Antitrust Law and Competition for Distribution

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Abstract

An unsettled area of antitrust law is the regulation of the competitive process for product distribution and promotion. *Competition for distribution* involves vertical contracting with respect to product placement, promotional activity, or the decision to carry a particular product. This process includes controversial practices recently subject to intense scrutiny such as slotting allowances, loyalty discounts, bundled rebates, category management and exclusive dealing. Antitrust law has designed rules for each of these practices independently, ignoring the economic relationships between these business practices. This paper examines those relationships by focusing on the economics of competition for distribution. Viewing these practices as part of the competitive process for distribution exposes an antitrust policy that systematically mishandles the regulation of these contracts. The article concludes by arguing in favor of per se legality for distribution contracts foreclosing less than 40% of the market and agreements less than one year in duration.

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1 Introduction

The regulation of the competitive process for product distribution and promotion is an unsettled and sometimes incoherent area of antitrust law. One potential explanation for the lack of coherence and consistency in this area is the expansive nature of the subject matter. Marketing and distribution practices encompass a large and diverse set of contractual relationships between manufacturers and retailers. In this sense, the search for a single legal standard sufficient to gauge the competitive impact of this diverse set of practices may be the proximate cause of much of the confusion. A second explanation is that problems in the antitrust law governing distribution relationships are caused by a fundamental misunderstanding of the economics of these distribution relationships, and the competitive process for distribution more generally. This paper explores this second explanation.

For the sake of clarity, I define competition for distribution as: manufacturer and retailer contracts involving product placement, promotional activity, or the decision to carry a particular product. Under this definition, competition for distribution includes practices such as: manufacturer payments to retailers or other intermediates in the form of discounts or slotting allowances, category management, exclusionary terms, and bundled rebates. A survey of recent antitrust litigation shows that competition for distribution has been the subject of a number of recent antitrust challenges.

The primary contribution of this paper is to show that by focusing on the economics of the contracting environment surrounding the competitive process for product distribution and retailer promotional services, one can reveal

1 I will refer to retailers as “dealers” and “distributors,” while sellers are sometimes referred to as “manufacturers.”
previously ignored relationships between the controversial business practices of (1) payments for distribution, such as slotting allowances, and (2) the use of exclusionary distribution terms such as exclusivity, partial exclusivity, and category management. Of equal importance, a proper understanding of the competitive process for distribution exposes an antitrust policy that systematically mishandles the regulation of distribution contracts. This paper proposes improvements to this area of the law consistent with the economic insights provided herein.

The view that Sherman Act Section 2 ("Section 2") standards are potentially harmful to consumer welfare is near universal. Most commentators concede that the standards are, at a minimum, needlessly vague and lead to inconsistent application. The problem is particularly acute in the area of exclusionary distribution contracts which are currently hampered by a high degree of uncertainty which would be ameliorated by injecting some sensible bright line rules.

Part 2 of the paper summarizes the economics of competition for distribution, relying heavily on a growing economics literature describing the role of manufacturer payments for distributor promotion and exclusive dealing contracts. This economic framework provides the basis for the legal analysis that follows. Part 3 analyzes the state of modern antitrust jurisprudence governing distribution arrangements, emphasizing the recent struggles many courts have had in assessing the likely competitive consequences of manufacturer discounts, slotting allowances, exclusivity, category management, and bundled rebates. Part IV argues that the economics of competition for distribution clearly favor safe harbors making per se legal two types of distribution contracts: short-term
contracts less than one year in duration and contracts that foreclose rivals from less than 40% of distribution opportunities.

2 The Economics of Competition for Distribution

Manufacturers often make promotional investments rather than their dealers. It is often more efficient for manufacturers to make these investments, whether by giving promotional assets to retailers at zero price, in effect subsidizing their purchase, or by paying the dealer for promotional performance. Manufacturers must purchase promotional services because, under a rather broad set of conditions, they will desire a greater level of promotion than dealers would supply on their own. The economic reality of this distortion in demand for incentives creates the necessity for a distribution arrangement that will sufficiently compensate the dealer for supply of the desired level of services. In turn, manufacturer competition for these distribution services is a crucial part of the competitive process in a number of industries across the economy.

The following section outlines the economics of the dealer undersupply problem, and shows how manufacturers and retailers use a variety of contractual forms to solve it.

A. Promotional Contracts Solve a Pervasive Incentive Incompatibility Problem

Dealers will not supply or purchase sufficient promotion from the manufacturer’s point of view because they do not take account of the additional

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2 The original statement of the dealer undersupply problem, and the role of various vertical restraints in solving it, appears in Benjamin Klein & Kevin M. Murphy, Vertical Restraints as Contract Enforcement Mechanisms, 31 J. L. & ECON. 265 (1988). This analysis is extended in Ralph Winter, Vertical Control and Price Versus Nonprice Competition, 108 J. ECON. 61 (1993). Benjamin Klein and Joshua Wright, The Economics of Slotting Arrangements, unpublished working paper (2005), also present a model of slotting allowances as a particular form of manufacturer compensation for shelf space and test the model against available slotting data.
profit earned by the manufacturer on incremental sales when they make their promotion decisions. Dealers may not supply jointly profitable promotional effort inducing incremental sales even though the revenue earned on those sales is greater than the costs of providing the services. Accordingly, manufacturers must either pay for distribution or lose profitable incremental sales.

The incentive incompatibility between manufacturers and retailers with regard to retail promotion can also be illustrated mathematically. As a point of comparison, consider the retailer’s incentives with respect to price competition, which are generally aligned with the manufacturer. Assume that the retailer’s marginal cost of selling an additional unit of a product to consumers, \(MC_R\), is equal to the wholesale price charged by the manufacturer, \(P_W\), plus the retailer’s marginal cost of selling the product, \(MC_S\), which includes the retailer’s costs of providing shelf space. The joint profit maximizing condition with respect to price competition is:

\[
\frac{dQ_R}{dP_R} (P_R - MC_R) = \frac{dQ_M}{dP_W} (P_W - MC_M)
\]

Notice that even where the manufacturer’s margin is substantially larger than the retailer’s margin, in equilibrium \(dQ_R/dP_R\) will be proportionately greater than \(dQ_M/dP_W\) because a retail price decrease causes shifts in sales between retailers (inter-retailer effects) that largely cancel out in terms of the manufacturer’s net sales increase, or inter-brand effects. Therefore, though retailers do not take account of the manufacturer’s much larger margin on incremental sales when lowering price, competition results in the jointly profit maximizing level of retailer price competition because the manufacturer and

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3 This model appears in Klein and Wright, supra note 2.
retailers both adjust their prices so that their respective margins completely and exactly offset the increased retailer demand response with the higher manufacturer margin.

The key competitive distortion identified in the Klein and Murphy model relies on the fact that this offsetting does not occur for many forms of promotion, such as shelf space, which involve low inter-retailer demand effects. This competitive distortion is greatest where the manufacturer’s margin, the difference between the wholesale price and the manufacturer’s marginal cost, is particularly high. This is true for most differentiated products, where individual product demand is negatively sloped. Under these general conditions, manufacturers earn significant marginal profit from incremental sales and have strong incentives to induce retailer promotional effort by compensating dealers for supplying additional promotional services. Denote these forms of promotion, such as shelf space, \( S \). We can then assume that:

\[
\frac{dQ_R}{dS} = \frac{dQ_M}{dS}
\]

Without substantial inter-retailer effects offsetting the manufacturer’s larger margin on incremental sales, we know that the retailer’s profitability from the incremental sales produced by its increased supply of \( S \) will be much smaller than the manufacturer’s return. Mathematically, this Equation (3) represents this deviation from the jointly profit maximizing equilibrium:

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4 This does not imply that the manufacturers of these “differentiated” or “non-homogeneous” products possess any antitrust market power. See Benjamin Klein & John Wiley Jr., Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal, 70 ANTITRUST L.J. 599 (2003).

5 Where all consumers value a particular retailer service equally, such as a well-lit store, or parking, the retailer is compensated for the investment by increasing the retail price by the value of the service supplied rather than by manufacturer payments.
\[
\frac{dQ_R}{dS} (P_R - MC_R) < \frac{dQ_M}{dS} (P_W - MC_M)
\]

These conditions imply that retailer profit maximization will involve setting \( S \) at too low a level. Notice that the conditions necessary for Equation (3) to hold are not very restrictive: (1) heterogeneity in consumers’ valuation of \( S \); (2) the manufacturer’s margin is large relative to the retailer’s margin; and (3) the provision of \( S \) does result in substantial inter-retailer effects. Under these conditions, the manufacturer will want the retailer to provide more promotional shelf space for its products than the retailer would otherwise provide. Because joint profits will increase if the manufacturer can increase retail promotion levels, an economic incentive exists for manufacturers to contract with retailers over the supply of shelf space.\(^6\)

The essence of promotion is inducing purchases from those consumers that would not have purchased the product at current market prices, or “marginal consumers.” Promotional effort pushes the reservation values of marginal consumers towards or above the market price, while infra-marginal consumers’ reservation values are unaffected, or not increased to the market price, because they do not value the promotion offered, such as valuable shelf space.

Consider the following numerical example to illustrate the competitive distortion. Manufacturer X sells a brand name stereo. The wholesale price of X to retailers is $150, and the competitive retail price is $200. Infra-marginal consumers are purchasing the product at $200 and receiving consumer surplus.

\(^6\) Notice that where inter-retailer demand effects exist from the provision of a particular promotional service, the retailer will provide these services without manufacturer compensation because it will be adjust its retail prices to reflect the increased consumer demand.
A marginal consumer values X’s stereo at $150, and is therefore not purchasing the product. Providing X’s stereo premium shelf space would cost the retailer $100 and increase its value to the marginal consumer by $50. However, the shelf space would not be voluntarily supplied by the retailer. The incremental sale earns the retailer $50, which does not cover the $100 promotional expenditure. If the manufacturer’s marginal cost is less than $50, however, it will pay the manufacturer to purchase the promotion because the manufacturer’s incremental profit on the additional sale will be greater than the total cost of supplying premium shelf space.

The economic incentive to compete for retail distribution with payments has implications for the role of antitrust governance in this area. Not only does this competitive distortion provide an efficiency rationale for a series of highly scrutinized practices, but it also serves as the building block for building an antitrust policy informed by a better understanding of the economics of distribution relationships and free-riding incentives.

While the incentive incompatibility illustrates the necessity of a contract governing the promotional relationship between manufacturers and retailers, it does not determine the form of contract. For example, distribution contracts utilize slotting allowances, discounts, resale price maintenance, and cooperative marketing arrangements to this same end. A better understanding of the economic function of these different contractual forms should improve antitrust analysis by reducing the tendency to apply anticompetitive inferences to new forms.

Generally speaking, manufacturers seek to compensate retailers for providing the level of promotion that will likely achieve a specified percentage
increase in total sales. The important economic point is that manufacturers can resort to a spectrum of contractual forms to solve the problem of insufficient dealer promotional incentives. For example, the manufacturer might lower the wholesale price by a certain amount and engage in de facto resale price maintenance, use of cooperative advertising dollars to be rescinded if the dealer prices below a specified price, pay the retailer a per unit time slotting allowance, use quantity based rebates, or give the retailer other valuable consideration for its increased promotional effort.

One key determinant of the contractual form is the degree of inter-retailer competition in the particular product market, or the individual retailer price elasticity of the product. For instance, intense inter-retailer competition will likely dissipate the premium in the form of lower prices on the particular product, reducing the retailer’s incentive to supply the promotion. The use of resale price maintenance is sometimes necessary to solve this problem by insuring that inter-retailer competition does not completely dissipate the retailer’s compensation.\(^7\) Per unit time payments such as slotting allowances perform a similar function, providing the retailer a payment that is less likely to be dissipated through price competition on the particular product.

One advantage to retailers of receiving slotting allowances rather than quantity based rebates is that the former allows greater flexibility in selecting the margin upon which the payment is passed on to consumers. Since the payment is not necessarily passed on in the form of lower prices on the specific product,

\(^7\) Resale price maintenance, conversely, is not likely to be necessary to prevent inter-retailer competition from dissipating the retailer’s compensation where individual retailer price elasticity is low.
retailers will invest these payments in order to improve their competitive position vis-à-vis their rivals.\textsuperscript{8}

\textbf{B. Transactors Use a Variety of Contractual Mechanisms to Reduce Retailers’ Incentives to Cheat on the Promotional Contract}

Manufacturer purchase of dealer promotion creates incentives for dealers to violate the terms of the contractual arrangement by cheating on the manufacturer’s compensation mechanism. Retailers can free-ride on manufacturer promotion in a number of ways, each involving the use of promotional resources supplied or purchased by the manufacturer. The second commonality of these retailer free-riding strategies is that they involve efforts to promote rival brands, typically low brand name products, which earn the retailer a higher margin than the manufacturer’s “targeted product.”\textsuperscript{9}

Klein, Lerner and Murphy offer the following taxonomy of dealer free-riding strategies:\textsuperscript{10}

\begin{enumerate}
\item dealer switching of the manufacturer-supplied promotion to the sale of rival, higher profit margin products;
\item dealer switching of manufacturer-purchased promotion to the sale of rival, higher profit margin products;
\item dealer failure to supply promotion in a manner consistent with the implicit or explicit arrangement.
\end{enumerate}

\textsuperscript{8} Klein & Wright, \textit{supra} note 2. See infra, 2.D.

\textsuperscript{9} Low brand name products earn retailers a higher margin because the dealer may purchase these products at wholesale prices much closer to their marginal cost.

\textsuperscript{10} Benjamin Klein, Andres Lerner and Kevin Murphy, How Exclusive Contracts Protect Specific Investments Against Free Riding and Hold Ups (unpublished working paper, 2005).
The first category would involve situations where the manufacturer supplies promotional inputs such as sales leads or display racks. A retailer cheats on the promotional contract using sales leads to promote rival products. Because marginal consumers are not likely to have strong brand preferences for differentiated products, dealers may be able to induce switching with little promotional effort.

The second category involves the manufacturer purchasing or subsidizing retailer promotion rather than supplying it directly. For example, consider a manufacturer contracting and paying for premium eye-level shelf space. Where a manufacturer has paid for access to premium shelf space likely to increase profitable incremental sales, the retailer can cheat on the agreement by using the contracted-for shelf space to increase sales on rival products earning the retailer a higher margin.

The third category of free-riding involves dealer a total failure to supply contracted-for promotional inputs. This form of free-riding is analytically similar to the second, in that non-detection will result in the dealer receiving the manufacturer premium on whatever sales are made despite the reduced promotional effort (while saving the costs of promotion).

In sum, promotional contracts, regardless of their form, create a broad set of opportunities for retailers to free-ride on terms of the agreement. However, we can expect profit-maximizing transactors to make attempts to minimize the costs associated with each of these categories of dealer free-riding. It is unsurprising that the normal competitive process for distribution leads to the combination of promotional contracts which often include restraints intended to minimize the costs of free-riding.
Exclusive dealing is the most contractual mechanism by which the parties can minimize forms of dealer free-riding relying on the switching promotional effort to rival brands. Exclusive dealing reduces the retailer’s incentive to cheat on the promotional contract because manufacturers can easily detect violations (the presence of another product). However, exclusive dealing can be costly where consumers have significant demand inter-brand product variety. One would expect transactors’ choice of contractual form to economize on both free-riding and loss of variety costs.

Benjamin Klein and I have argued that category management reflects a trade off of these costs that is less restrictive than exclusivity, but nonetheless has attracted unwarranted skepticism with respect to its potential for exclusionary abuse. This commonly employed marketing device grants a manufacturer some level of input with respect to the retailer’s shelf space allocation and product selection decisions, and is pervasive in supermarkets, drugstores and bookstores. Like exclusive dealing, category management reduces the retailer’s ability to deviate from the specified or implied desired level of promotional performance by placing those decisions in the hands of the category manager, or

11 Howard Marvel’s seminal exclusive dealing analysis showed how exclusive distribution contracts could protect manufacturer-supplied promotional investments, the first category of free-riding strategy, but did not consider other forms of free-riding examined this paper. Howard P. Marvel, Exclusive Dealing, 25 J. L. & Econ. 1 (1982). Klein, Lerner and Murphy, supra note 10, show that exclusive dealing also solves free-riding problems associated with the more general phenomenon of insufficient dealer promotion. See also Benjamin Klein, Exclusive Dealing as Competition for Distribution “On the Merits, 12 Geo. Mason L. Rev. 119 (2003).


13 Id. See also, Category Management: An Interview with FTC Commissioner Thomas B. Leary, available at: http://www.ftc.gov/speeches/leary/050328abainterview.pdf (noting that the “extent to which the category manager actually gets into the details of promoting and pricing varies from retailer to retailer”).
lowering the costs of detection as a result of the manager’s increased involvement in shelf space allocation.

The purpose of this section has been to identify the relationship between two economic phenomena: manufacturer payments for promotion and exclusionary contractual mechanisms such as exclusive dealing and category management. Table 1 summarizes the variance in promotional contract form across two key dimensions: the degree of inter-retailer competition and consumer demand for variety.¹⁴

<table>
<thead>
<tr>
<th>Demand for Product Variety</th>
<th>Discount</th>
<th>Slotting allowances &amp; RPM</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>Category management &amp; partial exclusivity</td>
<td>Category management &amp; partial exclusivity</td>
</tr>
<tr>
<td>LOW</td>
<td>Discounts</td>
<td>Slotting allowances &amp; RPM</td>
</tr>
<tr>
<td></td>
<td>Exclusive dealing</td>
<td>Exclusive dealing</td>
</tr>
</tbody>
</table>

Antitrust law has not yet recognized the link between these contractual arrangements, and as a result, attached significant potential antitrust exposure to each practice discussed herein. The consequence of this failure has been to create a confused state of affairs in the antitrust jurisprudence of exclusionary distribution contracts.

C. Consumers Benefit from Competition for Distribution

¹⁴ My claim is only that product variety and individual retailer price elasticity are two of several important determinants of promotional contract form.
Competition for distribution frequently involves substantial manufacturer payments to retailers, who in turn, sell the product to end users. While much attention has been paid to whether these payments can deprive rivals of efficient scale or are predatory in the below-cost sense, the policy discussion has largely ignored the fact that these payments are passed on to consumers. This assumption has been particularly problematic in the discussion of fixed rebates such as slotting allowances, where it is often expressed that these payments do not create an incentive to lower retail prices, and are therefore likely to be anticompetitive. For example, several economists at the Federal Trade Commission Workshop on Slotting Allowances hypothesized that the fixed form of slotting allowances implied that they would not be passed on to consumers.\(^{15}\)

This view does not make economic sense in a competitive retail environment. If retailers earn a competitive rate of return, increased distribution payments should be offset by either lower retailer margins or higher retailer expenditures on non-price services. In other words, retailers are likely to invest these payments in forms of competition likely to have inter-retailer effects, such as an increase in store traffic.\(^{16}\) This retailer incentive is reinforced by its ability to sell shelf space (or other promotion) at a higher price to aim manufacturers if it successfully increases store traffic.

It is important to note that the form of payment is likely to impact how, not whether, consumers benefit from competition from distribution. In other

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\(^{15}\) See, e.g. FTC Report at 28-29, Tr. 181 (Greg Shaffer) (“if you give the retailer . . . upfront money the retailer has no incentive to lower its price to sell more. It’s got the money . . . [t]here’s no marginal effect’’) ; Tr. 142 (Robert Steiner) (“it is not competed away, and if it were a variable cost in the food business, I think it would be competed away”).

\(^{16}\) Klein and Wright, supra note 2, show that increased use of slotting allowances and promotional payments has not been correlated with an increase in retailer profitability over time.
words, one should not expect a slotting allowance for Coca-Cola to always result in lower Coca-Cola prices. Rather, these slotting dollars are likely to be passed on to consumers in the form of lower prices on some other product, or through increased non-price expenditures. While slotting fees or bundled rebates may not lead to a decrease in the price of the particular manufacturer’s product, this does not imply that consumers are worse off in an aggregate sense.

This insight presents a challenge in terms of how antitrust law should account for consumer benefits passed on to consumers outside the relevant antitrust market. Measuring the benefits created by distribution payments in a multi-product retail environment is likely to be very difficult. Even more difficult is the prospect of evaluating these benefits against any potential anticompetitive effects in a meaningful way. While stylized models that do not incorporate the various consumer benefits created by slotting allowances and discounts may add to our knowledge of these practices by isolating particular economic forces, they are not built for, and unremarkably are not capable of, contributing to the design of antitrust rules reflecting the trade-offs between identifying potentially anticompetitive distribution practices while protecting consumers’ interests in the indirect benefits passed on to them through retail competition.¹⁷

While formulating a workable antitrust rule that precisely captures both of these effects is likely impossible, a reasonable first step is design a standard that protects these sure consumer benefits by allowing manufacturers to compete

¹⁷ For a discussion of the bundling literature, including bundled rebates, see Bruce H. Kobayashi, The Economics of Loyalty Discounts and Antitrust Law in the United States, mimeo (2005); Bruce H. Kobayashi, Two Tales of Bundling: Implications for the Application of Antitrust Law to Bundled Discounts, mimeo (2005).
vigorously for distribution by reducing prices, or equivalently, by making payments to distributors. The most analogous area of antitrust law is predatory pricing because manufacturer payments for distribution result in indirect benefits to consumers that are similar to the direct benefits consumers receive from price competition.\textsuperscript{18} As Judge (now Justice) Breyer explained in \textit{Barry Wright Corp. v. ITT Grinnell Corp.}, “the antitrust laws very rarely reject such beneficial ‘birds in the hand’ for the sake of more speculative (future low-price) ‘birds in the bush.’”\textsuperscript{19} Likewise, the certain benefits of competition for distribution suggest that such practices should be judged with a standard similar to those used to identify illegal predatory price competition.\textsuperscript{20} To the contrary, Section 3 describes the confused state of modern antitrust analysis of competitive practices employed in market for product distribution.

3 \hspace{1em} \textbf{Antitrust Regulation of Competition for Distribution}

Modern antitrust enforcement battles frequently concern competitive issues surrounding product distribution and promotion. Neither manufacturer purchase of distribution and promotion, nor the use of vertical restraints to prevent dealer free-riding, have escaped antitrust scrutiny. For example, slotting arrangements have played a central role in recent antitrust litigation,\textsuperscript{21}

\begin{flushleft}
\textsuperscript{18} Id.
\textsuperscript{19} 724 F.2d 227 (1\textsuperscript{st} Cir. 1983).
\end{flushleft}
Congressional hearings, and a FTC Workshop and Study. Other forms of promotional payments, market-share discounts, bundled rebates, and resale price maintenance and cooperative advertising programs have not escaped challenge. Attempts to reduce retailer free-riding incentives, such as exclusive dealing contracts and category management have also been challenged. European Union antitrust law has experienced similar controversy regarding distribution arrangements. This section explores the state of antitrust law with respect to both manufacturer payments for distribution and contractual attempts to minimize dealer free-riding on these promotional contracts.

A. Promotional Payments and Foreclosure Analysis

One set of cases involves allegations that a manufacturer’s payment for shelf space or promotion causes competitive harm. The common feature to these claims is the allegation that the marketing arrangements are de facto exclusive, depriving rivals of efficient scale for a significant period of time by foreclosing


25 Slotting fees and other forms of shelf space payments were also to Coca-Cola’s recent settlement with the European Commission which significantly limits Coca Cola’s ability to offer rebates conditioned on exclusivity or specified levels of sales, as well as the amount of shelf space that it can purchase from retailers. See Undertaking, Case Comp/39.116/B-2-Coca-Cola. See also Case T-65/98, Van den Bergh v. Commission, [2003] E.C.R. I-4653 (finding contractual exclusivity in the provision of ice-cream freezers in violation of Articles 81 and 82); Case T-203/01, Michelin v. Commission (“Michelin II”) (finding Michelin’s rebate scheme in violation of Article 82).
opportunities for product distribution. These arrangements are generally analyzed under the rule of reason framework, assessing whether the defendant has market power, whether the challenged conduct “forecloses competition in a substantial share of the line of commerce involved,”26 and whether there is likely to be competitive harm. The fundamental economic inquiry in promotional payment cases is whether rivals are sufficiently disadvantaged by the promotional program such that they are unable to achieve minimum efficient scale for a significant period of time, because these conditions must hold for a monopolist to increase barriers to entry.

A leading case involves Philip Morris (“PM”) and its “Retail Leaders” program.27 Retail Leaders, introduced in October 1998, involved four different “participation levels” corresponding to both the magnitude of PM payments and the amount of advantageous display space provided to PM. At the highest two levels of Retail Leaders, PM not only made promotional payments to retailers but also granted retailers an “industry fixture” that would occupy a specified percentage of total display space for cigarettes. At the highest level, this

26 Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 329 (1961). Use of exclusive dealing analysis in cases involving shelf space and promotional programs is common. See, e.g., Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metro Bottling Co., 94 F. Supp. 2d 804, 816 (E.D. Ky. 1999); Beverage Mgmt., Inc. v. Coca-Cola Bottling Corp., 653 F. Supp. 1144, 1153-54 (S.D. Ohio 1986); Bayou Bottling, Inc. v. Dr. Pepper Co., 725 F.2d 300, 304 (5th Cir. 1984). Cf. Jonathan M. Jacobson, Exclusive Dealing, “Foreclosure,” and Consumer Harm, 70 Antitrust L.J. 311, 362 (2002), arguing that “foreclosure is a concept that [antitrust] analysis has forgotten,” and that courts focus instead on whether the exclusive dealing contracts increase the defendant’s market power. However, the economic logic of “raising rivals’ costs” implies that distribution contracts cannot increase the defendant’s market power without depriving a rival of efficient scale. Jacobson does concede that the foreclosure inquiry remains useful “as a screening device” in those cases “in which the factfinder is asked to infer competitive harm from the fact that a large percentage of the relevant market has been tied up by the challenged agreement.” Id. This exception may swallow the rule, as distribution cases frequently require the factfinder to make exactly this inference.

percentage was 100%. At the mid-level of Retail Leaders, the industry fixture would occupy half of the total category display space, specifying that PM brands were to be allocated proportionately to PM’s market share (otherwise known as a “space to sales” allocation). The other half of category space was to be divided between a “prime fixture” constituting approximately 25% of category space and promoting only PM brands and a “retailer’s choice fixture” which would occupy the remaining 25% of the space and contained competing brands and signage.28

Several other details of the Retail Leaders program warrant mention. First, PM paid retailers with per unit discounts known as retail display allowances (“RDAs”).29 Second, it was undisputed that Retail Leaders contracts were terminable at will without penalty upon thirty days’ notice.30 Third, under each Retail Leaders level of participation, retailers were never required to grant PM more than “space to sales,” or a greater percentage of shelf space than its market share.31

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

28 Id. at 370.
29 Id. at 369-70.
30 Id. at 371.
31 Id. at 370.
PM for premium shelf space and signage, and retailers were able to terminate agreements at will.\textsuperscript{32}

The result makes economic sense. In promotional payment cases, manufacturer payments will be passed on to consumers through retail competition.\textsuperscript{33} Competition between tobacco manufacturers resulted in a boon to consumers as RDAs were passed on in the form of lower prices.\textsuperscript{34} While anticompetitive foreclosure is a viable concern, the key policy requirement is that the competitive process for distribution is left “open,” meaning that rival manufacturers have the opportunity to bid for shelf space. This condition is clearly satisfied where contracts are of short duration and easily terminable like those in the Retail Leaders program.\textsuperscript{35} In fact, it appears that PM’s relative prices fell after the implementation of Retail Leaders, suggesting that the program was pro-competitive.\textsuperscript{36}

\textsuperscript{32} Id. at 391 (“because Retail Leaders agreements are terminable at will with thirty days notice, retail product and display space are subject to uninterrupted competitive bidding, and Plaintiffs are not substantially foreclosed from the relevant market”).

\textsuperscript{33} Supra Part II.D. Grocery retailer profitability has remained largely unchanged, with after tax profits as a percentage of assets averaging 4.63 percent during 1980-83 and only 4.09 percent during 1984-97. U.S. Department of Agriculture, Food Cost Review (1980-1997). These results are consistent with the conclusion that competition has continued in the grocery retail market despite significant increases in retail grocery concentration over the past two decades. See Joshua Wright, Vons Grocery and the Concentration-Price Relationship in Grocery Retail, 48 UCLA L. Rev. 743 (2001).

\textsuperscript{34} RJR’s economic expert conceded this point during the litigation. 199 F. Supp. 2d at 369-370. The fact that PM paid significant promotional payments is consistent with the very high margins on tobacco products, giving tobacco manufacturers the incentive to pay for premium shelf space and signage that might induce incremental sales.

\textsuperscript{35} The court made exactly such a finding. Id. at 391. Whether short-term agreements do not have substantial anticompetitive effects as a matter of law is an open issue subject to debate across the circuits. See cases cited infra n. 114.

\textsuperscript{36} See Peter Bronsteen et al., Price Competition and Slotting Allowances (2005) (forthcoming in Antitrust Bulletin).
RJR II illustrates the standard framework in exclusionary distribution cases, requiring plaintiffs to show monopoly power, substantial foreclosure, and focusing on the whether the duration of contract prohibits competitive bidding by rivals. RJR II also highlights one of the interesting challenges for antitrust in the context of complex promotional programs designed to increase a manufacturer’s shelf space or display presence: the differential “substantial foreclosure” analysis in cases involving payments shelf space. In addition to addressing this issue, I will also briefly address how the availability of Robinson-Patman Act as alternative enforcement method impacts the regulation of distribution practices and how the competition for distribution perspective informs the current debate on bundled rebates triggered by the recent Third Circuit decision in LePages.

1. **Shelf Space Foreclosure and “Space to Sales”**

Courts analyze foreclosure levels differently in shelf space cases. One commentator summarizes current antitrust law as “routinely sustain[ing] the legality of exclusive dealing arrangements with foreclosure percentages of 40 percent or less.”\(^37\) In the shelf space context, courts have frequently substituted the “space to sales” ratio as a rule of thumb for substantial foreclosure rather adhering to the established 40% levels or some other fixed percentage. The space to sales rule concludes that a dominant firm has achieved substantial foreclosure when it enters promotion contracts that require retailers to supply a percentage of category shelf space exceeding manufacturer’s market share.

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\(^37\) Jonathan M. Jacobsen, Exclusive Dealing, “Foreclosure,” and Consumer Harm, 70 Antitrust L. J. 311, 325, citing cases at n. 85 (2002). Professor Hovenkamp suggests 20% as the minimum foreclosure percentage and 50% as a level at which courts should routinely condemn foreclosure. See XI Herbert Hovenkamp, Antitrust Law ¶ 1821c (1988).
This rule likely owes it roots to the FTC investigation of ready-to-eat cereals. Subsequently, federal courts have frequently used the “space to sales” rule as a guideline in monopolization cases involving manufacturer discounts and slotting fees paid to retailers. In RJR II, PM persuaded the court that foreclosure was not likely because PM obtained space in an amount “equal or less than its market share” and sometimes “only 90% of its share of product space,” whereas RJR obtained contracts granting significantly more space than its market share.

The “space to sales” ratio substitutes sophistication and accuracy for convenience and ease of calculation. Were a comparison of market share to shelf share an accurate indicator of potential for competitive harm, perhaps the ratio would be defensible. It is not. An inference of competitive injury derived solely from the fact that one firm is able to obtain distribution share greater than its market share is likely to lead to problematic results.

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38 See Kellogg Co., 99 FTC 8 (1982). Factual findings 460 and 461 in that case supported “space to sales,” or allocation of shelf space in proportion to market share as a method that “ensured that the retailers would avoid out-of-stocks and overstocks, increase efficiency and profitability and reduce labor costs.” The findings of fact also stated that “sales volume is, and has been, the basic method of space allocation throughout grocery stores.”


40 199 F. Supp. 2d at 388, 390. PM’s appellate brief argues that PM did not substantially foreclose the market because “PM receives only its market share of display and advertising space,” “PM asks for no more than space-to-sales proportionality,” and “space to sales marketing strategies such as this are a ‘common place tool for competitors’ and are wholly lawful,” citing Frito Lay and Bayou Bottling. Appellee’s Brief, Fourth Circuit Court of Appeals Record No. 02-1595, at 48-51 (Sep. 23, 2002).
The key “foreclosure” inquiry for both courts and economists is whether competitors are prevented from reaching minimum efficient scale for a significant period of time. The answer requires evidence of manufacturer level scale economies, ease of entry, availability of alternative methods of distribution, and the duration of the marketing arrangements. These conditions necessarily vary by industry and require the type of “hands on” analysis conducive to Rule of Reason analysis. Rules of thumb such as “space to sales” are surely useful marketing tools for retailers determining shelf space allocation, but are just as certainly misleading and inaccurate tools for antitrust analysis.41

Further, use of the space to sales ratio injects additional uncertainty into the product distribution equation for manufacturers with monopoly power. The set of distribution practices such a manufacturer is able to use to defend its monopoly position under a space to sales regime is likely to be very different than those under a typical foreclosure rule. This additional layer of uncertainty in distribution cases is likely to deter consumer welfare enhancing distribution contracts in an effort to avoid uncertain antitrust liability.

2. **Robison-Patman Liability**

The Robinson-Patman Act ("the Act") prohibits certain discriminatory pricing and promotional programs in connection with the sale and distribution of products in the United States.42 The Act is complex, its application confusing, and its role in regulating the competitive process for distribution unclear. This

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41 Contracts specifying large percentage shelf space requirements, including space to sales contracts, may allow manufacturer’s to commit to providing sufficient variety while limiting dealer’s free-riding incentives.

section does not purport to provide an exhaustive review of its application. I focus solely on summarizing on the Act’s application to promotional shelf space payment programs.

A brief introduction of the Act’s provisions is in order. Section 2(a) of the Act is applicable to discrimination in prices that adversely affect competition. Section 2(c) prohibits “dummy brokerage” and has been applied to commercial bribery and “sham” transactions. Sections 2(d) and 2(e) prohibit discriminatory promotional programs or the discriminatory granting of allowances, services or facilities in connection with the resale of a product. Finally, Section 2(f) prohibits a buyer from knowingly inducing or receiving a discriminatory price. Plaintiffs must prove competitive injury regardless of what provision their claim falls under. The Act allows plaintiffs to prove competitive injury at one of three levels, however, depending on the type of promotional activity involved and which provision the action is brought under.

Section 2(a) claims may be brought against a manufacturer promotional program that encourages product purchases, maintains adequate inventory, or monitors product sales. Though the language of Section 2(d) appears to apply more naturally to claims involving payment for preferential shelf space or promotion, several recent cases indicate that courts are also willing to analyze these cases under Section 2(a).

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44 The Robinson Patman Act specifies three levels of competitive harm. Primary line injury is akin to the competitive injury in monopolization cases, i.e. injury to competition in the upstream market. Secondary-line injury may be shown between favored and disfavored customers, i.e. the “injury” of a retailer receiving less favorable allowances than other retailers may be sufficient to state a claim in a secondary-line case. Finally, tertiary line injury occurs between the retailers’ customers.
In rival supplier cases, the Section 2(a) standard is analytically similar to the predatory pricing standard, as plaintiffs must generally show competitive harm in the form of below cost pricing and likely recoupment.\textsuperscript{45} However, a disfavored retailer might bring a claim under 2(a) challenging a promotional program if it can prove second-line injury, i.e. that it lost sales to a favored retailer or was forced to reduce profits to maintain sales in the face of competition from the favored buyer. In \textit{Hygrade Milk}, for example, the court analyzed a group of plaintiff-distributors claims against Tropicana’s distribution practices under Section 2(a).\textsuperscript{46} The plaintiff-distributors attacked Tropicana’s pricing promotions, including the failure to offer slotting allowances to the plaintiffs’ retailer-customers. Though the court mistakenly addressed whether the distributors’ customers paid different prices for the product rather than whether the distributor paid a higher price than direct buying retailers, which would have properly established tertiary line injury, the claim was allowed to proceed under Section 2(a) and 2(d).

Section 2(d) applies to payments for preferential shelf space or in-store positioning, and seems most natural in its application to distribution payments.\textsuperscript{47} However, it is unclear whether manufacturers have standing to challenge the


\textsuperscript{46} Hygrade Milk & Cream Co. v. Tropicana Prods., Inc., 1996-1 Trade Cas. (CCH) P71,438 (S.D.N.Y. 1996).

\textsuperscript{47} See Frito-Lay, Inc. v. Bachman Co., 659 F. Supp. 1129, 1139 (S.D.N.Y. 1986)(slotting payments may be analyzed under Section 2(a) or Section 2(d)); Mary L. Azcuenaga, then-Commissioner, Federal Trade Commission, The Robinson-Patman Act: A Perspective from the FTC, Remarks before the ABA Section of Antitrust Law and Corporate Counsel Center, Northwestern University School of Law (May 13, 1993) (“Slotting allowances … to obtain access to a store in connection with the initial sale … generally are analyzed as plain vanilla discounts … under Section 2(a) … Slotting allowances … for preferential display space … generally are analyzed [under Section 2(d)]”).
promotional programs of rivals. \textsuperscript{48} Retailers, on the other hand, may bring a Section 2(d) claim by showing either primary line or secondary-line injury. \textsuperscript{49} Importantly, proof of discriminatory allowances causing the plaintiff to lose sales to the favored retailer, or a reduction in the plaintiff’s profits, are sufficient to prove competitive injury under this standard.

Section 2(c) prohibits “any person ... to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods . . ..” \textsuperscript{50} Section 2(c) has been suggested as an alternative approach to challenging slotting arrangements given the difficulties of proving competitive injury associated with 2(a) claims. Section 2(c) cases have had highly variable outcomes. In \textit{Zeller Corp. v. Federal-Mogul Corp.}, \textsuperscript{51} the Sixth Circuit dismissed a claim alleging that a signing bonus not requiring additional services fell within Section 2(c), while the court in \textit{Atlantic Coast Vess Beverages, Inc. v. Farm Fresh, Inc.}, found a slotting fee payment in violation Section 2(c). \textsuperscript{52} Other courts have declined to extend Section 2(c) to slotting allowances and incentive programs that are more properly analyzed under Sections 2(a),


\textsuperscript{49} See, e.g., Hygrade Milk, \textit{supra} note 46.

\textsuperscript{50} 15 U.S.C. §13(c).

\textsuperscript{51} 1999-1 Trade Cas. (CCH) 72,522, 1999 U.S. App. LEXIS 6345 (6th Cir. 1999)(not for publication).

\textsuperscript{52} No. 3:93CV284 (E.D. Va. Oct. 8, 1993).
2(d), 2(e) or the Sherman Act. In *Augusta News Co. v. Hudson News Co.*, for example, a newspaper distributor’s practice of offering large up front per-store fees in exchange for exclusivity, was challenged under Section 2(c). Augusta, the plaintiff, was a distributor that refused to offer retailers up-front fees and rapidly lost chain store customers. The court refused to apply Section 2(c) noting that it sought to “ban outright both such brokerage payments from seller to buyer and reductions in the selling price in lieu of brokerage.” The court saw through Augusta’s assertion that the payments were for brokerage services, realizing that the distributor payments were “simply price reductions offered to the buyers for the exclusive right to supply a set of stores under the multi-year contracts.”

The Act leaves private plaintiffs and enforcement agencies with the more favorable secondary-line injury standard, and manufacturer’s with a thorny maze of compliance issues. The availability of the more lenient secondary-line injury standard to enforcement agencies might be defended on the grounds that it is rarely used, but this is not a compelling defense of the Act. Even sparing

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53 See *Lupia v. Stella D’Oro Biscuit Co.*, 586 F.2d 1163, 1169-70 (7th Cir. 1998); *Empire Rayon Yarn Co. v. American Viscose Corp.*, 364 F.2d 491, 492 (2d Cir. 1965) (en banc); *In Re Whitney & Co.*, 273 F.2d 211, 215 (9th Cir. 1959); cf. *Yeager’s Fuel, Inc. v. Pennsylvania Power & Light Co.*, 953 F. Supp. 617, 665 (E.D. Pa. 1997)(holding that the case “would implicate 2(c) if [defendant] paid special consideration to the buyer, an agent of the buyer, or an intermediary subject to the buyer’s control [to influence its buying decision].”)

54 269 F.3d 41 (1st Cir. 2001).

55 Id. at 43.

56 Id. at 45 n.2.

57 Id. at 45.

58 Professor Hovenkamp recently testified to the Antitrust Modernization Commission in favor of repealing the Act, while recognizing that this option is unlikely to be politically feasible. See Herbert Hovenkamp, *Written Testimony on the Robinson Patman Act* (July 2, 2005), available at:
application of the Act is likely to deter consumer welfare increasing competition for distribution. Further, as illustrated by the recent FTC action against McCormick Spice Company, it is a weapon with within the arsenal of the agencies.

McCormick was brought under Section 2(a) of the Act. McCormick is the largest American supplier of spices to grocery stores. McCormick was brought under Section 2(a) of the Act. McCormick is the largest American supplier of spices to grocery stores. McCormick’s leading rival, Burns Philp Food, Inc. (“Burns”), instigated a price war in the early 1990s. McCormick responded to the price decrease by offering increased discounts and a variety of other payments to retailers. McCormick’s payment programs commonly included partial exclusivity requirements. In some cases, the McCormick and the retailer agreed that the latter would provide 90% of its shelf space devoted to spices to McCormick. McCormick signed more than 2,000 contracts with retailers accounting for the majority of spice sales in the United States.

http://amc.gov/commission_hearings/pdf/Hovenkamp.pdf (“as currently enforced [the Act] is a socially costly statute that produces no benefits to competition that could not be secured by means of litigation under the Sherman Act.”).

59 FTC File No. 961-0050, Dissenting Statement of Commissioners Orson Swindle and Thomas B. Leary (hereinafter “Dissenting Statement”).

60 FTC File No. 9610-0050, Dissenting Statement.

61 Id.

62 Id. at n. 12. The complaint actually alleges that McCormick discriminated in price “in no fewer than give instances … by providing different deal rates consisting of preferential upfront ‘slotting’-type payments or allowances, discounts, rebates, deductions, free goods, or other financial benefits to some purchasers of McCormick products including, but not limited to, McCormick’s spice line…. The complaint also alleges that the different “net price” paid by favored purchasers “were not justified by a good faith attempt to meet the equally low price of a competitor, nor were the favorable spices justified by a cost savings associated with doing business with the favored retailer.” Complaint, ¶ 13. Both good faith “meeting competition” and cost justification would be a defense under the Robinson Patman Act.

63 Id. at ¶ 5.
Recall that a primary-line theory would require the FTC to show that the
discriminatory prices charged by McCormick were below cost and that
McCormick had a reasonable prospect of recouping its losses.\textsuperscript{64} The FTC elected
against this route, failing to allege that McCormick’s price discrimination caused
primary-line injury. Rather, after a three year investigation, the FTC alleged that
McCormick’s contracts caused secondary-line injury. The FTC pointed to five
specific instances where McCormick charged higher prices to certain grocery
stores than it charged to their competitors as evidence of their claim.\textsuperscript{65} The
complaint essentially alleges that McCormick’s discriminatory pricing decreased
the disfavored retailers’ capacity to compete against favored retailers.

In a “secondary-line” case, the Commission has the choice to prove
competitive harm one of two ways: (1) directly showing the disadvantage to
disfavored retailers; or (2) indirectly through the Morton Salt inference. The
Morton Salt inference allows a finding of injury to competition when a persistent
price differential exists in a market where margins are low and competition is
intense.\textsuperscript{66} McCormick ultimately agreed to a consent order with the FTC
preventing its use of discriminatory prices between retailers over the dissent of
two Commissioners.

Commissioners Swindle and Leary argued that the Morton Salt inference
makes sense only when the “purchasing power of the buyer will cause the price
discrimination to be repeated across many items, with consequent competitive

\textsuperscript{64} This is the traditional predatory standard articulated in Brooke Group, 509 U.S. 209 (1993).

\textsuperscript{65} Complaint, ¶12.

injury to the small buyer.” The Commissioners therefore conclude that the *Morton Salt* inference is inappropriate where the FTC does not also allege that larger buyers are receiving lower prices than smaller buyers.

The Commissioners’ argument makes economic sense. If discounts were granted to favored purchasers as a result of the Burns price war, rather than as a function of purchasing power, there is no reason to infer that favored stores received discounts across all grocery products. Simply put, the dissenting Commissioners argue that McCormick was a primary-line case argued on a secondary-line theory.

In its defense, the Commission majority goes to great lengths to point out that it did not rely solely on the *Morton Salt* inference, but also upon evidence that McCormick was the largest supplier of spices in the United States and demanded large percentages of shelf space from retailers. These facts are irrelevant to the *Morton Salt* inquiry. Assuming *arguendo* that McCormick’s ability to extract exclusivity from retailers was a function of monopoly power, such dominance does not imply that the retailers receiving the largest payments from McCormick were also likely to receive larger payments from other suppliers.

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67 Id.

68 Dissenting Statement. There appears to be some disagreement as to the size of the favored retailers. The majority statement from Chairman Pitofsky and Commissioners Anthony and Thompson characterizes the favored buyers as larger chain store buyers (“[t]he fact remains that favored chain store buyers received from a dominant seller substantially better discounts than disfavored buyers, and they were injured, and competition at the secondary-line was injured, as a result”). Statement of Chairman Pitofsky and Commissioners Sheila F. Anthony and Mozelle W. Thompson (hereinafter “Majority Statement”). The dissenting statement rejects this characterization and points out that although “the majority tries to suggest that the disfavored stores are ‘mom-and-pop’ operations, in fact only one of the disfavored stores could be so characterized; the rest of the disfavored stores are all large or relatively large grocery store chains.” Dissenting Statement.
So why wasn’t McCormick a primary line case? One cynical view is that the decision to bring the case on a secondary-line theory was based on the Commission’s sense that it could not prevail under the more stringent primary-line standard which would have forced the FTC to prove either that McCormick’s contracts foreclosed a sufficient share of the market such that a rival may not achieve minimum efficient scale for a significant amount of time, or that the payments were large enough in magnitude to constitute below-cost pricing.\textsuperscript{69} It is difficult to assess the validity of this claim. It is unclear what percentage of total distribution McCormick contracts, which required participating retailers to dedicate up to 90\% of their spice category shelf space to McCormick’s products, foreclosed from rivals. However, the primary line claim may have also been unsuccessful if the contracts were of short duration. While there is no direct evidence of the duration of these contracts, most slotting arrangements are six months to one year in duration, therefore falling within the presumptive safe harbor in most jurisdictions.\textsuperscript{70}

McCormick’s use of discounts is consistent with the theory of competition for distribution outlined in Section 2. Klein and Wright’s promotional theory of shelf space payments predicts that manufacturers are more likely to purchase shelf space with these payments than per unit time slotting allowances where inter-retailer competition for a particular product category is low.\textsuperscript{71} This is because inter-retailer competition is unlikely to dissipate the premium paid to the retailer in the form of lower wholesale prices and a slotting allowance in not

\textsuperscript{69} 509 U.S. 209 (1993).

\textsuperscript{70} FTC Study, iii n. 14.; FTC Report at 11.

\textsuperscript{71} See Klein and Wright, supra note 2.
necessary to compensate retailers for the provision of promotional shelf space. This condition is likely to hold for spices, which are probably not a significant determinant of consumer store switching.

What of the exclusive nature of McCormick’s marketing arrangements emphasized by the FTC? The complaint alleges:

“McCormick has commonly included provisions that, much as is sometimes seen with slotting allowances, restrict the ability of customers to deal in the products of competing spice suppliers. Such provisions typically demand that the customer allocate the large majority of the space devoted to spice products – in some case 90% of all shelf space devoted to packaged spices, herbs, seasonings and flavorings of the kinds offered by McCormick – to McCormick.”  

Chairman Pitofsky defended the Commission’s position by pointing to McCormick’s market power and the “fact that discounts to favored chains were conditioned on an agreement to devote all or a substantial portion of shelf space to the McCormick line of products.” The observation that promotional payments are frequently observed alongside exclusivity provisions is inappropriately cited in support of the conclusion that this combination makes anticompetitive inferences appropriate.

To the contrary, this combination is entirely unremarkable because exclusionary distribution terms are used to minimize the costs associated with dealer free-riding on the manufacturer’s promotional payments, which solve a

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72 Complaint, ¶ 10.

73 Majority Statement.
pervasive dealer undersupply problem with respect to promotional effort. These vertical restraints enhance the transactors’ abilities to facilitate promotional performance under the contract.

The availability of the Act’s weaker standard suggests a backdoor for plaintiffs unable to meet the more stringent burden of proving competitive injury in a monopolization or primary-line claim. While it is doubtful that the FTC’s prosecution of McCormick represents a revitalization of the Act, it does create uncertainty for manufacturers in the growing number of industries relying on retailer promotional effort and product placement for sales.

3. Bundled Rebates as Competition for Distribution

In the wake of the Third Circuit’s ruling in LePage’s, Inc. v. 3M Co., holding 3M liable under Section 2 for offering retailers bundled rebates in exchange for the purchase increasing portions of its product line, the role of bundled rebates in raising barriers to entry has been a frequently discussed topic in the antitrust literature. The antitrust literature has subsequently focused attempts to articulate tests capable of identifying consumer welfare decreasing bundled rebates.

74 324 F.3d 141 (3rd Cir. 2003), cert. denied, __ US __ (2004).

75 See, e.g., Barry Nalebuff, Bundling as a Barrier to Entry, 119 Q. J. Econ. 159 (2003), Barry Nalebuff, Bundling, Tying, and Portfolio Effects, DTA Economics Paper No. 1 (2003); Steya Kolay et al., All-Units Discounts in Retail Contracts, 13 J. Econ. & Mgmt. Strategy 429 (2004). Kobayashi, supra note __, for a useful survey of these and other bundling models.

76 Barry Nalebuff, Bundling as a Barrier to Entry, 119 Q. J. Econ. 159 (2003); Patrick Greenlee et al., An Antitrust Analysis of Bundled Loyalty Discounts (working paper, 2004); Daniel A. Crane, Multi-Product Discounting: A Myth of Non-Price Predation, 72 U. Chi. L. Rev. 27 (2005). These tests are discussed at length in Kobayashi, supra note 17. See also Timothy Muris, Antitrust Law, Economics and Bundled Discounts (Comments to the Antitrust Modernization Committee Submitted on Behalf of the United States Telecom Association) (reviewing the modern industrial organization literature and concluding that it “does not supply a reliable way to distinguish uses of bundling that are on net procompetitive from those that are anticompetitive”).
Nalebuff, for example, argues that exclusionary bundling occurs when the incremental price of an XY bundle over the standalone Y price is less than the bundler’s long run average variable costs of X. When X and Y are consumed in variable proportions, the competitive price of X minus the implied discount on X required to retain consumers must be above the monopolist’s long run average variable costs. This is the test adopted in *Ortho Diagnostics Systems v. Abbot Labs*. Greenlee et al. propose a test that would condemn bundled rebates where the stand alone price of Y, where available, is greater than the monopoly price in the non-bundling equilibrium. While these models are useful in terms of identifying the possibility of exclusionary bundled rebates, the implications of these models for antitrust law are less clear because they do not consider other efficiency reasons for the practice, and are equivocal in their conclusions regarding welfare.

The primary challenge facing the creation of an antitrust rule that would successfully identify promotional practices that decrease consumer welfare on net is that such a rule must account for the pass-through of manufacturer payments to consumers, as well as other possible efficiency benefits. The existing models of exclusionary bundling purposefully ignore these potential benefits, and fail to offer a methodology for calculating the trade-off between consumer benefits and the potential for consumer harm.

Viewing bundled rebates as a form of competition for distribution informs the antitrust analysis in a manner that stylized models cannot. Bundled rebates, like slotting allowances and discounts, may be viewed as a method to compensate distributors for providing promotion that would not otherwise

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occur, and are likely to be an important component of the competitive process where consumers are likely to be sensitive to point of sale services and incremental sales are highly profitable.

An economic analysis of bundled rebates mapping into an administrable antitrust rule is likely to require fact-intensive analysis rather than abstract and highly stylized modeling. I do not dispute the results of models finding some exclusionary effect under the assumption that bundling does not create consumer benefits. The goal of this discussion is not to provide a general theory of bundled rebates, but simply to show that bundled rebates are similar to substitute forms of competition for distribution, such as slotting and quantity discounts, which are efficiency enhancing methods of increasing highly profitable promotional sales. Viewing bundled rebates as part of the competitive process for distribution leads one to focus on the question of whether this process is “open” to rivals, rather than whether the conditions of stylized models have been satisfied, when assessing competitive effects. I believe such a shift in focus would be an improvement for antitrust policy as a general matter, as there is a void of empirical evidence suggesting that practices

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78 As Timothy Muris, state of the modern industrial organization economics “justifies concern about virtually any practice.” Muris, supra note 76. It is important to note that even under the narrow conditions of the exclusionary bundling models, consumer welfare typically increases in the bundling equilibrium. See, e.g., Barry J. Nalebuff, Bundling as an Entry Barrier, 119 Q. J. Econ. 159 (2004); Timothy J. Brennan, Competition as an Entry Barrier? Consumer and Total Welfare Benefits of Bunding, Mimeo (2005). Proponents of these models argue that short-run consumer welfare benefits increase to the expense of long run anticompetitive effects that generally not captured in the model. Carlton and Waldman incorporate dynamic effects into their tying model but warn against relying on these models to design antitrust policy. Dennis Carlton and Michael Waldman, The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries, 33 Rand J. Econ. 194 (2002); Dennis W. Carlton & Michael Waldman, How Economics Can Improve Antitrust Doctrine Towards Tie-In Sales, 1 Competition Policy Int’l 27 (2005).

79 See also Kobayashi, supra note 17; Muris, supra note 76 (“bundled rebates, therefore, can serve the same efficiency-promoting functions as has been identified in the literature examining the use of exclusive dealing and other forms of vertical restraints”).
satisfying the conditions of these models cause a decrease in consumer welfare. A first principle of regulation of the competitive process for distribution should be to limit liability to situations where rivals are not able to compete for distribution on equal footing with the dominant firm.

B. Exclusivity and Category Management as Bad Conduct

The competitive process for distribution frequently involves the use of exclusionary terms that have also been the subject of antitrust challenge. Continental T.V., Inc. v. GTE Sylvania requires such non-price vertical restraints to be analyzed under the rule of reason.\textsuperscript{80} Post-Sylvania, courts have followed its teachings that analysis of vertical non-price restraints should focus on the “market impact” of the restraints.\textsuperscript{81} Economic theory suggests that exclusionary contracts may have an anticompetitive market impact when they raise rivals’ costs by depriving it the opportunity to achieve efficient scale for a significant period of time.

A number of necessary economic conditions follow from this theory. The most frequently discussed condition in this analysis is foreclosure. Foreclosure of a share of distribution sufficient to force a manufacturer’s rivals to operate at less than minimum efficient scale will result in a cost disadvantage to existing competitors and potential entrants. If this condition persists for a significant duration of time, competitive injury can occur as the duration of the monopolist’s reign is extended. Exclusive dealing jurisprudence has, in large part, embraced an analytical approach that is consistent with economic theory. One

\textsuperscript{80} 433 U.S. 35 (1977).

\textsuperscript{81} Id. at 51.
commentator notes that modern decisions generally attach liability only upon foreclosure greater than 40% for liability.\(^\text{82}\)

Even where foreclosure does not exceed 40%, antitrust liability often attaches in the absence of a reasonable pro-competitive justification. In many cases, the most frequently recognized justification for use of exclusives, protection of manufacturer-supplied investments, does not fit the facts. When there is no immediately apparent pro-competitive rationale for exclusivity, courts frequently shift the liability burden to the firm using the exclusive contract on the grounds that competition does not appear to be occurring “on the merits.” This narrow search for efficiency justifications is partially attributable to economists’ failure to explain the broader set of free-riding problems confronting manufacturers and retailers.\(^\text{83}\)

As described in Part 2, exclusionary contracts are more likely to address problems related to facilitating retail promotion than solving the classic dealer free riding problems frequently accepted by courts as an efficiency justification. Distribution contracts including exclusionary terms frequently do not involve the type of manufacturer investments that lend themselves to “discount” free riding. Consumers are not likely to frequent a retailer supplying premium shelf space to a particular product before purchasing it at a “no frills” retailer. Rather, exclusivity in these contracts minimizes costs associated with dealer free-riding

\(^{82}\) Jacobson, *supra* note 37.

\(^{83}\) Retailers will find it uneconomical to supply promotional effort where the presence of discounters threatens to eliminate the return to the retailers’ investment. Customers consume the promotional services at the full-service retailer before purchasing the item for a lower price at the discounter. This is frequently described as “classic dealer free-riding.” This free-riding problem is the only justification for exclusionary distribution contracts discussed in the recent FTC Report. FTC Report at 39.
on manufacturer promotional payments by either pocketing the payments without supplying the desired services or promoting rival brands.

Business school students are commonly taught that producers use exclusive dealing where they “hope to obtain more dedicated and knowledgeable selling.”\(^{84}\) Manufacturers frequently assert that these agreements increase dealers’ dedication to their product, and similar defenses have been recognized in a handful of antitrust cases, though no there is no formal economic explanation of the role of exclusive dealing in increasing dealer loyalty.\(^{85}\)

Section 2 has also been used to challenge category management practices as exclusionary conduct. When viewed from the competition for distribution perspective, category management is a far less suspicious practice than has been suggested.\(^{86}\) Again, because shelf space payments also create dealer free-riding incentives, transactors will seek devices to minimize these free-riding costs and facilitate valuable promotional performance. Category management is one such mechanism, allowing manufacturers to minimize these free-riding costs without resorting to an exclusive dealing term, which retailers may find prohibitively costly when consumer demand for variety is substantial.

C. Operationalizing Naked Exclusion

The narrow view of the role of exclusionary contracts in preventing free-riding frequently runs the risk of treating efficient distribution contracts as

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\(^{84}\) Philip Kotler, Marketing Management 513 (11th Ed. 2003).


\(^{86}\) Klein and Wright, supra note 12.
“naked” attempts at exclusion, found to violate the antitrust laws without a full-blown inquiry into their market impact. For example, Microsoft appears to prematurely shift the liability burden to the defendant as a result of the failure to produce a persuasive business justification for its exclusive dealing contracts with Internet access providers. Notably, the burden shifted despite the fact that the foreclosure was nominally below 40%. Other commentators have noted that defendants with market power rarely prevail in exclusionary distribution cases by asserting a valid business justification after the plaintiff meets its prima facie burden.

Conwood Co. v. United States Tobacco Co. fits this pattern. United States Tobacco was category manager in a number of retail outlets and therefore had significant input with respect to product allocation, as well as in-store marketing decisions. Conwood alleged that United States Tobacco injured competition by: (1) removing and destroying competitors’ display racks without permission of store management; (2) training its salespeople to take advantage of store clerks;

87 Conduct that harms rivals and is without an intuitive business justification is frequently defined negatively as “not competition on the merits,” following the famous formulation of Professors Areeda and Turner. See, e.g., Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 595-96, 605 n. 32 (1985) (quoting III PHILLIP AREEDA & DONALD TURNER, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 78 (1978)). This may also describe the state of European Community doctrine where abuse of a dominant position is roughly defined as conduct by a dominant firm that both (1) hinders competition and (2) is not “normal competition.” Case 85/76, Hoffman-La Roche & Co. AG v. Comm’n, 1979 E.C.R. 461 (1979), 3 C.M.L.R. 211, ¶ 91. Many commentators have criticized this distinction as mysterious, vacuous and problematic. See, e.g., Einer Elhauge, Defining Better Monopolization Standards, 56 STAN. L.R. 253, 265 (2003).

88 253 F.3d at 52-53.


90 Conwood Co. v. United States Tobacco Co., 290 F.3d 768 (6th Cir. 2002). Klein and Wright, supra note 12, discuss Conwood and the economic function of category management in facilitating contract performance.
(3) providing misleading information to retailers in order to trick them into believing that United States Tobacco’s products were better selling; and (4) entering into exclusive agreements with retailers.\textsuperscript{91} The Sixth Circuit took great pains in distinguishing the alleged conduct from conventional exclusive dealing as a result of United States Tobacco’s role as category manager and the drastic nature of the product destruction allegations.\textsuperscript{92}

While destruction and lying are obviously not efficiency-enhancing conduct, United States Tobacco argued that its category management program helped retailers efficiently allocate shelf space, increased consumer loyalty, and improved the presentation of products. The court dismissed these arguments out of hand. It was Conwood’s burden, nonetheless, to show evidence of anticompetitive effects. So what evidence did Conwood produce to satisfy this burden? The evidence consisted primarily of expert testimony showing that a 10% increase in United States Tobacco shelf space was correlated with a 7% increase in moist snuff retail prices.\textsuperscript{93} The court ruled that this evidence was alone sufficient to satisfy Conwood’s burden and proceeded to this issue of calculating damages.\textsuperscript{94} However, the evidence was not uncontroverted. The record also includes the following evidence: (1) Conwood’s market share, and the market shares of several competitors, increased during the relevant time.

\textsuperscript{91} Id. at 778-79.

\textsuperscript{92} Id.

\textsuperscript{93} Id. at 789.

\textsuperscript{94} The damages calculation in Conwood has been subject to heavy criticism for its failure to separate out the sales lost to illegal conduct from those lost to legitimate competition and other factors. See, e.g. David Kaye, The Dynamics of Daubert Methodology, Conclusions, and Statistical Fit in Econometric Studies, 87 U. VA. L. REV. 1933 (2001); Adversarial Economics in United States v. Tobacco Co. v. Conwood Co., 43 Jurimetrics 343 (2003).
period; (2) the market experienced a 45% increase in output; (3) successful entry by new brands; and (4) United States Tobacco enjoyed a modest 10% success rate at obtaining exclusive product display racks. What is notable about the Sixth Circuit’s analysis is that the liability burden was satisfied largely by anecdotal evidence of United States Tobacco’s obviously bad conduct, in lieu of any serious attempt to figure out the degree of foreclosure. A reasonable hypothesis is that the conventional analysis was set aside as a result of the lack of any obvious competitive justification for the conduct at issue.

District court decisions are not immune to this trend. Consider Avery Dennison Co. v. Acco Brands, Inc. Avery had at least a 75% share of market for the sale of machineable labels to commercial customers in the United States. The court denied Avery’s motion for summary judgment, finding that the cash payments and rebates Avery offered to customers in exchange for exclusivity were likely to be recouped through supracompetitive pricing. Avery’s payments included payments of up to $2 million, and included a three year exclusivity term in one contract. The court relied heavily on Avery’s own internal “hot documents” which contained predictably aggressive business propositions.

95 2000-1 Trade Cases ¶ 72,882.

96 Id. at 87,559.

97 Id. One internal Avery document stated that “we will use the time bought through multiyear agreements to build an Avery consumer franchise fortress. The consumer leverage we develop will allow us to renegotiate better backend deals upon termination of the multiyear deals.” Another described Avery’s marketing strategy as to “go on the attack in ways that we can withdraw from if and when we are successful, so that the higher level of cost to the business has a chance of not being permanent.” Id. On problems with the use of “hot documents” to determine whether antitrust violations have occurred, see Geoffrey A. Manne & E. Marcellus Williamson, Hot Docs v. Cold Economics, 47 Arizona L. Rev. 1 (2005).
The court’s analysis is troublesome for a number of reasons. Like in *Conwood*, the analysis eschewed a rigorous analysis of the likely competitive effects in favor of anecdotal evidence and hot documents. Further, Avery offered significant evidence that payments for distribution were a normal part of the competitive process. In fact, it appeared that the plaintiff paid slotting fees and offered various rebates and that these payments were a competitive reality of the marketplace. The court ultimately found that Avery’s internal documents, success in obtaining brand loyalty, and payments for exclusivity alone were sufficient to create a triable fact as to competitive harm. It is difficult to imagine an easier standard for survival of summary judgment.

Some debate exists as to whether the results in *Microsoft*, *Conwood*, *LePage’s*, *Avery*, and other recent distribution cases constitute a disturbing trend in antitrust analysis. I believe these cases, combined with the specter of Robinson-Patman prosecution, expose the failure of antitrust to articulate a workable standard a large set of common marketing arrangements.

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98 The court did discuss “entrenched buyer preferences,” and “Avery’s ties with commercial customers” as barriers and concludes that Acco’s payment of slotting fees for placement are the result of these barriers. Id. at 87554-57. Why these payments are considered barriers to entry rather than part of the competitive process for distribution is unclear and unexplained by the court.

99 Avery appeared to rely on the argument that slotting payments and rebates for exclusivity were commonplace in the market rather than asserting an affirmative business justification defense, such as a free-rider claim, explaining its use of exclusivity.

100 See, e.g., Elhauge, *supra* note 87; Kenneth L. Glazer and Brian R. Henry, Coercive v. Incentivizing Conduct: A Way Out of the Section 2 Impasse?, 18 Antitrust 45 (Fall 2003) (“a consensus seems to be emerging that not all is right with how cases of this kind are handled by the courts”); Brief of Amici Curiae Economics Professors in Support of Respondent at 3-4, Verizon Communications v. Law Offices of Curtis V. Trinko, LLP, 305 F.3d 89 (2d Cir. 2002), *cert. granted*, 123 S. Ct. 1480 (2003) (describing the problem of identifying exclusionary conduct as “vexing”). Not all commentators find the Section 2 standards so troublesome. See Gavil, *supra* note 89, at 50 (“there is no data to support the conclusion that Section 2 is over-deterring some kind of ‘legitimate’ conduct”).
The analysis here provides a few immediate solutions. One simple step towards solving this problem would be to recognize the role of exclusive dealing and category management as valid business justifications minimizing dealer free-riding. Although courts occasionally recognize exclusive dealing contracts as insuring “undivided loyalty” among dealers, this description does not adequately embrace the role of this class of contracts in facilitating contract performance.

Partial exclusion, exclusive dealing and category management provide transactors a set of tools available to control free-riding incentives created by the use of promotional payments for shelf space. Identifying the most efficient tool for the job will depend on the nature of the free-riding incentive, consumer demand for inter-brand variety and other factors. These tools allow the parties to maximize the return on the manufacturer’s promotional investments and reap the fruits of their relationship by controlling the costs of dealer free-riding. Beyond these immediate solutions, Part 4 argues in favor of two improvements to current antitrust analysis of distribution arrangements in light of the economic analysis in Section 2.

4 Improving Antitrust Standards

The potential dangers of falsely condemning competitive conduct are well known. Those error costs are exacerbated when one deals with unfamiliar forms of competition. In dynamic distribution environments, the myriad of

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101 See, e.g., Verizon, 124 S.Ct. at 882 (citations omitted).

102 One is reminded of Ronald Coase’s observation that “if an economist finds something – a business practice of one sort or another- that he does not understand, he looks for a monopoly explanation.” Ronald Coase, Industrial Organization: A Proposal for Research, in POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 67 (V. Fuchs ed., 1972).
competitive tools available to manufacturers and retailers often involve novel business practices such as slotting allowances, bundled rebates, and category management. The key economic feature of these agreements is that they are components of the competitive process for distribution, which generally produces benefits to consumers in the form of lower prices, targeted price discounts, and greater amenities.

The response of antitrust doctrine to the difficult task of trading off short run consumer benefits against potential anticompetitive consequences has been largely consistent. In *Brooke Group*, for example, the Court held that plaintiffs must satisfy a very difficult standard because above-cost discounting, which benefits consumers, “is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting.”103 Judge Breyer expressed a similar judgment in *Barry Wright*, favoring existing consumer benefits beneficial for more speculative “birds in the bush.”104 This is wisely designed policy which secures the immediate short run benefits to consumers in the absence of serious empirical evidence of anticompetitive effects. Further, the predatory pricing standard is adminstrable, creating a safe harbor upon which lawyers can confidently advise their clients regarding antitrust exposure.105

Modern distribution antitrust jurisprudence might be described as deviating from the generally accepted wisdom of the teachings of *Brooke Group*

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103 509 U.S. at 223.
104 724 F.2d 227.
105 See, e.g., Muris, *supra* note 76, arguing in favor of the application of the Brooke Group standard to bundled rebates.
and Barry Wright regarding the regulation of conduct producing both obvious consumer benefits and some risk of anticompetitive harm.

A. Safe Harbors for Exclusionary Distribution Contracts

Building on these general principles, substantial room for improvement exists within modern distribution jurisprudence. One strategy for improvement has been to propose new tests aimed at distinguishing anticompetitive business practices from those that are part of the normal competitive process. A second strategy is to exploit current economic knowledge to create bright line rules of liability, therefore providing guidance to firms and their counsel.

I follow the second path, relying on the economics of competition for distribution to suggest that two safe harbors should be included in any standard meant to identify exclusionary conduct capable of producing competitive harm by depriving rivals of efficient scale while minimizing false positives. Specifically, I argue that the following contracts should be per se legal: (1) exclusionary contracts foreclosing less than 40% of the market; and (2) contracts of less than one year in duration.

1. The Case for Per Se Legality for Foreclosure less than 40%

A 40% safe harbor is largely consistent with the case law which routinely dismisses claims where foreclosure does not reach that level. Though such a safe harbor will not completely eliminate the uncertainty associated with foreclosure analysis, because the degree of foreclosure will continue to vary with


107 See Jacobsen, supra note 37, at 325 n. 85.
how broadly the distribution market is defined, it will compel consistent results for a large set of cases.

While the case law suggests that sufficient legal support exists for such a safe harbor, some might object that the 40% safe harbor would avoid the proper economic question: whether the level of foreclosure is sufficient to deny a rival minimum efficient scale. Professor Elhauge, for example, proposes a standard making per se legal distribution contracts allowing a monopolist to appropriate unexhausted scale. Per se legality of such contracts is the right result. The more complex task is operationalizing minimum efficient scale into a workable rule.

While the cases suggest that 40% is a good starting point for identifying levels of foreclosure where rivals were able to compete for distribution and unable to prove anticompetitive effect, interestingly, the Elhauge standard would classify all contracts foreclosing more than 50% of distribution per se illegal. Per se illegality of these contracts does not appear to be based on sound economic theory or empirical evidence. The empirical justification for the rule would be evidence that economies of scale are exhausted well below 50% in the great majority of industries. I am aware of neither theoretical nor empirical support for this proposition. Nonetheless, this does not appear to be Professor Elhauge’s argument. Rather, Professor Elhauge argues that the monopolist using contracts that foreclose greater than 50% of the market, even if lowering its own costs, could have exploited those economies with less restrictive means, such as vigorous price-competition or internal expansion (vertical integration). ¹⁰⁸

This argument is problematic. A firm can always use means other than exclusionary contracts over any range of output, though it may be significantly

¹⁰⁸ Elhauge, supra note 87, at 324.
more costly to utilize one rather than the other. One might believe that we should think differently of efficiency claims by firms with dominant share. The kernel of Professor Elhauge’s reasoning is that it is better to allow “free market competition” to dictate firm size “rather than to allow those issues to be determined by a form of private self-regulation through discriminatory conditions.”\textsuperscript{109} Is unclear why competition resulting in distribution contracts rather than internal expansion differs from “free market competition.” Elhauge defends this proposition asserting that a \textit{monopolist’s} claim of efficiencies is analogous to the “well-accepted rejection of the natural monopoly defense.”\textsuperscript{110} This explanation is equally unsatisfactory.

The standard willingly sacrifices efficiency gains earned by firms competing for distribution when foreclosure exceeds 50\%.\textsuperscript{111} Why? Professor Elhauge suggests that is that the costs of condemning efficiency enhancing conduct by monopolists will be outweighed by the costs of having the merit of these claims determined by “an undistorted market test” rather than distribution contracts. Hence, we return to the same issue: that competition for contract is not “free market competition” and somehow “distorts” the competitive process when a monopolist is involved.

Elhauge also argues that competition for contract may allow a dominant firm to take advantage of scale economies today while disadvantaging rivals who may become more efficient in the future as a result of changes in market

\textsuperscript{109} Id. at 325.

\textsuperscript{110} Id.

\textsuperscript{111} Elhauge concedes that claims that economies require such distribution shares may have economic merit. Elhauge, \textit{supra} note 87, at 326.
demand or technology.112 Responding to this remote threat does not require a harsh rule sacrificing efficient behavior to achieve this goal. A rule declaring short term exclusionary contracts per se legal would solve this problem since such contracts would allow a firm that achieves most-efficient status in the future to compete for distribution at asymptotically continuous intervals.

My point is not to illustrate what I view as technical flaws in Elhauge’s proposed standard. Indeed, with some minor exceptions, the standard generally asks the right economic questions about exclusionary contracts and would be a significant improvement over current law. However, even Elhauge’s analysis succumbs to the temptation to claim that competition for distribution by a monopolist is not “free market competition,” and is thus relegated to second class status in antitrust analysis.

The immediate consumer benefits secured by allowing open and vigorous competition for distribution suggest that we should protect these benefits where rivals are able to bid openly for distribution, even where the competitive process results in dominant share or monopoly. Antitrust law has been equally accepting of competition for contract.113 Mistakenly ignoring this form of competition in designing antitrust rules will result in chilling remarkable amounts of consumer welfare-enhancing activity. A 40% foreclosure safe harbor for exclusionary contracts would significantly reduce the incidence of false positives.

2. Short-Term Contract Safe Harbor

112 Id. at 327.
113 For example, Judge Frank Easterbrook has explained that “competition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe, and it is common.” Paddock Publ’ns, Inc. v. Chicago Tribune Co., 103 F.3d 42, 47 (7th Cir. 1996).
The second proposed safe harbor would immunize contracts of up to one year in duration (or longer if they are terminable-at-will). The duration of exclusionary contracts has long been recognized as an important factor in antitrust analysis. Contracts that successfully exclude rivals from the ability to compete for distribution for long periods of time are objectionable on the grounds that they extend the duration of the monopolist’s dominance while rivals seek to realign distribution contracts. Contracts of short duration are likely to allow rivals and potential entrants to compete for distribution to be delivered in the immediate future, which should be in ample supply.

There are likely to be some economic and legal objections to such a safe harbor. For instance, some might object to a one-year safe harbor on the grounds that termination of agreements with short terms, even if terminable at will, may prove difficult as a practical matter.\(^\text{114}\) One such practical difficulty is the special case of short term agreements with staggered expiration dates, and another is switching costs.

Where distribution contracts expire at varied dates, it may prove difficult for a rival or potential entrant to obtain distribution sufficient to support its operation at minimum efficient scale.\(^\text{115}\) Antitrust courts have seldom evaluated

\(^{114}\) At least three modern cases support this proposition. See, e.g., United States v. Dentsply, Inc., 2000-1 Trade Cas. (CCH) ¶ 73,247, at 91,139-41 (D. Del. 2001); Minnesota Mining & Manufacturing Co. v. Appleton Papers, Inc., 35 F. Supp. 2d 1138, 1144 (D. Minn. 1999) (“3M has produced evidence that Appleton’s sole sourcing agreements often include incentives that have the practical effect of tying up the paper sheet inventory of a merchant over a period of several years.”); United States v. Dairymen, Inc. 1983-2 Trade Cas. (CCH) ¶¶ 65,651 & 65,704 (W.D. Ky. 1983) (enjoining requirements contracts covering large percentage of the market though only 30 days to one year in duration), aff’d per curiam, 758 F.2d 654 (6th Cir.), cert. denied, 474 U.S. 822 (1985).

\(^{115}\) This claim is frequently made in the antitrust literature though I am not aware of any formal or empirical evidence of its truth. See, e.g., Steven C. Salop & R. Craig Romaine, Preserving Monopoly: Economic Analysis, Legal Standards and Microsoft, 7 GEO. MASON L. REV. 617, 637-38 (1999) (citing the coordination problems inherent in switching retailers when expiration dates are staggered in support of the claim that “bidding for exclusives is not inherently ‘competition on the merits’”); JEAN TIROLE, THE
claims that staggered expiration dates prevent rivals from competing for
distribution. In United States v. Pullman Co., the court addressed Pullman’s
sleeping car service contracts with the railroads of the United States. The
court, in condemning the Pullman’s long term contracts (the majority lasting 15
years or longer) under the Sherman Act, noted that the staggered expiration
dates increased Pullman’s bargaining power in negotiating with individual
railroads. This is a distinct issue from whether potential sleeping car business
entrants were deterred from entry because of the staggered expiration dates,
though the court’s opinion leaves one with the impression that it believed the
staggered dates were at correlated with the lack of entry in the forty years
preceding the action.

Staggered expiration dates have been an issue in modern exclusive
dealing claims only twice. In Amigo Gift Association v. Executive Properties, Ltd.,
the court considered and rejected a trade organization’s request for preliminary
injunctive relief under Sherman Act Sections 1 and 2 against the owner of retail
space which it leased to the plaintiff’s members.

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117 Id. at 129 and n. 8.
118 Id. at 130 (responding to Pullman’s argument that any railroad is free to hire a competitor at the
expiration of its contract by noting that “there have been no others in the field since Pullman bought out
Wagner more than forty years ago”).
119 588 F. Supp. 654 (W.D. Mo. 1984). The plaintiff claimed that the staggered expiration dates prevented
from leaving the current location at the defendant’s building. Id. at 656. The court held that the plaintiff
had shown neither irreparable harm nor likelihood of success on the merits. Id. 659-60.
The argument that staggered expiration dates prevent competition for distribution was rejected on behalf of the Seventh Circuit by Judge Easterbrook in the only case (I could find) that directly addresses the issue. In *Menasha*, both parties were sellers of at-shelf coupon dispensers sold to manufacturers for use in supermarket promotions. The defendant pursued exclusive contracts with manufacturers in different product categories, obligating the retailer to forego the use of at-shelf coupon dispensers for competing products, and offered retailers a portion of the manufacturer’s payments. The plaintiff, Menasha, did not pursue exclusivity of offer compensation. Menasha argued that the staggered expiration dates of the defendant’s exclusive contracts prevented it from “organiz[ing] a network of retailers” to obtain “critical mass.” Judge Easterbrook rejected Menasha’s claim that staggered expiration dates prevented competition for distribution.

A second, more frequently asserted proposition is that switching costs prevent termination as a practical matter. Switching costs are often associated

120 Menasha Corp. v. News Marketing In-Store, Inc., 354 F. 3d 661 (7th Cir. 2004).
121 Id. at 662.
122 Id.
123 Brief of Plaintiff-Appellant Menasha Corporation, at 26-27.
124 354 F.3d at 663 (pointing out that Menasha does not seem to “notice the irony that under its reasoning this sign-everyone-up strategy would create an unlawful monopoly” and that “[p]erhaps Menasha should thank [the defendant] for keeping it on the straight and narrow.”). Menasha’s claim also lacks credibility since its apparently never offered compensation or exclusive contracts, even to those retailers with expired contracts.
125 In *Appleton*, 3M argued that the switching costs were the cause of “deeply rooted customer preference” for Appleton’s products. In *Dentsply*, the Department of Justice argued that the agreements, as a practical matter, were “self-perpetuating” because dealers would not abandon the popular Dentsply brand. Government’s Memorandum in Opposition to Motion for Summary Judgment at 26-35, United States v. Dentsply, available at www.usdoj.gov/atr/cases/f7000/7048.pdf).
with brand loyalty inducing effects of the manufacturer’s payments. The argument raised in these cases is not compelling. The economic question is not whether costs are imposed on the dealer by switching to a rival manufacturer. Dealers certainly incur costs by terminating the contract and finding a new supplier. Not only did the dealer like “price in” the potential future switching costs when deciding whether to accept the manufacturer’s contract offer, but brand loyalty earned by the monopolist’s investment is not a barrier to entry in any meaningful sense of that term.

The real antitrust issue is whether staggered expiration dates, increased consumer loyalty, or loss of payments can prevent rivals from openly competing for distribution. The answer is no when the contracts are of short duration. Sufficient distribution is likely to be available at any given time. The argument that a rival manufacturer cannot come up with an appealing offer to consumers is the analytical equivalent to the statement that the dominant firm has submitted a superior bid. Antitrust rules should protect the bidding process, not micro-manage the content of the bids. As long as contracts are of short duration, the competitive process for distribution is fair to both incumbents and rivals and should be left alone.

Professor Elhauge has articulated a number of other economically oriented objections to per se legality for short term agreements. Elhauge is persuaded that collective action and seller-buyer collusion problems will “make it in [buyers’] interests not to terminate an exclusionary agreement that offers

126 Elhauge, supra note 87, at 340-41.
those discounts even though termination by all buyers would eliminate the anticompetitive effect.”¹²⁷

In the case of collusion between sellers and intermediate buyers, who in turn sell to the ultimate downstream consumer, Elhauge argues that intermediate buyers would have no incentive to terminate the agreement. The classic case of buyers agreeing to an arrangement that allows sellers to facilitate a cartel is the Standard Oil case.¹²⁸ Elhauge argues that Standard Oil exemplifies the reasoning that the existence of seller-buyer side payments funded by supracompetitive profits show that antitrust policymakers should not infer from dealer decisions to sign exclusionary agreements that consumer welfare is increased. Standard Oil, perhaps the seminal empirical documentation of a successful raising rivals’ cost strategy, did not involve unilateral conduct that is typically the subject of Section 2 monopolization claims. Rather, it involved an agreement to facilitate a horizontal price-fixing arrangement that would be per se illegal under Section 1 of the Sherman Act. While horizontal collusion is certainly a problem that antitrust enforcement should be concerned with, as it always has been, I do not believe that the potential for horizontal collusion supplies any guidance for designing monopolization law.

What about collective action problems? Elhauge argues that the logic of collective action implies that it should be no defense that exclusionary agreements are short term or terminable by buyers on short notice.¹²⁹ The crux of

¹²⁷ Id.


¹²⁹ Id.
the logic is that individual buyers will not have sufficient incentive to terminate, because individual termination will not have much market impact. It is true that dealers facing a collective action problem might rush to join the manufacturers’ cartel. But this does not mean that dealers do not have the incentive to leave the cartel. Consider a monopolist’s exclusionary contracts with distributors as analogous to a conspiracy among distributors organized by a dominant manufacturer. An individual distributor has more to gain by remaining outside the conspiracy and contracting with a rival manufacturer. In the case of significant economies of scale in distribution (or economies of scope), an individual distributor can supply a manufacturer of minimum efficient scale. In these circumstances, a rival could defeat the exclusionary scheme by winning a single distribution contract.

Lastly, Professor Elhauge argues that to the extent terminability is relevant, it should cut against the procompetitive justifications offered for exclusionary agreements. He asserts that defendants asserting that exclusionary contracts achieve efficiencies such as providing certainty in supply, or encouraging relation-specific investments, or otherwise increase efficiency are likely pretextual if buyers can terminate whenever they like.

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130 The original exposition of this point was made in Eric Rasmusen et al., Naked Exclusion, 81 AM. ECON. REV. 1137 (1991); see also Ilya R. Segal and Michael D. Whinston, Naked Exclusion: Comment, 90 AM. ECON. REV. 296 (2000).

131 This is not unusual. This is analytically identical to the familiar incentive to cheat on a horizontal collusive agreement by expanding sales.

132 Elhauge, supra note 87, at 341.

133 Id.
This analysis ignores the role of exclusionary contracts minimizing dealer free-riding incentives.\textsuperscript{134} The short-run gain to a dealer from violating its performance obligations under the agreement is always positive since manufacturer’s do not always instantaneously detect nonperformance. Similarly, agreements that are terminable at will also decrease the dealer’s potential for short-term gains appropriated by violating the parties’ understanding.

However, the issue in antitrust cases is typically the role of the dealer’s right to terminate. The economic reasoning is analytically identical: allowing the dealer to terminate at will reduces the manufacturer’s incentive to violate the implicit understanding of the parties’ distribution arrangement for his gains from doing so will be limited to only one period. The manufacturer’s performance obligation might be to supply a quality product, to supply it on time, or any other form of performance that the parties mutually understand. For example, consider the role of dealer termination in a category management relationship wherein the manufacturer’s performance obligation is to supply sound advice regarding product allocation decisions and supply sufficient product variety to satisfy consumer demand.\textsuperscript{135} In order to facilitate efficient self-enforcement of these performance obligations, the dealer’s right to terminate at will is an essential part of the arrangement.

There is also a legal objection to the short term contract safe harbor. Specifically, the safe harbor does conflicts on some level with Supreme Court authority invalidating a number of exclusionary agreements that were of short

\textsuperscript{134} \textit{Supra}, Part II.

\textsuperscript{135} See Klein & Wright, \textit{supra} note 12.
duration and terminable on short notice. The issue of presumptive legality of short-term exclusionary contracts is still open to some debate in the lower courts as well. However, the majority of courts appear to adopt the view that short-term exclusionary contracts are not likely to deprive rivals of distribution.

The argument that Supreme Court precedent prohibits such a safe harbor is not without force. “Old” case law that is largely ignored in modern antitrust analysis has been part of the antitrust policy landscape, for better or worse, for many years. A strict interpretation of Supreme Court precedent would render at least the modern law of horizontal merger, vertical integration, exclusive

136 See, e.g., Standard Oil Co. v. United States, 337 U.S. 293, 296 (1911); Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 352 (1922) (invalidating agreements that were terminable upon three months notice).

137 See cases cited at n. 114. In addition, the district court denied Coca Cola’s motion to dismiss claiming that its distribution agreements were per se lawful because they were terminable at will upon ten days’ notice. Jacobson, supra note 37, at 337, discusses this motion. The district court later granted Coca-Cola’s motion for summary judgment on the grounds that Coke did not have market power in the relevant market. PepsiCo., Inc. v. Coca-Cola Co., 114 F. Supp. 2d 243 (S.D.N.Y 2000), aff’d per curiam, 315 F.3d 101, 111 (2002) (affirming the district court’s market power findings while briefly noting that Coca-Cola’s exclusive distributorships are short in duration and terminable at will).

138 Most recently, the First, Second, Fourth, Seventh and Ninth Circuits have embraced the notion that contracts terminable in less than one year are either presumptively legal or most likely are unable to foreclose rivals. See U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 (1st Cir. 1993); CDC Techs., Inc. IDEXX Labs, Inc., 186 F.3d 74 (2d Cir. 1999); Thompson Everett, Inc. v. Nat’l Cable Adver., 57 F.3d 1317, 1325 (4th Cir. 1995); Roland Mach Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984); Paddock Publications, Inc. v. Chicago Tribune Co., 103 F.3d 42, 47 (7th Cir. 1996) (“the FTC and the Supreme Court concluded that even exclusive dealing contracts are lawful if limited to one year’s duration”); Omega Envtl, Inc. v. Gilbarco Co., 127 F.3d 1157, 1163-64 (9th Cir. 1997) (“short duration and easy terminability of these agreements negate substantially their potential to foreclose competition”).

139 Horizontal merger decisions prior to General Dynamics are the best example of “old” case law that no longer influences antitrust policy. I have advocated overturning these outdated and weak precedent due to the risks that they might influence modern antitrust policy through private actions or otherwise. Wright, supra note 30, at 746-47. An excellent example in the vertical merger context is Ford Motor Co. v. United States, 405 U.S. 562 (1972), which invalidated Ford’s purchase of Electric Autolite, a sparkplug manufacturer, on the basis that the merger would harm competition because rival sparkplug manufacturers would be foreclosed from sales to Ford (10% of the market).
dealing, and tying useless.\textsuperscript{140} This would be an absurd result that should be avoided if it at all possible. Admittedly, designing modern antitrust policy in a manner that ignores the precedential value of traditionally disregarded “old” case law is certainly not ideal. Modern common law has evolved in just this fashion. The first best solution is clearly to take weak and outdated precedent off the books rather than design antitrust laws around obsolete economic and legal thought regarding exclusionary contracts. Short of that, I believe that the short duration contract safe harbor is at least consistent with modern exclusive dealing case law and the economic theory.

B. Application to Recent Exclusionary Distribution Cases

Applying the standard to the following nine appellate level exclusionary distribution cases – \textit{Microsoft, LePage’s, Conwood, Concord Boat},\textsuperscript{141} \textit{Virgin Atlantic},\textsuperscript{142} \textit{RJR II, Coca-Cola, Omega, and Dentsply}\textsuperscript{143} – what impact would the safe harbors have on the ultimate outcomes?

\textsuperscript{140} Professor Elhauge also argues that because all contracts that are unreasonable restraints of trade are not enforceable at common law, they have always been terminable at will. Combining this insight with the fact that antitrust liability still lies for agreements in restraint of trade in the face of terminability at will, Professor Elhauge concludes that terminability at will has no place in determining antitrust liability. He argues that the assertion that terminability at will can immunize conduct from antitrust liability would thus render horizontal price-fixing agreements per se legal. Elhauge, \textit{supra} note 87, at 342. This is incorrect. The point of the safe harbor is not one of mere formality, but economic substance. The safe harbor protects such agreements that are terminable at will because, as a matter of economics, they cannot result in anticompetitive harm. Compare this to a horizontal price-fixing agreement, which can reduce social welfare whether the agreement is terminable at will because, as a matter of economics, they cannot result in anticompetitive harm. I disagree with Professor Elhauge that the necessary implication of this distinction is to “take Sherman Act § 1 and Clayton Act § 3 off the books, as well as any application of Sherman Act § 2 to exclusionary conduct that requires buyer acquiescence.” Id.

\textsuperscript{141} Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8\textsuperscript{th} Cir. 2000).

\textsuperscript{142} Virgin Atlantic Airways Ltd. v. British Airways PLC, 257 F.3d 256 (2d Cir. 2001).

\textsuperscript{143} United States v. Dentsply Int’l, Inc., 2005 WL 426818 (3\textsuperscript{rd} Cir. 2005) (reversing judgment for manufacturer on the grounds that plaintiff did not successfully prove the existence of monopoly power and its use to exclude rivals).
The short term safe harbor would change only the outcome of *Dentsply*, where the Third Circuit recently overturned the district court’s judgment in favor of the defendant.\(^{144}\) There, the fact that the agreements were terminable-at-will would immunize the manufacturer from liability on the grounds that competition for Dentsply dealers and others, was feasible on short intervals.\(^{145}\) *Omega, Coca-Cola, Concord Boat*\(^{146}\) and *RJR II* would also fall under the safe harbor, though this would not change the ultimate result in those cases.

Interestingly, the foreclosure safe harbor may have provided Microsoft immunity under Section 2 from challenges to its exclusive dealing contracts with Internet access providers. The district court conceded that the plaintiff failed to produce evidence that “Microsoft’s arrangements excluded Netscape altogether from access to [at least] forty percent of the browser market,”\(^{147}\) but held that Microsoft’s arrangements gave rise to Section 2 liability because they excluded Netscape from the most efficient means of distribution. The D.C. Circuit upheld

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\(^{144}\) 2005 WL 426818.

\(^{145}\) This was the crux of the district court’s rejection of the Department of Justice’s claim that the contracts were anticompetitive. 277 F. Supp. 2d at 190 (“direct distribution is viable, non-Dentsply dealers are available, and Dentsply dealers may be converted at any time.”).

\(^{146}\) 207 F.3d at 1059. Most agreements were of one year duration and terminable at any time, though an additional 1-2% were available for commitments of two to three years. Id. at 1059-60.

\(^{147}\) United States v. Microsoft Corp., 87 F. Supp. 2d 30, 52-53 (D.D.C. 2000), aff’d in part, rev’d in part, 253 F.3d 34 (D.C. Cir.), cert. denied, 122 S. Ct. 350 (2001). Though the district court does not show its work in coming to a foreclosure share of less than 40 percent, Benjamin Klein has estimated the percentage to be approximately 38 percent of total distribution based on the fact that the exclusives covered approximately 55 percent of distribution, since 25 percent of users obtained their browsers directly from Internet access providers and another 20 percent from of users from the purchase of their home computer. Incorporating the fact that Microsoft’s exclusive contracts typically required Internet access providers to obtain a maximum of 85% Internet Explorer usage, these facts would result in a foreclosure share of less than 40 percent (.45 x .85 = 38 percent). Klein, supra note 11, at 127 n. 23.
the district court’s Section 2 analysis. Some may object that this safe harbor would immunize agreements likely to cause anticompetitive harm. The evidence in Microsoft, however, is not overwhelmingly suggestive of anticompetitive effect in the absence of sufficient foreclosure. Barriers to entry cannot be increased without sufficient foreclosure. Microsoft’s distribution contracts resulted in zero pricing of Internet Explorer, and large promotional payments to Internet access providers, both producing significant benefits for consumers.

The remaining two cases are perhaps the most difficult to analyze: Conwood and LePage’s. Because both defendants conceded their market power, each case focused on the plaintiff’s prima facie evidence that the conduct was anticompetitive since neither was able to persuade the jury that its proffered business justification was valid.

First, consider the impact of the 40% foreclosure safe harbor. It is unclear whether the level of foreclosure created by the combination of United States Tobacco’s exclusive racks and destruction of Conwood’s display racks would have deprived Conwood of access to more than 40% of display racks. I am skeptical that United States Tobacco’s aggregate conduct foreclosed 40% of display racks from the evidence in the record. To the contrary, United States

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148 253 F.3d at 64.

149 LePage’s, Inc. v. 3M, 324 F.3d 141, 146 (3d. Cir. 2003), cert. denied, 124 S. Ct. 2932 (2004); Conwood, 290 F.3d at 782.

150 LePage’s, 324 F.3d at 163-64; Conwood, 290 F.3d at 787 n. 4 (rejecting defendant’s assertion that its conduct increased consumer loyalty and improved product presentation).

151 Conwood presented evidence that product destruction amounted to costs of $100,000 per month. Conwood, 290 F.3d at 778. This analysis assumes that the short term contract safe harbor would not immunize United States Tobacco because Conwood’s allegations included some forms of non-contractual conduct.
Tobacco was only able to obtain exclusive racks in 10% of retail stores, suggesting robust competition for distribution and ample availability for rivals.

LePage’s is also unclear on this point, in large part due to the scarcity of the record. The debate as to whether above cost multi-product bundled discounts should be treated as exclusive dealing, tying, or predatory pricing is unresolved and likely to continue for some time.\textsuperscript{152} 3M’s two exclusive dealing contracts were ruled immaterial to the disposition of LePage’s.\textsuperscript{153} LePage’s did not claim that 3M’s promotional payments amounted to below cost pricing,\textsuperscript{154} opting instead to argue that 3M’s discounts deprived it of “efficiencies of scale” in the tape manufacturing business.\textsuperscript{155} Would 3M’s bundled rebates foreclose rivals from more than 40% of the market for distribution? Again, I am skeptical.

The critical antitrust question is whether the competitive process for distribution was open to LePage’s to engage in competitive bidding. It appears it was. LePage’s offered its own price discounts to large customers such as Wal-Mart, K-Mart, Staples, Office Max, and Walgreens.\textsuperscript{156} The size of these retailers

\textsuperscript{152} See Gavil, \textit{supra} note 89, at 34; Ronald W. Davis, LePage’s v. 3M: Five Ingredients in Search of a Monopoly Broth, \textit{ANTITRUST SOURCE} (November 2004); David L. Meyer, LePage’s II: The Third Circuit Revisits 3M’s Bundled Discounts and Sees Unlawful “Exclusion” Instead of Below-Cost Pricing, \textit{ANTITRUST SOURCE} (July 2004); Glazer & Henry, \textit{supra} note 100, at 45; Daniel A. Crane, Multi-Product Discounting: A Myth of Non-Price Predation, \textit{72 U. Chi. L. Rev.} 27 (2005); Nalebuff, \textit{supra} note \__ (arguing that an Ortho predatory pricing standard is appropriate); Greenlee et al., \textit{supra} note \__ (advocating a tying approach); Muris, \textit{supra} note 76 (arguing in favor of the Brooke Group standard).

\textsuperscript{153} 324 F.3d at 157.

\textsuperscript{154} They could not have done so successfully since there was no evidence that 3M priced below any relevant measure of cost even if one allocated all discounts in the product line to transparent tape.

\textsuperscript{155} Id. at 154-55.

\textsuperscript{156} Id. at 171-73 (Greenberg, J., dissenting). The Solicitor General’s amicus brief notes that the “Third Circuit did not say there was sufficient evidence for the jury to conclude that LePage’s could not have made comparable offers” to 3M customers. Brief for the United States as Amicus Curiae, 3M v. LePage’s Inc., at *6.
suggests the presence of significant economies of scale existed in distribution, which if large enough to support a manufacturer of efficient scale, would allow LePage’s to achieve minimum efficient scale by winning a single distribution contract. Therefore, while the record is not sufficient to calculate the degree of foreclosure resulting from 3M’s bundled rebate programs, the evidence suggests that the contracts were not capable of depriving LePage’s of minimum efficient scale and therefore may have been immunized under the foreclosure safe harbor.

5 Conclusion

The increasing importance of manufacturer payments for distribution, category management, and exclusive dealing to marketing relationships suggests a dynamic environment which will continue to present challenges for antitrust authorities. This world of competition for distribution necessary involves competition-for-contract, where consumer benefits flow to consumers indirectly through payments to distributors. Designing antitrust rules to govern the competitive process for distribution is a challenging and important task, and one some commentators believe antitrust is failing.157

The economic insights collected in this paper show that manufacturer payments and exclusionary distribution terms are frequently related phenomena, the former increasing highly profitable promotional sales and the latter minimizing dealer free-riding incentives. Competition for distribution results in the use of variety of efficiency enhancing contractual mechanisms. A key feature of these promotional contracts, regardless of form, is that they produce significant benefits for consumers.

157 David Balto comments that “few areas are as unsettled or need a foundation of clear guidance.” David Balto, Ten Developments in the Antitrust Treatment of Category Management and Slotting Allowances, Antitrust Report (Spring 2004).
Three significant policy implications are suggested by the economics of competition for distribution. The first is that antitrust law should broaden its search for efficiency justifications to include the pro-competitive role of promotional contracts in solving a pervasive incentive incompatibility problem and the use of exclusionary terms and category management minimizing the retailer free-riding on the manufacturer’s compensation mechanism. The second is that antitrust law should respect the wisdom of *Brooke Group* and *Barry Wright* which teach that short-run benefits should not be sacrificed to protect against future harm without convincing theoretical and empirical evidence of anticompetitive effects. Finally, a greater understanding of the economics of competition for distribution alone will not provide much needed bright line guidance to firms with dominant market shares. The introduction of important safe harbors for promotional contracts foreclosing less than 40% of distribution and for those shorter than one year in duration would significantly reduce false positives, providing certainty without significant offsetting risks of competitive harm.