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"EXCLUSIVE DEALING"

REMARKS OF

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Before

The Association of the Bar
of the City of New York.
April 11, 1956.

According to my private instructions tonight, I am to speak briefly, forthrightly, and authoritatively about current antitrust problems of exclusive dealing. These are the simple instructions of diabolic minds. Without being needlessly grim about the subject, I point out in passing that one Federal Trade Commission trial attorney recently told me that he wouldn't take another exclusive dealing case unless he were given hazardous duty pay. I hasten to add at this point that any opinions which I express tonight are not necessarily those of the Federal Trade Commission.

Since my topic relates primarily to current problems of exclusive dealing, I trust you will allow me arbitrarily to limit the discussion to problems arising under Section 3 of the Clayton Act. I recognize that Federal antitrust enforcement authorities may attack exclusive arrangements via the Sherman Act, where the practices are used unreasonably to restrain trade or to monopolize, or via the Federal Trade Commission Act as an unfair method of competition. Realistically, however, current problems in the field congeal almost entirely around Clayton Act Section 3; the Sherman Act has been used sparingly, and to the extent that exclusive practices may be attacked under the Federal Trade Commission Act, I am prepared to accept Justice Frankfurter's statement in Motion Picture Advertising Service [FTC v. Motion Picture Advertising Service Company, 344 U.S. 392 (1953)] that Clayton Act Section 3 is an expression of policy underlying Section 5 of the Federal Trade Commission Act.

Section 3 outlaws leases or sales

> on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor, or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Although the section enumerates no specific practices, it is designed to attack two broad categories of restrictive agreements; so-called "tying" arrangements which restrict the buyer or lessee of a product or facility to its use only in connection with a "tied" product or facility; and exclusive dealing arrangements wherein a buyer or lessee agrees not to deal in the product of his seller's or lessor's competitors, thereby cutting off those competitors from access to the buyer's or lessee's market. "Full-line forcing" in which an entire line of the seller's or lessor's products may be bound together by agreement is a variant of the tying sale; "requirements" contracts whereby the buyer or lessee agrees to take all or a specified amount of a product exclusively from a seller or lessor are a type of exclusive dealing agreement.

Although the illegality of both tying and exclusive arrangements under the statute are conditioned upon a showing that the practices' effect "may be to substantially lessen competition or tend to create a monopoly in any line of commerce," the courts have developed different standards of legality for each. This is, I suppose, an unassailable hornbook conclusion, although I would add it is my own impression that the different standards have a rather unnerving tendency to differ in different ways at different times.

Since I am allowed to draw my own ground rules, I am inclined to abbreviate the discussion of tying contracts. There are still problems in this field, but they are clearly less pronounced, or, at least, less fashionable than in the neighboring area of exclusive agreements. I take it that most authorities are willing to accept the "perceptible pattern of illegality" which the Supreme Court traced in Times-Picayune v. U. S. /345 U.S. 594 (1953)/ through its earlier decisions in United Shoe Machinery Corp. /258 U.S. 451 (1922)/ FTC v. Sinclair Refinery Company /261 U.S. 463 (1923)/, International Business Machines Corp. v. U. S. /298 U.S. 131 (1936)/, and International Salt Company v. U. S. (332 U.S. 392 (1947)/, to produce the rule that:

> When the seller enjoys a monopolistic position in the market for the "tying" product, or if a substantial volume of commerce in the "tied" product is restrained, a tying arrangement violates the ... standards expressed in § 3 of the Clayton Act because from either factor the requisite potential lessening of competition is inferred.

I take it, too, that all of us as reasonable men are not particularly offended at the per se implications of this rule, since, as the Supreme Court has told us, "tying agreements serve hardly any purpose beyond the suppression of competition." /Standard Oil Company v. U. S., 337 U.S. 293, 305 (1949)/. This will probably not fully satisfy the hardy minority of the Attorney General's Committee who insisted that tying arrangements may serve useful and proper purposes. And there will be those, I suppose, who would charge the FTC in its 1954 Insto-Gas decision /3 CCH Trade Reg. Rep. Par. 25,188/ with a certain leggard's unresponsiveness to case precedent, when it refused to hold contracts tying the lease of gas cylinders to the sale of gas per se illegal "without more," and remanded the case to the Hearing Examiner to flesh out a "barren" record with relevant market data. Yet I imagine an unsentimental answer to the Attorney General's Committee's dissidents would be that, however compelling the economics of their contentions, the cases are heavily against them. And whatever atavistic implications some critics would read into Insto-Gas, I suspect that even they would concede that the most automatic per se offense requires some evidence. Moreover, the Commission's remand there, calling only for production of evidence of monopolistic leverage in the "tying" product, or, alternatively, proof of restraint of a substantial volume of commerce in the "tied" product, seems properly deferential to Times-Picayune.

With this brief discussion of tying arrangements, I move on to the more savory confusion of exclusive arrangements. Here we have one of the classic battlegrounds of antitrust--where per se theories of illegality clash heatedly with the rule of reason, and in the lulls, the lawyers mop up with a steady cross-fire of learned commentaries: What the courts have said, what the courts should have said, what the courts have said the courts have said, what the Federal Trade Commission has said, what the Federal Trade Commission shouldn't have said, what the Federal Trade Commission has said the courts have said, what the courts have said the Federal Trade Commission has said, and even what the Federal Trade Commission has said the courts have said the Federal Trade Commission has said. Lest any of you who are only briefly familiar with this field think I exaggerate, I suggest you consult with any lawyer who is currently trying exclusive dealing cases. Am I right?

This being the general condition of the law, I may as well add to the fire.

I start with the thesis that Section 3 on its face, is not presumptively a per se statute. I take it that per se offenses, in conceptual antitrust terms, relate to those few commercial practices--price fixing, territorial divisions, boycotts--which are considered according to some immutable economic law inevitably damaging to competition, hence per se illegal. The legality of the multifarious remainder of commercial practices is determined by the so-called rule of reason, which I understand to premise vulnerability to antitrust not on any automatic basis but upon a proven anti-competitive effect, i.e., when they are proven to be unreasonable.

Now let me quickly add that these descriptions, for my purposes, are not entirely sufficient. Too readily the words "per se" or "rule of reason" have become kinds of superstitious images, warding off any kind of critical legal or economic analysis. Per se crusaders too often consider advocates of a rule of reason petulant antitrust reactionaries. And vice versa. Yet, the per se doctrine is, after all, only one extreme along the continuum of reasonableness; practices, per se illegal are simply, according to the rule of reason, always unreasonable. Other practices may tend toward per se unreasonableness so that in certain prescribed situations or when certain market tests are met, they are then held per se unreasonable. It is my own feeling--and this may throw a new element of confusion into the whole field--that blind exaltation of the virtues of either a per se or rule of reason approach obscures the fact that both approaches, with only differences in degree, are closely related. Thus, when we refer to per se rules, we are saying only that there is a point of market analysis beyond which, presumption takes over and illegality attaches. But the process of identification of those market conditions or of analysis is very clearly a technique of the rule of reason.

And so via this complex route, I come full circle to my original assertion that I do not consider Section 3 a per se statute. By this I mean that I do not consider the section to invalidate, without more, every exclusive arrangement; I assume that the statute's substantial lessening of competition or tendency to monopoly provisions have some meaning. On the other hand, I am willing to concede that the cases may indicate some element of per se reasoning.

Which brings us finally to the cases.

Most of the present-day exclusive dealing problems swirl around the now-legendary decision of the Supreme Court in the Standard Stations case. /Standard Oil v. U. S. 337 U.S. 293 (1949)_7. Writing elsewhere I have referred to the "internal enigmas" of Standard Stations. On the whole, I consider this a restrained characterization. In Standard Stations, it is argued, the Supreme Court laid down the simple, forthright equation of "quantitative substantiality" with the statutory requirement of injury. In other words, proof that a substantial volume of commerce was blanketed by the contracts equalled competitive injury. Or did it?

Standard Oil had entered into requirement contracts with 16% of the service stations selling 23% of the total gallonage in seven western states, binding them to take their entire gasoline needs from Standard. Although Standard was the largest producer of gasoline in the area, it was by no means dominant. /Thus distinguishing the case from earlier Supreme Court cases where the condemned exclusive contractor had been dominant in his field. cf. Standard Fashion Company v. Magrane Houston Company, 258 U.S. 346 (1922), Fashion Originators Guild of America v. FTC, 312 U.S. 457 (1941)_7. The District Court, applying the test of quantitative substantiality, found that Section 3's competitive injury test was met by proof that the contracts "affect a substantial number of outlets and a substantial amount of products whether considered comparatively or not." The Supreme Court affirmed the lower court decision. But it is important to note the shift there in probative emphasis.

The issue, said the Supreme Court, was whether the statute's competitive test could be met "simply by proof that a substantial portion of commerce is affected" (the lower court test), "or whether it must also be demonstrated that competitive activity has actually diminished or probably will be diminished." The answer, said the court, was that Section 3's injury standard "is satisfied by proof that competition has been foreclosed in a substantial share of the line of commerce affected." (Emphasis added) But this conclusion, though apparently rejecting any actual proof of competitive injury test, is not clearly responsive, either, to the quantitative substantiality test. Proof of substantial foreclosure requires more than a simple quantitative showing of business affected.

Here is a fictional example. Take a small town with all the business concentrated on Main Street. Suppose a seller tied up exclusively every retail store on the north side of the street. This would certainly be a quantitatively substantial portion of business affected. But suppose all the prestige stores were on the south side of the street and competitors had full access to these stores, or there was no parking on the north side, or the south side was always warm and sunny, the north cold and windy. Under these circumstances the likelihood of substantial foreclosure of competitors from the market would seem slim.

Bolstering this conclusion in Justice Frankfurter's concession that the Section 3 cases require "some sort of showing as to the actual or probable economic consequences of the agreement" absent a showing that the supplier dominated the market. Moreover, the court agreed that in a given market context, exclusive contracts might "serve legitimate economic needs." (This accords with the great weight of authority which holds, for instance, that exclusive dealing by small firms attempting to gain a foothold in an established market, not only is, or ought to be, legal but also has a healthy competitive effect).

From all of this, I dissect not a simple quantitative substantiality standard but a test of substantial market foreclosure, though I add honestly that a distinguished array of authority would take issue with me.

Yet, I think my contentions are strengthened by the Supreme Court's subsequent decision in FTC v. Motion Picture Advertising Service Company /344 U.S. 392 (1953)/. There the Court, without reference to Standard Stations, upheld a Section 5 FTC Act order banning exclusive screening arrangements between an advertising film producer and its theater outlets. But note, if you will, the dissent of Justice Frankfurter, in which he discoursed at length on his Standard Stations' opinion. Standard Stations emphasis on business volume was unique to that case, he said, because of Standard's "obvious bargaining power" over service stations; and he stressed the need in the ordinary case for economic analysis into the question of market foreclosure. Is this the hallmark of quantitative substantiality? I doubt it. To me, Standard Stations and Motion Picture Advertising Service, read together, frame Section 3's competitive injury test in realistic terms of substantial market foreclosure.

I would like to be able to say that this analysis of the cases has proven as hypnotic on the courts as on myself, but since I am at least making a pretense of intellectual honesty tonight, I must concede that this has not been the case.

No exclusive dealing case has been decided by the Supreme Court since Motion Picture Advertising Service, but the Federal Trade Commission has issued orders in six contested Section 3 cases, two of which were reviewed in courts of appeals. /Dictograph Products, Inc., CCH Trade Reg. Rep. Par. 11,526, aff'd, 217 F. 2d 821 (2d Cir. 1954); Anchor Serum Co., CCH Trade Reg. Rep. Par. 11,634, aff'd, 217 F. 2d 867 (7th Cir. 1954); Harley-Davidson Motor Co., CCH Trade Reg. Rep. Par. 25,108; Revlon Products Corp., CCH Trade Reg. Rep. Par. 25,184; Maico Co., CCH Trade Reg. Rep., Par. 11,577, 25,475; Beltone Corp., CCH Trade Reg. Rep., Par. 25,874./

It is these Commission decisions, perhaps more than any others, which are cited by many authorities as prime examples of the so-called "new" Commission's resurgence as an expert tribunal. In all of the cases, the Commission shunted aside automatic presumptions of illegality--what rightly or wrongly are called per se rules--in favor of penetrating analysis into the true competitive effects of the challenged practices. In each, the Commission found actual foreclosure of competitors from market access and ordered the respondents to cease the exclusive practices. The Commission's proof requirements in these cases have been labeled by some critics "deplorable" and obstructive of antitrust enforcement. I shall not belabor my defense beyond saying that I consider the Commission decisions properly responsive to judicial precedent, and perhaps, more importantly, an exercise of administrative expertise which directly justifies the existence of an agency such as the Federal Trade Commission at a time when some of our brothers at the Bar seem intent on turning back the clock and judicializing through fragmentation the whole administrative process.

Now what has happened to these prime examples of administrative rectitude in the courts? Two, Dictograph and Anchor-Serum, were appealed to the courts; both were affirmed. But the courts' decisions, particularly Dictograph, I fear, confuse the picture once more. However compelling you may have found my prior exposition of the law, I am forced to admit that on their face the court decisions indicate a disquieting reversion to per se theories. Perhaps apropos is the statement of one commentator last week in Washington that per se rules, like the old Bolsheviks, are coming back.

In Dictograph, exclusive-dealing contracts binding some 22 per cent of the nation's premium hearing-aid dealers were held violative of both Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act. Dictograph was one of the nation's three largest producers of hearing aids. The accounts frozen to Dictograph's products constituted the "best market" for hearing aids. The Commission found Section 3's test of competitive injury met "where one of the largest producers in the field has tied up a substantial portion of the established retail outlets with exclusive dealing contracts and where the contracts not only tend to foreclose a substantial portion of the market to respondent's competitors, but also deny competitive opportunities to sell competing brands. On appeal, Dictograph was affirmed by the 2d Circuit in what I have elsewhere labeled "a curiously dated opinion," and what the Attorney General's Committee bemoaned as "reverting to a rigid per se rule." Yet the court's reasoning is less than totally compelling. It is uncertain from the shifting language whether the decision rules out any economic inquiry into market effects or simply "elaborate economic inquiry" in the case of a dominant producer, or merely a "Sherman Act type of inquiry into all economic factors in every Clayton Section 3 case." (Emphasis added) It is my own feeling that Dictograph need only be read as a verbally intricate affirmance of the proof standard there used by the Commission. And certainly neither that decision nor Anchor-Serum, which is also capable of per se implications, can be read to repudiate the Commission's own standard of proof. So construed, discretion as to the extent of economic inquiry properly remains with the Commission.

I suspect that not all will accept my own minimization of Dictograph, yet short of labeling it clearly aberrational I submit that it must be reconciled with the still-ruling Standard Stations and Motion Picture Advertising Services decisions. And, if I may venture a prediction the case will be so considered by the FTC. It is my own belief and hope that the Commission will continue to pursue that course of administration marked out in the clear line of cases from Dictograph to Beltone. Evidence of the relevant market, of market shares, of the size and vigor of competitors, of industry trends will be considered in reaching an ultimate determination of market foreclosure. This is to suggest neither a frivolous nor prodigal excursion into economic irrelevancies. It is to suggest a continued comprehension of the Commission's own responsibilities as an expert fact-finding body and of its unique competence to resolve complex economic problems. I think it safe to predict that the Commission still recognizes that refusal to exercise its talents as an administrative tribunal would, in the words of Commissioner Mason's Maico opinion, "deprive the country of the very service which we were created to furnish." I can see no real conflict between such responsible administration and judicial precedent.