Sale or Contract for Sale"*

The language of § 3 requires a lease, sale or contract for sale, or the fixing of a price, or the discounting from or rebating upon such a price.[17] Construing this aspect of the statute, the courts have required a completed sale or lease, or a signed contract for sale.[18] Refusals to sell are not covered by § 3,[19] nor are agreements of agency or consignment subject to the terms of the Act.[20]

The term "contract for sale" produces some confusion. By addition of this language, Congress obviously meant to specify something other

[16] *Accord,* Moore v. Mead's Fine Bread Co., 348 U.S. 115 (1954) (case decided under the Robinson-Patman Act).

[17] The statute, in covering the "fixing" of a price, may appear to operate upon an activity not necessarily involved in the sale, lease or contract for sale, as for instance, the submission of a bid. Nevertheless, it seems apparent that the statute must refer to the fixing of a price only in the process of a completed sale, lease or contract for sale. Any other analysis would lead to the conclusion that the lawmakers were able to imagine a situation in which the mere specification of a price, even though no goods were actually sold, had the effect of substantially lessening competition.

[18] FTC v. Curtis Publishing Co., 260 U.S. 568 (1923); McElhenney Co. v. Western Auto Supply Co., 269 F.2d 332 (4th Cir. 1959).

[19] McElhenney Co. v. Western Auto Supply Co., 269 F.2d 332 (4th Cir. 1959); Meyberg Co. v. Eureka Williams Corp., 215 F.2d 100 (9th Cir.), *cert. denied,* 348 U.S. 875 (1954); Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir.), *cert. denied,* 348 U.S. 821 (1954). A refusal to deal might provide evidence in a government suit that completed sales by the same supplier were in violation of § 3.

[20] FTC v. Curtis Publishing Co., 260 U.S. 568 (1923).

than a sale or lease. Accordingly, Congress must have intended that § 3 would reach an executory contract for sale, or a general supply contract to be implemented by separate and periodic sales. Both possibilities have been sanctioned by the courts.[21] Indeed, in *B. S. Pearsall Butter Co. v. FTC*[22] the court went so far as to say that an agreement, though lacking in elements required to make it a contract for sale, such as specification of price and quantity, did form the basis for subsequent sales and the parties were therefore estopped to deny its status as a contract for sale.

Aside from this possibility of "contract by estoppel," courts sometimes have difficulty distinguishing between a sale or contract for sale, on the one hand, and agency or consignment agreements on the other. Where under traditional agency law an agreement leaves title and control over goods in the seller and the other party is not empowered to act inconsistently therewith, § 3 has been held not to apply.[23]

Nevertheless, in the recent Supreme Court case *Simpson v. Union Oil Co.*,[24] the distinctions under the antitrust laws between agency or consignment and sale have been weakened. The Court, in reviewing a so-called consignment agreement under which the consignor controlled prices and retained title while the consignee bore the responsibility of loss and received a guaranteed commission, held the agreement in violation of the Sherman Act. But more importantly here, the Court gratuitously stated that a consignment might not be employed as a "cloak" to circumvent the prohibitions of § 3 of the Clayton Act.[25] Yet this view was expressed as dictum, and is further suspect in that the opinion ignored the fact that the language of § 3 is more explicit than § 1 of the Sherman Act. If all the Court meant was that the terminology describing the agreement will not be determinative, that is surely correct. Most lower courts have fortunately read *Simpson* as not changing the rule that agency or consignment agreements are not within the scope of § 3.[26]

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21 *See* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961); B. S. Pearsall Butter Co. v. FTC, 292 F. 720 (7th Cir. 1923).

22 292 F. 720 (7th Cir. 1923).

23 Columbia Broadcasting Sys. Business Equip. Corp. v. Underwood Corp., 240 F. Supp. 413 (S.D.N.Y. 1964).

24 377 U.S. 13 (1964).

25 *Id.* at 18.

26 Columbia Broadcasting Sys. Business Equip. Corp. v. Underwood Corp., 240 F. Supp. 413 (S.D.N.Y. 1964).

C. *"Commodities" Requirement*

Section 3 of the Clayton Act governs the sale only "of goods, wares, merchandise, machinery, supplies, or *other* commodities . . ." (Emphasis supplied). The grouping of the terms suggests a requirement of tangibility. Courts have generally adhered to this approach.

In *United States v. Investors Diversified Services, Inc.*,[27] the court explained the meaning of "commodities" in light of the *ejusdem generis* rule of construction, so as to confine the definition to articles similar to those specifically enumerated, thereby excluding others, such as money which is not a commodity, but a medium of exchange.[28] In short, the court suggested the term "commodities" be afforded its usual and natural meaning. Thus, generally, tangible items have been held within the scope of § 3, and other products have been excluded from the statute's coverage. Loans, transfers of rights or privileges, transactions involving money or credit, and services have generally been excluded.

The distinction between tangible commodities and intangibles is unhelpful when it must be applied to nontangibles, such as electricity or natural gas. *Pennsylvania Water & Power Co. v. Consolidated Gas, Electricity & Power Co.*[29] has been cited for the proposition that contracts for the sale of electricity are apparently subject to § 3 of the Clayton Act. The *Penn Water* case, however, primarily involved the Sherman Act. Neither the opinion of the court of appeals nor that of the district court, nor any of the briefs in the court of appeals, addressed the issue of whether electricity was a commodity within § 3.

The same problem exists with respect to gas. In an early case,[30] it was held that acetylene gas was not within the scope of § 3. However, more recently, courts have assumed that natural gas was a commodity.[31] Modern physics has made matter of nontangibles. The courts will no doubt stay in step by likewise enlarging the concept of "commodities" for § 3.

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[27] 102 F. Supp. 645 (D. Minn. 1951).

[28] *Id.* at 648-49.

[29] 184 F.2d 552 (4th Cir.), *cert. denied,* 340 U.S. 906 (1950). *See also* State *ex rel.* Spillman v. Interstate Power Co., 118 Neb. 756, 226 N.W. 427 (1929).

[30] Auto Acetylene Light Co. v. Prest-O-Lite Co., 276 F. 537 (6th Cir. 1921).

[31] B. & W. Gas, Inc. v. General Gas Corp., 247 F. Supp. 339 (N.D. Ga. 1965); Rural Gas Service, Inc., 59 F.T.C. 912 (1961).

D. *The Requirement of Exclusivity*

The final jurisdictional requirement of § 3, and the most important, is that the transaction under review must include a commitment by the purchaser not to deal in the products of a competitor of the supplier. This commitment to exclusivity may be in the form of a "condition, agreement, or understanding."

The finding of a commitment to exclusivity on the part of a purchaser or lessee triggers the operation of § 3.[32] But a purchaser unilaterally deciding to trade only with a single supplier, though not making any legal commitment to that effect, will not be a party to an exclusive dealing agreement violative of § 3.

The commitment to exclusivity, once legally concluded, is not exculpated by its desirability from the purchaser's point of view, or his willingness in having undertaken it. Such factors, though perhaps relevant to the transaction's effect upon competition,[33] do not bear upon the existence *vel non* of the commitment to exclusivity. Of course, a commitment into which the purchaser has been coerced by the tactics of the seller is clearly covered by § 3.

Normally the condition or understanding not to deal in the goods of a competitor of the supplier is stated explicitly in the agreement between supplier and purchaser. There have been cases, however, in which the courts have inferred an exclusionary condition from the pattern of dealings between supplier and purchaser.[34] Such inferences have typically been drawn where the seller makes it clear to the purchaser by words, actions, or example that disloyalty in the form of dealing with competitors of the supplier will be disadvantageous to the purchaser.[35]

In any event, the seller should not be precluded from using hard-sell tactics to induce a buyer to concentrate on the seller's products,

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32 The gravamen of a Section 3 violation is the forbidden condition, agreement or understanding of exclusivity, and a proper pleading should assert this ultimate fact. It makes no difference whether this is voluntary or is imposed by coercion, but without such agreement, condition or understanding, there can be no statutory infraction. It is only in the presence of this essential element that consideration must be given as to whether competition may be substantially lessened or whether there is any tendency toward monopoly.

McElhenney Co. v. Western Auto Supply Co., 269 F.2d 332, 338-39 (4th Cir. 1959).

33 *See, e.g.*, Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961).

34 *See, e.g.*, United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922).

35 Richfield Oil Corp. v. Karseal Corp., 271 F.2d 709 (9th Cir. 1959); Englander Motors, Inc. v. Ford Motor Co., 267 F.2d 11 (6th Cir. 1959).

nor should a seller be inhibited from terminating an arrangement producing, by accepted and reasonable standards, unsatisfactory results.[36] The courts have not yet gone so far.

The clearest grounds for inferring exclusive dealing are the extension of favorable treatment to those who as a matter of practice do not deal in the goods of a competitor of the supplier, or the imposition of onerous terms upon those who do. Accordingly, exclusive dealing has been found where customers are given preferential discounts if they deal only in the supplier's products,[37] or where such customers are permitted special privileges, such as the privilege of returning unsold goods.[38]

Similarly, if penalties are imposed upon those who deal in the goods of a competitor of a supplier, courts have been quick to infer exclusive dealing agreements as to those customers who decline to deal with the competitor. In *Carter Carburetor Corp. v. FTC*,[39] the withholding of service information from service stations not dealing exclusively with the supplier gave the court grounds for inferring exclusive dealing. Punitive payments required from those who deal with competitors or the requirement of surrender of the right to use the trade name of the seller are also grounds permitting inference of the requisite commitment to exclusivity.[40]

In summary, the required commitment to exclusivity will frequently be explicitly defined in the agreement between purchaser and seller. In any event, in appropriate circumstances, courts will infer such a commitment from the pattern of conduct of purchaser and supplier.

E. *Exclusivity in Requirements and Partial Requirements Contracts*

Supply contracts sometimes take the form of contracts to supply the total or partial requirements of the customer. It can readily be seen that a total requirements contract is simply a variation of an exclusive dealing contract, for if the customer must look to a given supplier for all requirements of the product, no opportunity exists for transactions involving that product with a competitor of the supplier.

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

37 Carter Carburetor Corp. v. FTC, 112 F.2d 722 (8th Cir. 1940).

38 Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346 (1922); Q.R.S. Music Co. v. FTC, 12 F.2d 730 (7th Cir. 1926).

39 112 F.2d 722 (8th Cir. 1940).

40 Anchor Serum Co. v. FTC, 217 F.2d 867 (7th Cir. 1954); Oxford Varnish Corp. v. Ault & Wiborg Corp., 83 F.2d 764 (6th Cir. 1936).

Yet, total requirements contracts are not identical to exclusive dealing contracts. The classic exclusive dealing contract prohibits the customer from dealing in any goods of a competitor of the supplier. A total requirements contract, in effect, prevents the purchaser from dealing with a competitor of the supplier, but normally only with respect to one product. Thus, the total requirements contract is less restrictive than the classic exclusive dealing agreement.

Nevertheless, courts have treated requirements contracts as falling within § 3 of the Clayton Act.[41] This broader reading of § 3 also may support the statute's application to tying agreements, where the commitment to exclusivity is restricted to one product (the tied product) in addition to that the purchaser desires to acquire (the tying product) from the supplier. Thus, while the exclusive dealing contract extends exclusivity to all products, the § 3 tying arrangement embraces only one additional product, and the requirements contract, only additional amounts of the same product the customer initially desires to purchase.

Note that the requirement of exclusivity is being differently applied to various practices.[42] In view of the varying business reasons for exclusive dealing and tying arrangements, and the contrasting court attitudes toward these practices, shifting application of the exclusivity requirement may not be surprising. But because requirements contracts are assumed to be simply reworded exclusive dealing contracts, though they are not in fact, the interpretation of § 3 to produce application of the statute even to requirements contracts may imply expanded coverage not foreseen by the authors of the statute. On the other hand, if the impact upon competition of the two kinds of contracts is similar, the original congressional policy clearly covers requirements contracts, even if the language of the statute plainly does not.

A legitimate question at this point is why the requirement of a commitment to exclusivity is relaxed, but on the other hand, the requirement of a "commodity" is strictly construed. An amendment to the statute to harmonize the policy and the language would seem to be in order.

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[41] Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961). *See also* Brown Shoe Co. v. United States, 370 U.S. 294 (1962); Standard Oil Co. v. United States, 337 U.S. 293 (1949).

[42] Of course in some instances a commitment in the form of a tying agreement may be in effect a total requirements contract, because the purchaser will necessarily have no additional need for the tied product. *See, e.g.,* United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922).

Even without such an amendment, the statute can be extended to cover requirements contracts without violence to the statutory scheme and without unduly expanding its scope. It is now commonly accepted that one of the purposes of enacting the Clayton Act was to bolster antitrust enforcement by outlawing practices in their incipiency which, if permitted fully to develop, would constitute violations of the Sherman Act. Further, if requirements contracts can have an adverse effect upon competition, it seems logical to analyze them under § 3, rather than under § 1 of the Sherman Act alone, whose standards of proof may be more demanding. A coherent analysis of actual competitive impact upon the Clayton Act can adequately take into account the fact that a contract is only for the requirements of a customer for one product, rather than for all products. But this kind of analysis cannot be characterized by the use of per se shortcuts, since such foreshortened review will inevitably assume the conclusions for many of the crucial issues to be resolved. What is thus called for is an extended balancing of business justification against competitive impact.[43]

Partial requirements contracts are even less restrictive than total requirements contracts. Where an agreement guarantees exclusivity only to the extent of a stated percentage or an absolute amount of a customer's total requirements, the customer is free to seek additional supplies of that same product from a competitor of the seller.

But the same problem which results from analyzing full requirements contracts under § 3 of the Clayton Act necessarily arises, in more extreme form, where partial requirements contracts are involved. Those seeking to subject partial requirements contracts to § 3 must argue that the language in the statute requiring a commitment to exclusivity applies to any amount less than the customer's total requirements, as long as that amount is substantial enough to have a market impact. If the argument is made without the requirement of substantiality, analysis soon reaches the absurd position that a sale of any item is an exclusive dealing agreement, or at least a partial exclusive dealing agreement, because to that extent the customer is precluded from dealing in the goods of a competitor of the seller.[44]

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[43] See discussion of analysis of "Competitive Effect," p. 243 *infra*.

[44] While such a position may not appeal to common sense, it has persuaded at least one court with the result that a utility's underground plans were held to be exclusive dealing under § 3 because their practical effect was a commitment not to deal in some, but not necessarily all, or even most, appliances of the utility's com-

Cases involving partial requirements contracts, described as such, are rare under § 3. One clear reason is that cases that are partial requirements cases are instead analyzed as total requirements cases. Such an approach was utilized in *Tampa Electric Co. v. Nashville Coal Co.*,[45] in which a supply of coal for a specific generation facility was contracted for, athough the electric company was not required to use coal at the facility nor was it inhibited from procuring coal from competitors of the supplier for use at other facilities. The trial court and the appeals courts chose to handle the contract as a full requirements contract, no doubt taking into account that it covered all coal requirements of Tampa Electric foreseeable at the time of the contract's execution.[46]

The courts may be reluctant to apply § 3 to partial requirements contracts, as such. This would seem to be consistent with the exclusivity language of § 3. Antitrust enforcement is probably not damaged by such reluctance since § 1 of the Sherman Act is available for use. However, even if some courts do choose to jam partial requirements contracts into § 3 framework, the substantive requirement of that section can be depended upon, if properly interpreted, to treat the practice fairly.

F. *The Requirement of Anticompetitive Effect*

Section 3 of the Clayton Act prohibits those sales, leases or contracts for sale involving a commitment to exclusivity only where the effect of such transactions ". . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce."[47] Thus, once all the jurisdictional requirements of § 3 are satisfied, the statute still contains a substantive requirement of defined impact upon competition before the course of dealing under examination may be held unlawful.[48] The nature of the substantive requirement compels analysis

petitor. Washington Gas Light Co. v. Virginia Elec. & Power Co., 309 F. Supp. 1119 (E.D. Va. 1970), *rev'd on other grounds*, 438 F.2d 248 (4th Cir. 1971).

45 365 U.S. 320 (1961).

46 *See also* Fashion Originators Guild Inc. v. FTC, 312 U.S. 457 (1941); Judson L. Thompson Mfg. Co. v. FTC, 150 F.2d 952 (1st Cir.), *cert. denied*, 326 U.S. 776 (1945).

47 15 U.S.C. § 14 (1970).

48 The language of the substantive requirement in § 3 is similar to the language in the Robinson-Patman Act, 15 U.S.C. § 13 (1970), and § 7 of the Clayton Act, 15 U.S.C. § 18 (1970), which mention the same anticompetitive effect. Much of the law

to delineate the market, both geographic and product, in which the effect upon competition will be assessed. The purpose of such analysis is to examine that relevant market to determine the extent of the impact upon competition and, finally, in defining the anticompetitive effect to gauge whether its likelihood rises to the level of "probability" required by the terms of § 3.[49]

The concept of "probability" is at the heart of the distinction between § 3 of the Clayton Act and § 1 of the Sherman Act. Congress, in enacting the Clayton Act, sought to reach practices not serious enough to be violations of the Sherman Act, yet containing the likely potential, if unarrested, of becoming Sherman Act violations. Recognizing the cost of delaying antitrust enforcement until trade had actually been restrained, the Clayton Act anticipates the operation of the Sherman Act by prohibiting restraints of trade in their incipiency.

Yet the mere possibility of such anticompetitive results has been held insufficient to produce a finding of illegality under § 3. If the qualifying language of § 3 has any function at all, it is to distinguish those exclusive dealing contracts that the Congress sought to render unlawful from those it intended to conserve. The allowance of a showing of the mere possibility of anticompetitive effects would reduce § 3 to an undiscriminating ban of all exclusive dealing contracts. The Supreme Court has consistently required a probability of anticompetitive effect:

> [Section 3] deals with consequences to follow the making of the restrictive covenant limiting the right of the purchaser to deal in the goods of the seller only. But we do not think that the purpose in using the word "may" was to prohibit the mere possibility of the consequences described. It was intended to prevent such agreements as would under the circumstances disclosed probably lessen competition, or create an actual tendency to monopoly. That it was not intended to reach every remote lessening of competition is shown in the requirement that such lessening must be substantial.[50]

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interpreting the requirement in one section has been freely used to assist in the exploration of the meaning of the other sections.

[49] The so-called "reasonable probability" standard is found in the specific language of the Clayton Act, which prohibits exclusivity "where the effect . . . *may* be to substantially lessen competition or *tend* to create a monopoly in any line of commerce." (Emphasis added).

[50] Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356-57 (1922).

In *Tampa Electric*, forty years later, the Court again stated that an exclusive dealing arrangement does not violate § 3 "unless the court believes it probable" that anticompetitive effects will follow.[51]

The requirement of probability is only meaningful where courts evaluate exclusive dealing contracts in terms of all the relevant circumstances. An invalidation of an exclusive dealing contract, simply because it involves a certain dollar volume of commerce, leaves no room for assessment of the degree of probability that anticompetitive effects would result from implementation of the exclusive dealing contract.

In any event, the language of the statute appears to require a finding of probability of anticompetitive effect, and the courts have for the most part so held.

1. *The product market*

Before the exclusive dealing agreement's impact upon competition can be properly determined, the appropriate product market, or "line of commerce," in which to measure such an effect must be identified. The process of product market delineation is essentially the same under § 3 as in other cases where market definition is necessary, including those involving § 7 of the Clayton Act and § 2 of the Sherman Act.[52]

The guiding principle in antitrust market definition is that products and their substitutes must be considered together, with regard to their "reasonable interchangeability."[53] In *United States v. E.I. du Pont de Nemours & Co.*,[54] the Court defined "reasonable interchangeability" in terms of use, price and physical characteristics. Of these, use was considered the most important.[55] Thus, identical products are clearly within the same market. A product and its alleged substitutes will be considered within the same market if their end-use is the same. Even

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51 Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961).

52 Though the proof requisite to a finding of a violation of § 3 of the Clayton Act is less than that required for a finding of a violation of § 2 of the Sherman Act, (citations omitted) a demarcation of the relevant market is as essential to one as to the other; and the standard used in determining the proper relevant market is the same.

United States v. Charles Pfizer & Co., 246 F. Supp. 464, 471 (E.D.N.Y. 1965).

53 The outer boundaries of the product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.

Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

54 351 U.S. 377 (1956).

55 *Id.* at 395-96.

products so physically dissimilar as glass bottles and metal cans have been considered in the same product market because their end-use competition was "insistent, continuous, effective and quantity-wise very substantial."[56] Consequently, it is settled that even if the arena of competition cuts across normal industry lines, so must the antitrust conception of relevant product market, for only then can the impact of the practices under review be adequately measured.

In situations where two products are not physically identical and it is unclear whether they compete directly in end-use, the price responsiveness of one to the other—another measurement of demand cross-elasticity—may provide evidence that the two products belong in the same product market.[57] Thus, if there is economic evidence that consumers will switch back and forth from one product to the other, depending upon price level, it is said that the products have a high cross-elasticity of demand and are involved in the same product market.[58]

In *International Boxing Club, Inc. v. United States*,[59] comparisons of customer demand, price levels and total receipts showed that championships boxing contests constituted a market separate and apart from professional boxing contests generally. Thus, in a close question, a showing of a certain level of price responsiveness may be determinative. The crucial inquiry, not yet answered either by economists or courts, is the degree of cross-elasticity that will be considered conclusive.[60] The result is that product markets are unlikely to be defined with certainty.

There are two different ways of handling market boundaries where the classic tests of cross-elasticity or substitutability do not yield clear results. First, the example of § 7 of the Clayton Act can be followed so that the market is made more inclusive, but various more restricted

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[56] United States v. Continental Can Co., 378 U.S. 441, 453 (1964).

[57] *See, e.g.*, United States v. Charles Pfizer & Co., 246 F. Supp. 464 (E.D.N.Y. 1965).

[58] An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market.

United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377, 400 (1956) (footnote omitted).

[59] 358 U.S. 242 (1959).

[60] For a discussion of this problem and others in defining relevant product markets, *see* Dirlam & Stelzer, *The DuPont-General Motors Decision: In the Antitrust Grain*, 58 COLUM. L. REV. 24, 38-42 (1958).

submarkets are also defined. An acquisition is then examined within the context of both the market and the included submarkets.[61] The use of submarkets in § 7 analysis has been explained by reference to the language in § 7 calling for an examination of the effect of the acquisition in any line of commerce, thus suggesting the possibility of more than one. Precisely the same language is found in § 3.

The Court in *Brown Shoe Co. v. United States*[62] described the method of delineating submarkets in terms of ". . . examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."[63]

As a result it appears that initial market determination in difficult cases may not be crucial if the definition errs on the side of inclusiveness, because submarket delineation can correct the distortion.

On the other hand, a second means of resolving difficult market boundary questions in the context of § 3 of the Clayton Act is to define the market, where choice exists, more narrowly, in view of the purpose of the Act. Because the statute was enacted to reach practices in their incipiency which if full-grown might constitute violations of the Sherman Act, it can be argued that such preventive medicine ought to be applied at the least hint of anticompetitiveness, which would show up most clearly in a more restricted market. Also, it has been suggested that the large absolute size of defendants should be enough to lead to narrow market interpretation, no matter the precise effect on competition, because of the bias of the antitrust laws[64] against sheer bigness.[65]

It seems preferable, however, to try to avoid result-oriented determinations of market boundary, if for no other reason than to preserve consistency. The language of § 3 requires only the probability of anticompetitive effect, rather than its actual existence. Such a relatively low standard of proof should adequately serve the intentions of the enacting Congress to reach antitrust violations in their incipiency. It

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61 Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

62 *Id.*

63 *Id.* at 325.

64 United States v. National City Lines, Inc., 186 F.2d 562 (7th Cir.), *cert. denied*, 341 U.S. 916 (1951).

65 Dirlam & Stelzer, *supra* note 60.

should not be necessary to further relax the standards of the statute by gerrymandering the definition of the product market.

Accordingly, the product market in which the effects of the exclusive dealing arrangement are to be examined is defined by the standard antitrust principles of functional interchangeability and cross-elasticity of demand. Submarkets can be defined in appropriate cases.

2. *The geographic market*

The second stage in defining the relevant market in which the effects upon competition must be measured is to delineate the appropriate geographic market.[66] Failure to define properly the relevant geographic market is fatal to analysis and can itself be the grounds for reversal.[67]

Two apparently contradictory standards for defining the relevant geographic market have emerged over the years, and curiously, both are mentioned in *Tampa Electric Co. v. Nashville Coal Co.*[68] On the one hand, the Court in that case described the process of selecting the relevant geographic market by examining ". . . the market area in which the seller operates, and to which the purchaser can practicably turn for supplies." [69] But in selecting the relevant market, the Court declined to analyze the area to which the Tampa Electric Company could practicably turn for supplies, and instead focused upon ". . . the area in which these [coal] producers operated, and in which they were willing to compete for the consumer potential." [70]

The Court may have thought these two apparently contradictory standards were nevertheless consistent in *Tampa Electric.* The opinion reasoned that Nashville Coal and some 700 other producers "were capable" of serving Tampa Electric, and that accordingly the area into which the total production of Nashville Coal and its 700 theoretical competitors was sold, including most of the Atlantic seaboard area, comprised the relevant geographic market. Whether this entire area realistically meets the requirement that it be the market area of the seller, here Nashville Coal, is open to substantial question.[71]

66 Section 3 does not include a reference to "any section of the country," as does § 7. Courts have not, however, hesitated to analyze the geographical dimension of the relevant market.

67 Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961).

68 *Id.*

69 *Id.* at 327.

70 *Id.* at 331.

71 The choice as a relevant market of the area in which the supplier and its com-

Whatever may have been the intention of the Supreme Court in *Tampa Electric*, many cases delineating relevant geographic markets since that case have focused upon the area to which the customer can practically turn for supplies.[72] And it is clear that in the § 3 context this more restricted market definition best protects the buyer, whose commitment to exclusivity may not be to his advantage, and is best adapted to examine anticompetitive impact at an early stage. On the other hand, it would be logical, in a suit brought by a foreclosed supplier who is within the narrower market, to assess the impact of foreclosure in the entire geographical area in which the supplier and the foreclosed competitor compete. This might well be substantially larger than the area to which any given buyer can practicably turn for supplies, yet be a realistic context in which to measure the actual influence upon the competition among sellers in given exclusive dealing arrangements.

3. *Competitive effect*

The relevant product and geographic markets provide the context in which the effect upon competition of the exclusive dealing arrangement must be examined. The statute prohibits the exclusive dealing if its effect within the relevant markets may be "to substantially lessen competition or tend to create a monopoly. . . ."

In attempting to develop a legal standard under which a market could be tested for the requisite anticompetitive effect, the Supreme Court has announced two quite different approaches. The first, used frequently in the earlier years of § 3 and authoritatively incorporated in *Standard Oil Co. v. United States*,[73] (*Standard Stations*), conclusively presumes an exclusive dealing arrangement to be unlawful if it is found to involve a share of the relevant market that the court decides is "substantial." This test, requiring "quantitative substantial-

petitors operate is inconsistent with the cases cited by the Supreme Court in *Tampa Electric*. First, in Standard Oil Co. v. United States, 337 U.S. 293 (1949), the relevant market was thought to be certain western states in which Standard Stations operated, even though competitors of Standard Stations operated outside those states. Likewise, in United States v. Columbia Steel Co., 334 U.S. 495 (1948), the relevant market for measuring the impact of a vertical acquisition was a multi-state area in which the acquired corporation sold its products, rather than the nationwide area in which U.S. Steel and its competitors operated.

72 *See, e.g.*, United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963). *See also* United States v. Bliss & Laughlin, Inc., 202 F. Supp. 334 (D.C. Cal. 1962).

73 337 U.S. 293 (1949).

ity," may be reckoned in market share or absolutely, in terms of dollars or in amounts of a given product.

The second test, known as the standard of "qualitative substantiality," was announced in *Tampa Electric Co. v. Nashville Coal Co.*[74] That decision's qualitative substantiality test considers the amount of commerce, however reckoned, to be only one of several factors to be examined. In addition, the court reviewing an exclusive dealing arrangement must take into account relative bargaining strength of the parties, the length of the contract term and other economic facts which could be of assistance in evaluating the full impact of a given pattern of exclusive dealing.

Standard Stations was handed down in 1949. Perhaps under the influence of its own reasoning in *International Salt Co. v. United States*,[75] in which the application of § 3 to a tying agreement had been made to depend upon the amount of commerce affected, the Supreme Court sought to transfer the concept to the exclusive dealing-requirements contract area. After analyzing the legitimate economic and commercial purposes that could be fulfilled by requirements contracts, the Court nevertheless shied away from attempting to predict the probable impact which the existence of such contracts would produce upon competition. Instead the Court developed an automatic rule applicable whether or not benefits outweighed the disadvantageous effect upon competition.[76]

The result in *Standard Stations* was a condemnation of a pattern of exclusive dealing contracts covering nearly 6,000 independent outlets, or 16%, in the relevant market. This condemnation came in spite of the fact that Standard's sales under the contracts aggregated 6.7% of the total gasoline and 2% of the tires and batteries sold in the relevant market by all suppliers. Dominance of the supplier did not seem to be a factor in the case, as it might have been in earlier cases where similar quantitative standards were suggested.[77] While Standard Sta-

[74] 365 U.S. 320 (1961).

[75] 332 U.S. 392 (1947).

[76] The Court in *Standard Stations* applied the following inflexible standard:

> We conclude, therefore, that the qualifying clause of § 3 is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected . . . . Standard's use of the contracts creates just such a potential clog on competition as it was the purpose of § 3 to remove wherever, were it to become actual, it would impede a substantial amount of competitive activity.

337 U.S. at 314.

[77] *See, e.g.*, Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346 (1922).

tions controlled 23% of total sales, and its six leading competitors accounted for 43%,[78] the Court spoke of Standard's "minority share of the 'line of commerce' involved" and alluded to the absence of any recent increase,[79] and the trial court failed to make a finding of dominance.

The standard of quantitative substantiality, not admitting of economic or commercial justification, but operating automatically at a given level of market share or dollar volume, produced a storm of criticism.[80] In general, the comment was to the effect that the automatic standard resulted in a per se outlawing of exclusive dealing arrangements, except in de minimis circumstances, in the face of Congress' intention to conserve those without harmful anticompetitive impact. But it was twelve years before the Supreme Court took the opportunity to articulate a new rule for exclusive dealing.[81]

In *Tampa Electric Co. v. Nashville Coal Co.*, [82] an electric utility located in Florida constructed a coal-burning generation plant and entered into a 20-year requirements contract with Nashville Coal Co. to supply coal to the plant. The anticipated maximum requirements of the plant were 2.25 million tons annually, about 1 per cent of the total amount of the same type of coal mined and marketed by the 700-odd coal suppliers in Nashville Coal's producing area. The value of the coal for the full 20-year term of the contract was $128 million. Tampa Electric brought a declaratory judgment action to test the validity of the contract, and it was held to violate § 3 of the Clayton Act by both the district court and the court of appeals.

The Supreme Court reversed. The Court assumed, without deciding, that § 3 was applicable. The narrow holding of the case was that the trial court, in defining the relevant market too narrowly, could not accurately have analyzed the market impact of the exclusive dealing.

78 Some cases since *Standard Stations* have been content with foreclosure of even less than 6.7 percent. *See* Lessig v. Tidewater Oil Co., 327 F.2d 459 (9th Cir.), *cert. denied,* 377 U.S. 993 (1964), in which the court found a violation where 5 percent of the product in the relevant market was sold under requirements contracts.

79 337 U.S. at 298.

80 Typical of such criticism is Lockhart & Sacks, *The Relevancy of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act,* 65 HARV. L. REV. 913 (1952).

81 Indications of a change in Supreme Court approach are to be found in FTC v. Motion Picture Advertising Serv. Co., 344 U.S. 392 (1953).

82 365 U.S. 320 (1961).

But the opinion goes much further than a mere reversal of the result below. Whatever else is accomplished in the case, Justice Clark plainly sets the Court against a purely mechanical approach to the determination of legality of exclusive dealing:

> To determine substantiality in a given case, it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein. It follows that a mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence.[83]

Of the three factors mentioned, only one—the proportionate volume of commerce—was in any way a legacy from *Standard Stations*.

The opinion also contains other pieces of evidence that the Court had rejected an automatic and mechanical rule. In determining product and geographic market, the opinion suggests attention to facts "peculiar to the case,"[84] and elsewhere refers to the relevance of "particularized considerations of the parties' operations."[85] And not only does the opinion recite the various ways in which the relevant contract benefitted both buyer and seller, but the opinion calls for a "weighing" of those factors.[86]

Yet lawyers anxious to defend exclusive dealing arrangements should beware of taking too much comfort from the *Tampa Electric* decision. While it is tempting to hope that it represents a reversal of *Standard Stations* and the establishment instead of a more flexible rule, subsequent cases do not permit unrestrained confidence. While the Supreme Court has continued to speak of the "lawful" exclusive dealing arrangement,[87]

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[83] *Id.* at 329.

[84] *Id.* at 327.

[85] *Id.* at 335.

[86] *Id.*

[87] Yet a requirement [sic] contract may escape censure if only a small share of the market is involved, if the purpose of the agreement is to insure to the customer a sufficient supply of a commodity vital to the customer's trade or to insure to the supplier a market for his output and if there is no trend toward concentration in the industry.

Brown Shoe Co. v. United States, 370 U.S. 294, 330 (1962).

lower courts have nevertheless sometimes persisted in using what is in effect a strict quantitative substantiality test.

The reason for this may lie in the nature of *Tampa Electric* itself. First, as the Court defined the market, the amount of commerce affected was less than 1 per cent. Accordingly, even under *Standard Stations*, the requirements contract in the *Tampa Electric* was not unlawful. It may thus be argued that the rest of the *Tampa Electric* opinion is only helpful dicta.

In addition, the facts were quite different from those in *Standard Stations*, and virtually every difference was in favor of the lawfulness of the Tampa Electric requirements contract. The seller was not itself dominant nor did the record show a large market share. There was apparently no industry-wide practice, nor was there a substantial disparity in bargaining power between seller and buyer. The contract was of economic advantage to both buyer and seller, and indeed, the buyer itself had brought suit, clearly demonstrating its desire for specific performance. The contract, though significant in dollar volume, was not significant in percentage of the market foreclosed. In fact there was only a single contract involved, in contrast to the 5,937 contracts in *Standard Stations*.

Finally, in *Tampa Electric*, the Court left unclear the method of evaluation of the various relevant economic factors to arrive at a conclusion on the ultimate issue of lawfulness. The enumeration of appropriate factors to consider is helpful as a corrective approach to *Standard Stations*. But unless some indication is given of the relative weight of the factors or the order in which they are to be considered, the logical trial of actual cases is impossible.

Perhaps in an effort to attain the simplicity of a working rule, or perhaps aware of the factual differences between *Standard Stations* and *Tampa Electric*, or perhaps content to rely upon that part of *Standard Stations* reaffirmed by the subsequent decision, lower courts have continued to isolate the proportionate volume of commerce involved as a grounds upon which to judge the illegality of exclusive dealing arrangements with which they have been confronted. Typical of these cases is *Becker v. Safelite Glass Corp.*,[88] in which the court cites *Tampa Electric* but depends entirely upon the absence of any evidence on the question of proportionate volume of com-

[88] 244 F. Supp. 625 (D. Kan. 1965).

merce involved as a grounds for dismissing the § 3 portion of the complaint.[89] In *Mytinger & Casselberry, Inc. v. FTC*,[90] the court not only cited the quantitative substantiality test as authority for its holding, but further implied that *Tampa Electric* was decided on the basis of the same test. In *Mytinger* itself, in the market with percentages most favorable to the defendant, it was found that competitors had been excluded from 8.6 per cent of the potential sales volume. The court found a violation, citing *Standard Stations*. The petitioners justifiably sought to rely upon *Tampa Electric*, but were greeted with the conclusion that that holding was "quite different." The court pointed to the low percentage of market foreclosed in *Tampa Electric*, only .77 per cent, and concluded that the case was irrelevant to a foreclosure of at least 8.6 per cent. Had the qualitative substantiality test been applied, the result in *Mytinger* might well have been different.[91]

What this history subsequent to *Tampa Electric* may signify is that in actuality two parallel tests exist for assessing anticompetitive effects of exclusive dealing agreements. It may well be that *Tampa Electric's* qualitative analysis will be applicable only where the seller is not dominant among his competitors, or foreclosure is moderate. On the other hand, courts may tend to apply the *Standard Stations* quantitative substantiality test in cases involving a seller in a position of dominance within the relevant market, or where the extent of foreclosure is excessive.

This thesis seems to be supported by an examination of the kinds of cases in which the more flexible standards have been utilized. In *Aluminum Shapes, Inc. v. K-A-Liquidating Co.*,[92] the opinion justifies exclusive dealing provisions on the grounds that they insure price stability and reliable supply, and fulfill other similarly legitimate business needs. Given the fact that the product involved was aluminum extrusion, it seems highly likely, although the opinion specifies no market share, that the amount of foreclosure in the relevant market

[89] *See also* Perryton Wholesale, Inc. v. Pioneer Distrib. Co., 353 F.2d 618 (10th Cir. 1965), *cert. denied*, 383 U.S. 945 (1966); 2361 State Corp. v. Sealy, Inc., 263 F. Supp. 845 (N.D. Ill. 1967), *rev'd and rem'd*, 402 F.2d 370 (7th Cir. 1968).

[90] 301 F.2d 534 (D.C. Cir. 1962).

[91] It would have been relevant that the particular means of distribution under review in *Mytinger* accounted for a negligible portion of the total product sales, and there was little if any barrier to the establishment of unlimited numbers of additional distributors.

[92] 290 F. Supp. 356 (W.D. Pa. 1968).

was negligible and that the seller was anything but dominant. Other cases have used *Tampa Electric* to validate exclusive dealing contracts accounting for less than 2% and 4% foreclosure in the relevant market, respectively, and involving non-dominant suppliers.[93]

At least one lower court case confronts the distinction between *Standard Stations* and *Tampa Electric*, and treats the former as having been superseded by the latter. In *Susser v. Carvel Corp.*[94] in the absence of data demonstrating significant market foreclosure, the plaintiffs argued that under *Standard Stations* the exclusive dealing agreements were nevertheless unlawful. The court disagreed, however, on the grounds that the inflexible *Standard Stations* rule had been altered by *Tampa Electric*, in which the Supreme Court had ". . . erected criteria which demand close scrutiny of the economic ramifications of an exclusive dealing arrangement in order to determine the probable anticompetitive effects of such a device."[95]

The flexibility of the *Tampa Electric* approach should commend itself as the clearly superior rule across the board, despite the nature of the particular case, whether involving dominant suppliers or extensive foreclosure, and without regard to the variety of business justification adduced to support the form of agreement. Although the Supreme Court in *Tampa Electric* did not choose specifically to overrule *Standard Stations*, it did clearly repudiate the mechanical approach with its suggestion that a showing of a given level of foreclosure will rarely be sufficient to invalidate exclusive dealing. The lower courts should follow more faithfully the spirit of the *Tampa Electric* decision, even if they do not always understand the letter of its teaching. Only in this way can logical consistency and business predictability begin to work their way into this confused area of the antitrust law.

The factors that should be considered in evaluating exclusive dealing include those mentioned in *Tampa Electric* and others which place the exclusive dealing in the proper economic and commercial perspective. Once the factors are isolated, their relative importance and interrelationship need to be analyzed.

The qualitative substantiality test, properly applied, would begin—though not end, as in *Standard Stations*—with an examination of the

93 *See, e.g.*, Curly's Dairy, Inc. v. Dairy Co-op Ass'n, 202 F. Supp. 481 (D. Ore. 1962); Rural Gas Serv., Inc., 59 F.T.C. 912 (1961).

94 332 F.2d 505 (2d Cir.), *cert. denied*, 379 U.S. 885 (1964).

95 *Id.* at 516.

extent to which suppliers or customers may be foreclosed in the relevant market, as an indicator of the effects on competition. This could be done by a determination, as prescribed in *Tampa Electric*, of the volume of commerce affected by the exclusive dealing as a percentage of the total volume of commerce in the relevant market, or the number of outlets foreclosed by exclusive dealing could be assessed as a proportion of the total number of outlets available in the relevant market.[96] If the latter approach is taken, it should be supplemented by an analysis of whether the outlets foreclosed are equivalent in terms of efficiency, prestige or other quality indicia to those not covered by the exclusive dealing.

Thus, the alternatives of the foreclosed suppliers to seek new or different distributors are relevant. Where the number of customers is limited, or where some peculiar requirement of capital or training serves to inhibit the development of alternative customer sources, exclusive dealing arrangements resulting in the foreclosure of any substantial share of the market should usually be invalidated.

Similarly, even if foreclosure of a particular distribution mode is significant, it is still relevant to inquire into the question whether that necessarily precludes the foreclosed suppliers from reaching the ultimate consumer. Consequently, if competition for the consumer is affected only to the extent the foreclosed supplier loses access to a particular distribution method, though he can readily supplant it with an alternative system, exclusive dealing arrangements ought in those circumstances not to be invalidated without further examination.

Another aspect of the foreclosure inquiry should take into account the dominance of a seller in his industry. Exclusive dealing contracts imposed by dominant suppliers have fared poorly partly because they would seem to be less necessary for a dominant supplier and partly because they are more likely to be coercive of the buyer, rather than agreed upon between the parties. Courts have not precisely defined the standards of dominance in this context, except to make it clear that any of several leaders within an industry can be adequately dominant for § 3 purposes. Logically, then, a newcomer firm in an industry may utilize exclusive dealing contracts to gain a foothold but no blanket

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96 As a practical matter, given the present state of precedent, a finding of foreclosure amounting to in excess of 6% of the relevant market is likely to incline most courts to at least a prima facie finding of unlawfulness.

validation of exclusive dealing involving a newcomer is as yet provided by judicial authorities.

Likewise, the relative strength of the parties to the exclusive dealing agreement may reveal the extent to which legitimate business needs of the parties are being thereby served. The finding of a gross disparity in bargaining power will often suggest the seller has coerced the buyer into participation. The existence of such coercion will almost certainly produce a violation of § 3 if such bargaining power has resulted in the foreclosure of any appreciable portion of the relevant market.

If the exclusive dealing is not clearly unlawful because of excessive foreclosure, dominance or coercion, the analysis ought then to examine the business justification for the practices. The contracts may have the effect of reducing the costs of the supplier by providing a more dependable market, with resulting reductions in selling and advertising expense and more efficient utilization of capital, planning and research resources. Likewise, the purchaser may be advantaged by obtaining security of supply at a steady rate, never fearing either shortage or the storage cost associated with oversupply. His average unit price ought to be lower because his purchases can be spread out, not falling at a time of peak demand on the supplier.

Similarly, the purchasers may be wholly dependent upon reliable supply. Short of corporate integration, exclusive dealing arrangements may be the only dependable means of assuring a steady flow of the necesesary products. Antitrust law should consider more sympathetically the anticompetitive effects of exclusive dealing where the only other feasible alternative for securing adequate reliability is vertical integration.

For substantiation of asserted business justifications, it may be useful to inquire into the use within the industry of exclusive dealing contracts by other suppliers. The business justifications of one buyer and seller are likely to make sense for others, and it may well be that the absence of exclusive dealing contracts in an industry suggests the invalidity of the business justifications asserted in a particular case. On the other hand, while networks of exclusive dealing contracts criss-crossing an industry may demonstrate the validity of the justifications, they would also have a greater adverse effect upon competition.

If the justifications are plausible, and the exclusive dealing arrangements are not more anticompetitive than necessary to serve the stated business needs, courts should still examine the duration of the agreements. It is this time period during which competition for particular customers will be frozen, and consequently the number of years of exclusivity may well be crucial.

But a given number of years does not have the same significance in every industry. Where product development is rapid and price changes, frequent, a long exclusive dealing agreement can be harmful. On the other hand, a stable industry, particularly one which is regulated as to price, should be viewed in a longer time-frame, and exclusive dealing agreements of greater duration ought to be permitted.

Further, it would seem appropriate in this context to examine whether the exclusive dealing agreements contain termination clauses for the party committed to exclusivity at his option in the event implementation of the contract becomes unduly onerous. Where such provisions are found in the agreement, or where the agreement contains price escalation clauses which are effective, the burden of exclusivity upon the buyer is less and the extent of foreclosure diminishes accordingly.

On the other hand, if after examination, the asserted business justification is insubstantial, it would seem to be logical to sacrifice the exclusive arrangements to the congressional policy of fostering active competition. In any event, courts should not lose sight of the fact that if exclusive dealing contracts have been widespread within an industry, newcomers arguably should be permitted to avail themselves of the practice, since any blanket prohibition after years of exclusive dealing have established firm supplier-customer relationships would only serve to ratify the competitive status quo.

One final test should be applied to situations where the examination of foreclosure and dominance indicates that the exclusive dealing is likely to be having some adverse impact on competition, and the business justifications are weak. Before condemnation, some effort ought to be made to measure the actual effect of such exclusive dealing contracts upon competition. If it is demonstrated that competition has in fact flourished, that new suppliers and new outlets have become available in the face of exclusive dealing, and that the suppliers availing themselves of exclusive dealing arrangements have presided over a declining market share, it would seem difficult to find the requisite adverse effect upon competition. Of course it is possible to speculate that, but for the exclusive dealing arrangements, competition would have flourished even more healthily and the exclusive dealer's market share would have declined even more drastically. If evidence of any such inhibiting effect exists, it should be taken into account and properly evaluated, but speculation ought not to be permitted to replace proof.

The same standard ought to be applied to contentions that exclusive dealing agreements have had the effect of bringing additional business entities into the market—as for instance, new distribution facilities—or have forestalled the trend toward vertical integration, as Justice Douglas argued in *Standard Stations*. The first position involves the difficult task of weighing loss of competition at one level of the market against possible deconcentration at another level of the market, and long-term benefits against short-term disadvantages. The argument that exclusive dealing makes integration unnecessary should not be given much weight since integration that is unlawful should be prevented under § 7 of the Clayton Act. Nevertheless, the state of competition in a market being tested for the effects of exclusive dealing is surely relevant, and if competition has not been damaged, that fact would seem to suggest the probable adverse effect called for by § 3 is unlikely to evolve.

All of these factors properly belong in the qualitative substantiality analysis. Any such evaluation of their impact serves to test the harmfulness of exclusive dealing agreements reasonably efficiently. The automatic per se treatment of *Standard Stations* is avoided and yet the analysis is still of manageable proportions.

III. Other Relevant Antitrust Provisions

Although the exclusive dealing arrangements are generally analyzed under § 3 of the Clayton Act, mention should be made of § 1 of the Sherman Act[97] and § 5 of the Federal Trade Commission Act.[98] The method of evaluation of the anticompetitive effects of exclusive dealing should be similar under all three statutes. But the Sherman Act and the Federal Trade Commission Act, because of their less demanding jurisdictional requirements, may be useful to government prosecutors or private treble-damage plaintiffs when § 3 of the Clayton Act is unavailable.

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[97] 15 U.S.C. § 1 (1970).

[98] 15 U.S.C. § 45(a)(1) (1970).

A. *Section 1 of the Sherman Act*

The relevant provision of the Sherman Act provides that: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. . . ."[99] Since *Standard Oil Co. v. United States*[100] the so-called "rule of reason" is the basis of the statute's application to all but the most clearly anticompetitive activities.

It is frequently said, citing *Times-Picayune Publishing Co. v. United States*,[101] that practices not unlawful under § 3 of the Clayton Act cannot be found unlawful under § 1 of the Sherman Act. This conclusion follows from the difference between § 3's outlawing practices whose probable effect may be to restrain trade and the Sherman Act's operation only upon accomplished restraints. Nevertheless, because of § 3's more specific jurisdictional requirements, it is conceivable that a practice could fail to be held unlawful under § 3, yet fall under Sherman Act attack.

Exclusive dealing arrangements are not unlawful per se under the Sherman Act. Accordingly, they are subjected to rule of reason analysis, which to a large extent parallels qualitative substantiality analysis under § 3 of the Clayton Act. The market affected by the restraint must be identified, the percentage of that market to which the restraint applies must be assessed[102] and any factors which put the restraint in the appropriate commercial perspective must be recognized.

If the percentage of market affected by the restraint under review does not yield any clear answer, analysis must proceed to examine the further factors that bear on the reasonableness of the practice. Included among these should be the size and strength of competing firms and their number, the history of defendant's market share, the

99 15 U.S.C. § 1 (1970).

100 221 U.S. 1 (1911).

101 345 U.S. 594 (1953).

102 The upper limit may be furnished by the monopolization cases under § 2 of the Sherman Act which make it clear that arrangements affecting in excess of 80% are likely to be held unreasonable. American Tobacco Co. v. United States, 328 U.S. 781 (1946); United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945). The lower level can perhaps be taken from United States v. United Shoe Mach. Corp., 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954), in which exclusive dealing covering approximately 50 percent of the relevant market was sustained.

ease of entry into the relevant market and other factors which permit a balanced judgment as to the impact of the exclusive dealing arrangement upon competition. In summary, the factors comprising the qualitative substantiality test under § 3 are just as relevant under § 1, except that the Sherman Act requires actual anticompetitive effect rather than the mere probability thereof.

One kind of exclusionary agreement which must be analyzed under § 1 of the Sherman Act is the "output contract," in which a supplier commits to sell his entire production to a given buyer. It can readily be seen that the language of § 3 of the Clayton Act, describing the imposition by a supplier of conditions upon a distributor, is hardly applicable to the output contract. If any restrictions are being imposed, it is the requirement that the entire production of the supplier be sold to the customer.

In situations where the customer owns the manufacturing facilities and leases them to the supplying firm,[103] it might be possible to reach an output contract under § 3 by treating the customer as the "lessor" and to focus upon the imposition of restrictions upon the manufacturing facility's production. Difficulty arises, however, because land and attendant fixtures are probably not within the category of "commodities" specified in § 3. Similarly, even if that difficulty were surmounted, the "condition" required is that the lessee not use or deal in the goods of a competitor of the lessor, here the customer. Chaos can be the only result. The preferable conclusion is clearly that § 3 does not apply to a transaction in which the purchaser imposes restrictions upon the supplier.[104]

Under the Sherman Act, output contracts are analyzed under the rule of reason. A contract requiring a supplier, not a monopolist, to sell its entire output to a specific purchaser for a term of years is not generally thought to produce serious anticompetitive results. Of course, any purchase limits the remaining available supply to the extent of the amount purchased. But no anticompetitive effect follows therefrom unless competing customers are denied necessary sources of supply.

The addition of a term of years by itself should not produce anticompetitive effects, unless it could be shown that the arrangement,

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[103] This situation might obtain, for instance, where an electric utility customer owns a coal mine but leases it to a coal operator.

[104] *See* HALE & HALE, MARKET POWER: SIZE AND SHAPE UNDER THE SHERMAN ACT, § 2.13 at 39 (1958).

mutually beneficial at the outset, was likely to become harmful to the supplier. If the agreement provides for no termination in such an event, it is likely that a court will sense coercion, particularly if the purchaser was disproportionately larger than the supplier or a special reciprocity relationship between supplier and purchaser can be found.

The cases which have dealt with output contracts confirm this analysis by exonerating a contract for the sale of an entire production or output under the antitrust laws.[105] But whereas a single output contract may not be vulnerable to antitrust challenge, a group of such contracts utilized as a method of suppression of competition or intended to result in the monopolization of a given industry would have obvious antitrust difficulty. In *United States v. Reading Co.*,[106] the Supreme Court, while acknowledging that individual output contracts might not violate the antitrust law, stated that as a means of controlling independent production they were clearly Sherman Act violations.

Thus, special circumstances, such as objectionable provisions or extraneous economic circumstances, may render the output contract violative of the antitrust laws. But viewed individually, in the absence of monopoly power on the part of the supplier or disproportionate size on the part of the buyer, the Sherman Act does not now make output contracts unlawful.

B. *Section 5 of the Federal Trade Commission Act*

Finally, it should be noted in passing that § 5 of the Federal Trade Commission Act[107] declares unlawful both unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce. Under § 5, the Federal Trade Commission can enforce the antitrust laws, including § 3 of the Clayton Act. In addition, however, the Federal Trade Commission is authorized to invalidate practices characteristic of, but falling short of classic antitrust violations.

Thus, practices which for jurisdictional reasons fall short of being subjected to the Sherman or Clayton Acts may come within the scope of § 5, and practices whose competitive impact would not satisfy the standards required by the antitrust laws may also be subjected to

[105] Virtue v. Creamery Package Mfg. Co., 227 U.S. 8 (1913); Fargo Glass & Paint Co. v. Globe American Corp., 201 F.2d 534 (7th Cir.), *cert. denied*, 345 U.S. 942 (1953).

[106] 226 U.S. 324 (1912).

[107] 15 U.S.C. § 45(a)(1) (1970).

§ 5 analysis. *FTC v. Motion Picture Advertising Service Co.,*[108] stated that the purpose of the Federal Trade Commission Act was to "supplement and bolster" the antitrust laws and to stop in their incipiency acts and practices which when fully developed would violate those acts.[109] As a result, in a landmark § 5 case[110] the Supreme Court rejected the argument that the Federal Trade Commission was required to prove that the contracts there in issue would produce a substantial lessening of competition or a tendency to create monopoly, as would be required for unlawful exclusive dealing under § 3 of the Clayton Act. It felt a lower standard of proof was appropriate under § 5, because the Federal Trade Commission was empowered ". . . to arrest trade restraints in their incipiency without proof that they amount to an outright violation of § 3 of the Clayton Act or other provisions of the antitrust laws." [111]

It would seem the state of the law in this area under § 5 of the Federal Trade Commission Act is unstable. If anything, the Commission has moved back toward the *Standard Stations* emphasis on a foreclosure percentage. A Commission proceeding obviously ought to take into account the same kinds of factors as are recognized in the qualitative substantiality analysis under § 3 of the Clayton Act. But the extent to which this is now Commission policy is unclear.

CONCLUSION

Exclusive agreements of all kinds should not necessarily be proscribed by the antitrust laws. The Supreme Court has pointed the way in *Tampa Electric* to an examination of such agreements that gives appropriate weight to their affirmatively beneficial role in the commercial setting, as well as to their anticompetitiveness.

The analysis suggested here is one means of following the Court's guide. An agreement, if it produces excessive foreclosure, would normally be unlawful. Yet even then, it should be necessary to study

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108 344 U.S. 392 (1953).

109 Because the Clayton Act was enacted to stop practices in their incipiency which would develop into Sherman Act violations, the Federal Trade Commission Act may justifiably be said, under the *Motion Picture* analysis, to operate upon acts in their incipiency which would develop into incipient violations of the Sherman Act.

110 FTC v. Brown Shoe Co., 384 U.S. 316 (1966).

111 *Id.* at 322. *See also* Luria Bros. v. FTC, 389 F.2d 847 (3d Cir.), *cert. denied,* 393 U.S. 829 (1968).

the quality of the foreclosure as well as the quantity. If that review continues to suggest unlawfulness, the business justifications should then be analyzed to see whether in a particular economic context the anticompetitive aspects might not by comparison be less weighty. Finally, to the extent possible, the actual effects on competition should be examined before declaring an exclusive agreement unlawful. Only then, if the arrangement is having or will be likely to have adverse effects on competition, should a finding of violation of the antitrust laws follow.

In the case of many agreements, the entire analysis will not be necessary, as the lawfulness will be established at an early stage. Where agreements deserve proscription, the antitrust laws will have ultimately been applied with the kind of rationality and attention to the real world that are too often lacking in antitrust judgments. Businessmen will then have only themselves, and their lawyers, to blame for any missteps in at least this small corner of the vast antitrust thicket.