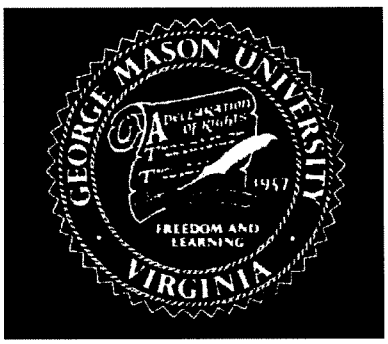
GEORGE MASON
LAW REVIEW



NETWORKS AND EXCLUSIVITY: ANTITRUST ANALYSIS TO PROMOTE NETWORK COMPETITION

David A. Balto

VOLUME 7 SPRING 1999 NUMBER 3

NETWORKS AND EXCLUSIVITY: ANTITRUST ANALYSIS TO PROMOTE NETWORK COMPETITION

David A. Balto[*]

INTRODUCTION

This Article addresses emerging issues involving exclusivity and networks. Exclusivity arrangements have often been at issue in some of the most important joint venture and network antitrust decisions. As networks become an increasingly prominent part of the U.S. economy, grappling with issues of exclusivity will be critical for both antitrust enforcers and decision makers.

Part I of this Article explains why exclusivity is a concern to antitrust enforcers, particularly where exclusivity is used by a network. Part II discusses how and why the enforcement agencies, the courts, and regulators have not always answered the exclusivity question correctly. Part III describes how the law currently addresses questions of exclusivity. Finally, Part IV presents several modest suggestions for modifying the traditional analysis of exclusivity where networks are involved.

I. THE IMPORTANCE OF EXCLUSIVITY

A. *Networks and Exclusivity*

Networks play an increasingly vital role in today's economy. A network is a mixture of facilities and rules that allow a firm or group of firms to exchange or share transactions, data, electronic impulses, information, energy, or physical traffic. Networks can dramatically reduce the costs of communication, permit firms to provide services of a scale and scope heretofore unknown. Moreover, networks permit the creation of new products or markets, where previously there was no market at all. As *The Economist* observed, "the new networks provide magnificent opportunities for innovation. . . . The sheer diversity of the networks now being developed makes it hard to see what the finished system will look like."[1]

---

* Assistant Director, Bureau of Competition, Federal Trade Commission. This Article was presented at the *George Mason Law Review* Antitrust Symposium (October 1998). The author expresses his gratitude for the assistance of Brian Grube and Michael McFalls. The views expressed herein are those of the author and do not necessarily reflect the views of the FTC or of any individual Commissioner.

1 *The Fruitful, Tangled Trees of Knowledge*, ECONOMIST, June 20, 1992, at 85.

Networks include a broad variety of entities that share certain common characteristics. For example, a network typically involves a set of facilities linked together electronically.[2] Examples of this type of network are Computer Reservation Systems, long distance telephone networks, and Automated Teller Machine networks. Other types of networks, such as computer operating systems, often establish a set of operating rules or standards to ensure that participants in the pertinent network(s) can communicate or interact with each other.

A network may enjoy economies of scale or scope in production, but what distinguishes a network from most other production facilities is that it also enjoys economies of scale or scope in demand. The value of a network to a consumer depends on the total number of users and the identities of other specific users. The larger the network, the greater the number of consumers who will join it and conversely, the smaller the network, the less attractive it will be to consumers. For example, a telephone network becomes more valuable as additional customers are connected to it. These increasing returns in consumption are called "network externalities."

Networks can be owned either by single firms[3] or joint ventures. A joint venture is a particularly attractive device for creating a new network because any single firm may lack the level of demand or potential output to justify the creation of a single network. A joint venture network may overcome the significant transaction costs involved in entering into vertical contracts with its members, and also enables firms to share the risks of new entry into the network market. In many cases, joint ventures have permitted groups of relatively small competitors to join together and offer a network facility similar to that offered by larger firms.

There has been tremendous recent interest in the economics and competitive effects of networks. The 1995 Federal Trade Commission (FTC) hearings on competition policy contained a lively discussion of whether the special economic characteristics of networks suggested the need for special antitrust rules.[4] As the hearing report observed, some of these characteristics include economies of scale and scope; coordination and interconnection problems; sunk costs (e.g., substantial R&D expenditures or network facilities); network externalities (e.g., where the network becomes

---

2 *Cf.* David S. Evans & Richard Schmalensee, *A Guide to the Antitrust Economics of Networks*, ANTITRUST, Spring 1996, at 36 ("Almost any structure that can be described in terms of nodes and links between them is regularly called a network."); Donald I. Baker, *Compulsory Access to Network Joint Ventures Under the Sherman Act: Rules or Roulette?*, 1993 UTAH L. REV. 999, 1002 (noting "a 'network' is a mixture of facilities and rules which allows 'primary' market competitors to exchange or share transactions, physical traffic, energy, electronic impulses, or information").

3 Examples of single-firm networks include long distance telephone companies such as MCI and AT&T, and the American Express credit card system.

4 FED. TRADE COMM'N, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH, GLOBAL MARKETPLACE, *reprinted in* NETWORKS AND STANDARDS (1996) [hereinafter FTC STAFF REPORT].

more valuable as the number of connected users rises); and switching costs and corresponding lock-in effects (e.g., when consumers who switch to another network must sacrifice their own investments in complementary products or specialized training usable only with the first network).

Whether network-unique antitrust rules are necessary is an interesting question. Some commentators and regulators have suggested that because of network externalities there may be no more than one or two networks in most environments.[5] Yet even where network externalities are significant, that does not mean that antitrust rules should be weakened. Indeed, because of the potential for the creation of monopolies, and the subsequent exercise of market power, heightened scrutiny may be appropriate.[6]

Perhaps the importance of network exclusivity is shown by the fact that the two most prominent cases currently being litigated by the Antitrust Division, *United States v. Microsoft Corp.*[7] and *United States v. Visa and Mastercard*[8] both involve challenges to exclusivity rules. The Division is challenging several practices of Microsoft including exclusive relationships with applications providers, PC manufacturers, and Internet content providers. The complaint charges the company not only with illegally tying its Internet browser to its Windows operating system but also with: (1) requiring computer manufacturers to license its Web browser as a condition to licensing the operating system; (2) precluding computer manufacturers from modifying the initial screen that appears during the "boot-up" sequence of the operating system; and (3) preventing Internet service providers and content providers from promoting non-Microsoft Internet browsers. Microsoft is allegedly taking these actions in an attempt to monopolize the Internet browser market.[9]

In *United States v. Visa and Mastercard*, the Antitrust Division is challenging rules of the two card associations which prevent banks from issuing American Express cards, Discover cards, or the cards of any competing network. The Department claims that these rules deter the ability of

---

5 *See* Evans & Schmalensee, *supra* note 2, at 36 ("[N]etwork industries tend to have only a handful of competing networks. There is only one network of fax machines, all conforming to standards that enable them to communicate with each other. There is only one Internet. When network externalities are important, multiple networks can survive only if they are offering consumers somewhat different services.").

6 For a discussion about why heightened antitrust scrutiny is appropriate for exclusivity claims, see Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards and Microsoft*, 7 GEO. MASON L. REV. 617 (1999); Carl Shapiro, *Exclusivity in Network Industries*, 7 GEO. MASON L. REV. 673 (1999). *See also* Daniel L. Rubenfeld, Deputy Assistant Attorney General, Antitrust Division, "Competition, Innovation and Antitrust Enforcement in Dynamic Network Industries," before the Software Publishers Ass'n (Mar. 24, 1998) (discussing how network economies affect competition analysis in various types of antitrust claims).

7 United States v. Microsoft Corp., 1998-2 Trade Cas. (CCH) ¶ 72,261 (D.D.C. 1998).

8 United States v. VISA, U.S.A., Inc., (S.D.N.Y. Oct. 7, 1998) (No. 98-civ-7076).

9 *Microsoft*, 1998-2 Trade Cas. (CCH) ¶ 72,261 (denying most of defendants motion for summary judgement).

these alternative networks from effectively competing and also restrict the entry of new networks.[10]

At the least, network exclusivity provisions need careful scrutiny by antitrust enforcers, regulators, and the courts. While exclusivity provides some of the same efficiencies in network settings as in non-network settings, some of the economic characteristics of networks heighten the potential competitive harm from exclusivity.

Networks are often characterized by exclusivity arrangements. While specific arrangements may vary, most exclusivity provisions can be characterized as being one of three main types: (1) joint venture exclusivity, where the network restricts its members from participating in alternative networks or from competing against the network;[11] (2) exclusive dealing, where the network requires that the dealers that distribute the network's product not sell the products of any network competitor; or (3) exclusive distribution, where the members of the network agree that the product they produce will be distributed solely through the network. To illustrate the importance of exclusivity, let me discuss an example of each type of arrangement.

1. Joint Venture Exclusivity

The first case is almost two generations old, yet despite its age it illustrates the importance of exclusivity in the network context. In the 1940s, a group of florists, under the aegis of the Florist Telegraph Delivery Association (FTD), created a floral services network. Up until that time, if a consumer wanted to send flowers to a distant location, she had to make a long distance call and deal with an unknown florist. To overcome this problem, florists formed a network, enabling a florist in one city to order flowers by telegraph throughout the U.S. The network was similar to modern Automated Teller Machine (ATM) networks in that it created and promoted a logo, conducted advertising, and served as a clearinghouse (or switch) for transactions. The network was very popular and enjoyed the participation of the majority of large florists.

In the early 1950s, some florists began to see the opportunity to es-

---

10 For a discussion of the issues raised in the litigation, see David A. Balto, *The Justice Department and VISA-MasterCard Face Off—A Challenge to the Potential for Network Competition* (forthcoming) (on file with author); William J. Kolasky, *Network Effects: A Contrarian View*, 7 GEO. MASON L. REV. 577 (1999).

11 In the joint venture context, it is important to distinguish between rules of exclusivity and exclusion. These concepts are often confused. *Exclusivity* rules may limit the members of the venture from competing with the venture, either through another venture or on their own. *Exclusion* rules limit membership within the venture, e.g., by denying membership to firms for failing to abide with certain rules. Although the rules sound similar, the effects may be quite different. Exclusivity rules primarily impact competition at the venture level (between competing ventures). Rules of exclusion primarily limit competition within the venture.

tablish their own networks. Their efforts were stymied, however, by an FTD rule that prevented members of the FTD network from belonging to another network or sending transactions for another network. How did the rule prevent the emergence of alternative networks? To compete on a national scale, a network needed a critical mass of floral agents with geographic dispersion comparable to FTD. Yet persuading FTD agents to change their allegiance was difficult because each agent realized that the penalty for switching would be the loss of all its current volume of FTD transactions. A new entrant network could not promise to replace that volume unless it had achieved the critical mass of agents.

In 1956, the Antitrust Division of the Department of Justice ("DOJ") stepped in and challenged the exclusivity rule as an unlawful restraint of trade. The case was settled with an agreement to drop the rule.[12] Soon thereafter new networks began to emerge as florists could belong to any of a number of networks.[13]

The FTD case illustrates the importance of two network effects: complementary relationships and network externalities. If the florist was evaluating an exclusive relationship with a flower supplier, its evaluation would simply be based on the relationship between the two parties. But an exclusive relationship with a network raises more complex issues. Before deciding to switch to a network, a florist will consider two questions. First, will the network have a sufficient base of florists (both in terms of member and geographic dispersion) in other locations to handle the transactions generated by the florist's customers? Second, can the network ensure a sufficient volume of transactions?[14]

2. Exclusive Dealing

The most prominent recent network exclusivity case was the challenge to Microsoft's agreements with original equipment manufacturers of

---

[12] *See* United States v. Florists' Telegraph Delivery Ass'n, 1956 Trade Cas. (CCH) ¶ 68,367 (E.D. Mich. 1956).

[13] This decree has continued in effect to the present and has resulted in recent enforcement action. In January 1995, FTD introduced an incentive program, known as "FTD only," to induce florists to use FTD floral wire services exclusively. This program provided financial incentives to qualifying FTD members. To qualify, a florist had to terminate its membership in competing wire clearinghouses and clear 100% of its orders through FTD's clearinghouse. The program was remarkably effective and by May 1995 over 750 florists had become exclusive FTD agents. The Antitrust Division claimed that the "FTD only" program violated the court's decree and threatened suit. FTD entered into a consent decree to terminate the "FTD only" program, in which it is enjoined from offering "any financial incentives or financial rewards" that are conditioned on terminating or forgoing membership in an alternative network. *See* United States v. FTD Corp., 60 Fed. Reg. 40,859 (E.D. Mich. 1995).

[14] As Shapiro explains, in a network context the question is not solely an individuals adoption costs, but the adoption costs of a sufficient number of members to form an alternative network. *See* Shapiro, *supra* note 6, at 675. These "natural collective adoption costs" may exceed the sum of all the individual adoption costs.

personal computers (OEMs). OEMs bundle an operating system with each personal computer. In the early 1990s, Microsoft had a dominant share in the operating system market, perhaps as much as 90%.[15] Microsoft's contracts with OEMs did not explicitly prohibit the OEMs from dealing with alternative operating systems. Rather, these "per processor" contracts required the OEMs to pay a royalty for a Microsoft operating system for every computer the OEM manufactured, whether or not the OEM used the operating system on each machine.[16] The contracts typically lasted from three to five years and also required certain minimum commitments for purchases. An OEM involved in such a contract faced a difficult choice. If an OEM wanted to use an alternative operating system, it would have to pay for two systems. Thus, the "penalty" for using a competing system was the payment for an unused Microsoft operating system.

One might suggest that the exclusive contracts could not entirely restrict competition because there were other distribution paths for competing operating systems to get their product to the market, such as through computer stores.[17] But other forms of distribution were distinctly inferior. Consumers had a strong preference for the preinstalled operating system. Moreover, consumers had already "purchased" the preinstalled copy of the Microsoft operating system. Thus, purchasing a separate operating system and installing it was time consuming and costly.

Both the European Union and the Antitrust Division challenged Microsoft's practice of per processor arrangements. The matter was settled in 1994 with Microsoft's agreement to use only per system or per unit arrangements, which in effect eliminated the penalty on using competing operating systems.[18] The consent decree also limited the duration of the contracts to one year.

---

15 *See* Kenneth E. Baseman et al., *Microsoft Plays Hardball: The Use of Exclusionary Pricing and Technical Incompatibility to Maintain Monopoly Power in Markets for Operating System Software*, 40 ANTITRUST BULL. 265 (1995); John E. Lopatka & William H. Page, *Microsoft, Monopolization, and Network Externalities: Some Uses and Abuses of Economic Theory in Antitrust Decision Making*, 40 ANTITRUST BULL. 317 (1995).

16 Although Microsoft was willing to enter into alternative, less restrictive arrangements, these were far more expensive than the per processor arrangements.

17 Another argument, not posed in this case, could be that if entry at the distribution level was easy, exclusive dealing arrangements could not have a significant anticompetitive effect. The suggestion would be that if an upstream manufacturer faced exclusive distribution arrangements, it could avoid foreclosure by supporting the entry of new distributors. Although this concept was suggested by the 1985 U.S. DEP'T OF JUSTICE, VERTICAL RESTRAINTS GUIDELINES (1985), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,105, at 20,575 (Jan. 23, 1985) [hereinafter 1985 VERTICAL RESTRAINTS GUIDELINES], no court has accepted this argument. The reason is simple: The expenses of two level entry could foreclose upstream entry.

18 *See* United States v. Microsoft Corp., 59 Fed. Reg. 42,845 (D.D.C.) (proposed final judgment and competitive impact statement), *and* 59 Fed. Reg. 59,426 (D.D.C. 1994) (response of United States to public comments), *denying consent decree*, 159 F.R.D. 318 (D.D.C.), *rev'd*, 56 F.3d 1148 (D.C. Cir.), *on remand*, 1995-2 Trade Cas. (CCH) ¶ 71,096 (D.D.C. 1995) (entry of final judgment). For a more extensive discussion of exclusive dealing and computer networks, see Carl Shapiro, Antitrust in

3. Exclusive Distribution[19]

United States v. Columbia Pictures Industries[20] illustrates the competitive problems that arise when a network creates an exclusive distribution arrangement. In 1980, four major motion picture studios established a pay television network ("Premiere"). The joint venture, which would have competed directly with Home Box Office and other pay cable television networks, almost surely would have become a major competitive presence. The venture parents supplied one third of all films shown on pay television, a total that accounted for about 50% of all pay television film revenues. The joint venture was perceived by its members as a legitimate enterprise that created a new cable network. Under the agreement, each motion picture company agreed to make its newly released films available exclusively to Premiere for a nine-month period. The agreement did not set specific prices for the films, but substituted an allocation formula for the valuation of the films.

The defendants attempted to justify the nine-month exclusivity as the "sole way" available to differentiate their network and overcome entry barriers in the cable television market. The U.S. District Court for the Southern District of New York rejected both arguments. First, as to product differentiation, the court noted that other networks were able to differentiate effectively by offering 24-hour service, by specializing on certain types of films, or by creating their own programming. Moreover, the court noted that several networks had been able to overcome these barriers without any exclusivity provisions. Of particular importance to the court was the significance of the members of this network: "It is unlikely that these defendants could establish that the drastic restraint the nine-month [exclusivity period] represents is necessary in order to enable a new competitor to enter the market."[21] Thus, the court condemned the exclusivity rule as an unreasonable restraint of trade.

There may have been other reasons why the court rejected the exclusivity provision. Although the period of exclusivity was limited in duration to nine months, the transitory popularity of newly released films suggested that even that brief period of exclusivity would have a significant anticompetitive effect. Furthermore, the parents of Premiere clearly had a substantial share of a concentrated market. Moreover, the court found an element

---

Network Industries, Address Before the American Law Institute and American Bar Association § IV.F. (Jan. 25, 1996), *available at* <http://www.usdoj.gov/atr/public/speeches/speech.mar> (visited Mar. 5, 1999).

19 Exclusive distribution can also be characterized as a form of input foreclosure in which a network enters into exclusivity arrangements to deny critical inputs to rival networks. For a description of the use of input foreclosure by the Nintendo network, see Shapiro, *supra* note 6 at 676.

20 507 F. Supp. 412, 430 (S.D.N.Y. 1980), *aff'd mem.*, 659 F.2d 1063 (2d Cir. 1981).

21 *Id.* at 431.

of overkill in the exclusivity provision, because it not only would have ensured the defendants market entry, but also would have resulted in their "arrogating to themselves one-half of the essential product of the industry." Indeed, the court suggested that the nine-month exclusivity period would put other struggling networks, such as Showtime and The Movie Channel, out of business.[22]

B. *Anticompetitive Effects of Network Exclusivity*

As the cases above suggest, exclusivity may present significant competitive problems, especially in terms of the foreclosure of new entrants. Exclusivity can also enhance the ability of dominant firms to exercise market power, engage in cartel activity, or deter innovation.

1. Foreclosure of New Entrants

Many commentators and courts observe that foreclosure is the primary anticompetitive effect of exclusive dealing arrangements.[23] As Judge

---

22 One interesting aspect of the case was the relief ordered by the court. In most cases where exclusivity is challenged the court simply eliminates the exclusivity provision. In this case, the court ordered the dissolution of the joint venture. Arguably, deletion of the nine-month exclusive marketing requirement would have improved competitive conditions and reduced the likelihood that the network could have exercised market power. However, perhaps the size and significance of the parents of the joint venture suggested that even absent the exclusivity provision, the network would have been able to harm competition.

23 *See* 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1803a, at 89 (1998); Howard Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1, 5 (1982) (noting exclusive dealing "may be pursued in order to erect barriers to entry by competing manufacturers"); Steven Salop & David T. Scheffman, *Raising Rivals' Costs*, 73 AM. ECON. REV. 267 (1983) (noting that exclusive dealing arrangements can raise rivals' costs of distribution); Shapiro *supra* note 6, at 683 ("Rules imposed by incumbent [networks] that prohibit consumers or members from joining a new network while still participating in the older network can deny the new network the foothold necessary to grow to become a genuine alternative to the established network."); Salop & Romaine, *supra* note 6; *see also* U.S. DEP'T OF JUSTICE, ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATIONS § 3.5 (1988), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,109, at 20,604 (Nov. 10, 1988) ("[I]f most or all of the outlets capable of distributing competing products were subject to exclusive dealing arrangements, a new entrant in the sale of such a product might have to enter into both the manufacture and distribution of the product. Under certain circumstances, the need to enter at both levels could significantly delay, if not completely prohibit, new entry into a product market that was not performing competitively."); Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 45 (1984) (O'Connor, J., concurring) ("Exclusive dealing is an unreasonable restraint of trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal."); Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 328 (1961) (noting "the opportunities for other traders to enter into or remain in that market must be significantly limited"); Interface Group v. Massachusetts Port Auth., 816 F.2d 9, 11 (1st Cir. 1987) ("Exclusive dealing arrangements may sometimes be found unreasonable under the antitrust laws because they may place enough outlets, or sources of supply, in the hands of a single firm (or small group of firms) to make it difficult for new, potentially competing firms to penetrate the market."); Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 393 (7th Cir. 1984) ("The objection to exclusive-dealing agreements is that they deny outlets to a competitor during the term of the agreement."); Beltone Elecs. Corp., 100 F.T.C. 68, 207 (1982) ("We are concerned primarily with restraints that may

Michael Boudin of the U.S. Court of Appeals for the First Circuit noted, "[a]n exclusive arrangement may 'foreclose' so much of the available supply or outlet capacity that existing competitors or new entrants may be limited or excluded and, under certain circumstances, this may reinforce market power and raise prices for consumers."[24] In the network context, a network may enter into exclusive arrangements with certain input providers or distribution outlets in order to prevent competitors from entering into or expanding in the network market.[25]

Exclusivity is more problematic in the network context because of the existence of network externalities or demand-side economies of scale. In the non-network setting, using exclusivity to foreclose rivals can be a very costly and risky strategy, since one must foreclose sufficient distribution outlets to make it impossible, or at least far more costly, for new entrants to get their products to the market. Thus, in the non-network setting courts have typically found liability only where at least 40% of the distribution outlets were foreclosed.[26]

In a network setting there are several factors that complicate the analysis and make the potential consequence of exclusivity arrangements

---

increase the costs of entry and reduce opportunities for new entrants to distribute their products, making it more difficult to open up less-than-competitive markets. If barriers to entry are heightened in this way, vertical restraints may preserve or enhance the market power of existing firms."); *cf.* Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1233 (8th Cir. 1987) ("Where the degree of foreclosure caused by the exclusivity provisions is so great that it invariably indicates that the supplier imposing the provisions has substantial market power, we may rely on the foreclosure rate alone to establish the violation.").

An example of the entry deterring aspect of exclusive dealing is from the industrial gas market during the 1960s. The major industrial gas producers used exclusive dealing arrangements with distributors to foreclose entry of firms into the small-lot segment of the market. The adverse effect of these arrangements was demonstrated because entry occurred in the bulk sales segment of the market where exclusive dealing was absent. *See* Gerald Brock, *Vertical Restraints in Industrial Gases*, *in* IMPACT EVALUATIONS OF FEDERAL TRADE COMMISSION VERTICAL RESTRAINT CASES 386 (1984).

24 U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 595 (1st Cir. 1993). In *U.S. Healthcare*, independent doctors signed exclusive dealing contracts with Healthsource in which they agreed not to provide services with any other HMO during the term of the contract. *Id.* The doctors could terminate the contract by giving 30 days notice. *See id.* at 592 n.1. The court ruled in favor of Healthsource because U.S. Healthcare made no effort to demonstrate either Healthsource's market power or that the agreements foreclosed a substantial percentage of the market. *See id.* at 597, 599.

25 *See* Dennis W. Carlton & Steven C. Salop, *You Keep on Knocking But You Can't Come In: Evaluating Restrictions on Access to Input Joint Ventures*, 9 HARV. J.L. & TECH. 319, 333 (1996) ("Exclusivity requirements force members of the venture to make all-or-nothing choices between obtaining their inputs from the venture or from alternative input market competitors. This can make obtaining inputs from alternative sources more costly, thereby decreasing demand for the inputs supplied by these alternative competitors.").

26 *See* United States v. Microsoft Corp., 1998 U.S. Dist. LEXIS 14231, at *61 (D.D.C. Sept. 14, 1998) (suggesting 40% may be sufficient); United States v. Dairymen, Inc., 1985-1 Trade Cas. (CCH) ¶ 66,638, at 66,156 (6th Cir. 1985) (59.5% market share and exclusive dealing contracts accounted for 50% of sales in the market); Kuhler Co. v. Briggs & Stratton Corp., 1986-1 Trade Cas. (CCH) ¶ 67,047 (E.D. Wis. 1986) (62% market share); *cf.* Hendricks Music Co. v. Steinway, Inc., 689 F. Supp. 1501, 1506 (N.D. Ill. 1988) (observing that market share of 48% may be sufficient).

potentially more pernicious. First, as Shapiro observes, a network natural posseses inertia that deter members or consumers from switching to other networks.[27] Second, a new entrant may need a certain number of distributors to achieve a minimum efficient scale. For example, assume that an ATM network needs the participation of at least 65 of the 100 banks in Washington D.C. to achieve scale economies and sufficient coverage in that market. To forestall new entry, the incumbent need only enter into exclusive arrangements with 36 banks. Because of the need to achieve a minimum efficient scale, exclusivity can be a more attractive strategy to deter entry.[28]

2. Enhancement of the Ability to Exercise Market Power

A network may attempt to create market power by aggregating a group of inputs or outputs. Yet any aggregation may be temporary because competing networks may offer more attractive arrangements. In order to forestall the entry or growth of competing networks, an incumbent network may use an exclusivity arrangement, as in the FTD case. Faced with the "all or nothing" decision, members of the network may be reluctant to defect to the new entrant. Thus, exclusivity arrangements can serve as the "superglue" to solidify or perpetuate the formation of network market power.[29]

This effect is illustrated in the antitrust litigation involving college football television broadcasts. The National Collegiate Athletic Association ("NCAA") formerly served as the exclusive selling agent for college football broadcasts and negotiated contracts with networks for a preset price. The NCAA also imposed an exclusivity rule that prevented individual schools from entering into alternative arrangements with the networks. Two football "power houses" – the Universities of Oklahoma and Georgia – challenged these rules as illegal price fixing. The Supreme Court agreed, focusing its attention on the exclusivity rule.[30] The Court noted, "[e]nsuring that individual members of a joint venture are free to increase output has been viewed as central in evaluating the competitive character

---

27 *See* Shapiro *supra* note 6.

28 *See* Eric B. Rasmussen et al., *Naked Exclusion*, 81 AM. ECON. REV. 1137 (1991).

29 *See* Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Antitrust Analysis of Joint Ventures in the Banking Industry: Evaluating Shared ATMs, Remarks Before the Federal Bar Association and American Bar Association (May 23, 1985), *reprinted in* DONALD I. BAKER & ROLAND E. BRANDEL, THE LAW OF ELECTRONIC FUND TRANSFER SYSTEMS, at A-148 (3d ed. 1996) ("In a world of dominant shared [ATM networks] exclusivity could be used to impede the entry of competing systems. This in turn would reinforce the market power of the dominant system in the market for switching services."); John M. Stevens, *Antitrust Law and Open Access to the NREN*, 38 VILL. L. REV. 571, 603-04 (1993) (describing how exclusivity provisions were used in the cable television market to solidify and strengthen market power).

30 *See* NCAA v. Board of Regents, 468 U.S. 85 (1984).

of joint ventures."[31] Once the exclusivity provisions were eliminated, different schools formed individual negotiating pacts.[32] There are now several groups of schools that have contracts with television networks and output has expanded significantly. Once the "exclusivity superglue" dissolved, the NCAA's market power diminished rapidly.

In their Health Care Policy Statements of 1996, the FTC and DOJ also recognized this concern with exclusivity.[33] In the Statement on physician network joint ventures, the enforcement agencies provide an "antitrust safety zone" for exclusive ventures that consist of 20% or fewer of the physicians in each physician specialty area that practice in the relevant market.[34] If the venture is nonexclusive, a more liberal, 30% safety zone is applied.[35]

Some of the literature on networks suggests that network market power is ephemeral because of the opportunities for significant technological advancement and leap-frog competition.[36] Yet it is precisely because market power may be transitory that networks have an incentive to forge exclusivity arrangements as a means to slow the erosion of market power.

3. Enhancement of Opportunity for Cartel Activity

Exclusivity arrangements may also enhance the opportunity for both the network and the network members to engage in cartel activity. To explain this idea, one must distinguish between competition in the market in

---

31 *Id.* at 114 n.54. *But see* United States v. United States Aviation Underwriters, Inc., 1968 Trade Cas. (CCH) ¶ 72,571 (S.D.N.Y. 1968) (consent decree required insurance underwriting pool to permit members to underwrite insurance separately). The Senate Report to the National Cooperative Production Amendments of 1993 cautions that "agreements precluding the party from competing with the venture or accomplishing objective similar to the venture [sic] independently[. . .] should be reviewed carefully to see if they have an efficiency justification." S. REP. NO. 103-51, at 16 (1993).

32 Soon after the *NCAA* decision, another group of colleges challenged an exclusive contract between the College Football Association ("CFA") and ABC. The court held that a rule that prevented CFA members from appearing on other networks would clearly restrict output. The court also rejected ABC's argument that the exclusivity rule was necessary to protect its efforts to create a distinct product of "CFA football." University of Cal. v. ABC, 747 F.2d 511, 518, 521 (9th Cir. 1984).

33 *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN THE HEALTH CARE AREA (1996), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,150 (Aug. 28, 1996) [hereinafter 1996 HEALTH CARE GUIDELINES].

34 *See id.* at 20,764-67.

35 The enforcement agencies have also challenged physician joint ventures which were viewed as overinclusive. *See* United States v. Health Choice of Northwest Mo., Inc., 60 Fed. Reg. 51,808 (W.D. Mo. 1995); United States v. HealthCare Partners, Inc., 60 Fed. Reg. 52,014 (D. Conn. 1995); *cf.* Justice Department, Antitrust Division, Press Release, Oct. 12, 1983 (announcing Department's intention to challenge creation of Stanislaus Preferred Provider Organization, Inc.; 50 to 90% of the providers in the relevant market were members of the PPO) (on file with author).

36 *See* Evans & Schmalensee, *supra* note 2.

which the network competes (the primary market) and the market in which the network members compete (the secondary market).

In the primary market, networks may compete for dealers to distribute the network product. If relatively few networks exist, there may be opportunities to collude. A cartel may reach an agreement on price, but any agreement will be effective only if the cartel can effectively monitor compliance. Monitoring prices may be difficult especially where the transactions are numerous. In this setting, networks may collude by allocating customers (dealers) through exclusive dealing arrangements. A customer allocation may be preferable to price fixing as a means of colluding since cheating can be readily detected. Moreover, exclusive dealing arrangements can facilitate collusion between competing networks by denying dealers the opportunity to force the networks to bid against each other. This could be a competitive problem even if the secondary market in which the dealers participate is competitive.

An example of the collusion-facilitating aspect of exclusive dealing is provided by a recent FTC enforcement action. In *Hale/Waterous*, the two dominant manufacturers of fire engine pumps used exclusivity arrangements with their customers to allocate markets and deter entry in the fire pump market.[37] The two firms collectively possessed over 90% of the market. The complaint alleged that, for over fifty years, both Hale and Waterous sold fire pumps to their customers on the condition or understanding that such customers would sell its pumps exclusively. The complaint further alleged that both companies believed exclusive dealing would tend to exclude competitors from the market and reduce competition over both price and non-price terms, such as quality differences and delivery times. Absent the exclusivity arrangements, the dealers would have been able to play the two manufacturers against one another so as to secure better prices or other services. Thus, the use of both customer allocation and exclusive dealing would greatly facilitate collusion. The FTC enforcement action prohibited the firms from entering into future exclusivity arrangements.[38]

Exclusivity arrangements may also enhance the opportunity of the members of a network to engage in cartel activity in the secondary market. For example, members of a network may set certain prices collectively, such as the price of the network product. If the members attempt to set the prices of the network product at a supracompetitive level, individual mem-

---

37 Hale Prods., Inc., 61 Fed. Reg. 40,225 (F.T.C. 1996) (proposed consent agreement); Waterous Co., Inc., 61 Fed. Reg. 40,229 (F.T.C. 1996) (proposed consent agreement).

38 *See id.* (analysis to aid public comment and separate statement of Chairman Pitofsky, and Commissioners Varney and Steiger); *see also* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 10.8b (1994) (describing how exclusivity arrangements can facilitate collusion).

bers of the network may be tempted to "cheat" on the cartel and enter into alternative arrangements with consumers for the secondary product. Depending upon the relationship between the secondary product and the network product, the ability to cheat may serve as an important deterrent to cartel behavior.[39]

This point is nicely illustrated by the BMI litigation, which concerned a joint venture's price setting for a blanket license for copyrighted music.[40] The Supreme Court held that collective price setting was not per se illegal, because the establishment of a price was necessary for offering a blanket license, which created tremendous transaction cost efficiencies in view of the numerousness of copyright holders and potential licensees.[41] The case was remanded for full analysis under the rule of reason. The U.S. Court of Appeals for the Second Circuit upheld the blanket license, based on a single factor: It held that there was no restraint of trade because, under the license, individual composers retained the right to negotiate fees for their own compositions outside the framework of the blanket license.[42]

Lack of exclusivity was crucial because an exclusivity restriction would be necessary to facilitate a cartel arrangement. Absent exclusivity,

---

39 *See* Joseph F. Brodley, *Joint Ventures and Antitrust Policy*, 95 HARV. L. REV. 1521, 1555-56 (1982) (discussing output joint ventures that involve exclusive marketing pose greater antitrust risk than those in which parents are free to market their own output). In many cases in which price fixing by putative joint ventures was held illegal, the ventures prevented the members from independently selling the joint venture's product. *See* United States v. Columbia Pictures Indus., Inc., 507 F. Supp. 412, 430 (S.D.N.Y. 1980) (price fixing agreements in joint venture to create cable movie network were per se illegal; agreements included exclusivity provision that prevented movie studios from selling films to other networks for a nine month period), *aff'd mem.*, 659 F.2d 1063 (2d Cir. 1981); *see also* COMPACT v. Metropolitan Gov't, 594 F. Supp. 1567, 1574, 1581 (M.D. Tenn. 1984) (finding agreement by black-owned architectural firms not to bid individually on projects on which they were bidding jointly *per se* illegal).

40 *See* Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979) ("*BMI*").

41 Both the ASCAP and BMI licensing arrangements are non-exclusive. In the 1940s and 1950s, the Justice Department had successfully attacked both associations' use of exclusivity provisions that prevented individual composers from selling their compositions outside the blanket license arrangement. *See* United States v. ASCAP, 1950-1951 Trade Cas. (CCH) ¶ 62,595 (S.D.N.Y. 1950); United States v. ASCAP, 1940-1943 Trade Cas. (CCH) ¶ 56,104 (S.D.N.Y. 1941).

42 *See* CBS v. ASCAP, 620 F.2d 930, 936 (2d Cir. 1980) ("[I]f the opportunity [to purchase individual licenses] is fully available, and if copyright owners retain unimpaired independence to set competitive prices for individual licenses to a licensee willing to deal with them, the blanket license is not a restraint of trade."); *see also* Stratmore v. Goodbody, 866 F.2d 189, 193 (6th Cir. 1989) (restriction on auctions were not considered a restraint since seller had alternative means to reach customers); Buffalo Broad. Co. v. ASCAP, 744 F.2d 917, 925 (2d Cir. 1984) ("blanket license" offered by a group of copyright owners not an antitrust violation because copyright owners had the ability to enter into separate arrangements); HOVENKAMP, *supra* note 38, at 236 (discussing the importance of nonexclusivity in the *BMI* decision); *cf.* National Bancard Corp. v. VISA U.S.A., Inc., 596 F. Supp. 1231, 1254 (S.D. Fla. 1984) (collective price setting by joint venture not a violation where members retained opportunity to bypass the venture), *aff'd*, 779 F.2d 592 (11th Cir. 1986); Business review letter from Assistant Attorney General Anne K. Bingaman to B. Bruce Rich (Aug. 2, 1993) (Justice Department stated that it would not challenge a joint venture's nonexclusive blanket license for copyrighted literary works, noting that several firms compete with the venture and that venture members would retain the ability to negotiate individual licenses with buyers) (on file with author).

members of the cartel retained the economic incentive and the ability to cheat on the cartel when the opportunity arose. Similarly, if BMI set prices at non-competitive levels, disgruntled buyers could enter into alternative arrangements with individual members of the venture. Thus, the ability of the individual members of the venture to enter into alternative arrangements ameliorated any concerns over price fixing.

4. Deterrence of Innovation

Finally, exclusivity can adversely affect innovation in the network's market. For example, suppose a network joint venture requires its members to market any product the member develops only through the joint venture. If one member develops a new product, it is faced with a difficult choice: Either withdraw from the venture and go it alone or stay with the venture and share the fruits of its invention with all of its co-venturers. Either way, the exclusivity rule may ultimately dampen the incentives to innovate.[43]

One example of the dampening effect of exclusivity on innovation was addressed by the Canadian Competition Bureau's challenge of certain rules of the national ATM network Interac.[44] Interac, the dominant ATM network in Canada, required its members to submit any proposed innovation or new product development to the Interac Board for approval. The rules further required all members to share equally in the costs of the product development and a two-thirds Board vote for approval. No new product development was approved for almost a decade. The Competition Bureau alleged that the "close cooperation and transparency required among [members] during the process of considering a proposal for the introduction of new Shared Services inhibits competitive rivalry . . . , increases the likelihood of interdependent conduct and limits product development."[45] The rules were changed to permit individual members to pro-

---

43 *See* HOVENKAMP, *supra* note 38, at 13; *see also* Thomas A. Piraino, Jr., *The Antitrust Analysis of Network Joint Ventures*, 47 HASTINGS L.J. 5, 50 (1995) ("As long as the members of a network are not expressly foreclosed from joining a competing network, they will have a natural incentive to participate in new networks designed to develop or commercialize a superior technology. . . . By precluding the members of a network joint venture from taking advantage of such an opportunity, exclusivity rules limit competition that would otherwise exist in [new technologies].").

"A network may argue that an exclusivity rule is [needed to protect its trade secrets or] proprietary know-how from disclosure to a rival network. There are, however, less restrictive means of protecting a network's know-how, such as rules requiring members to maintain the confidentiality of such information." *Id.*

44 D.I.R. and Bank of Montreal et. al., (CT-95/2 June 25, 1996) (on file with author).

45 *Id.* at 18; *see also* Robert D. Anderson & Brian Rivard, *The Competition Policy Treatment of Shared EFT Networks: The* Interac *Case* (May 1998) (on file with author) (discussing the *Interac* litigation).

vide new services, with the approval of the senior management of the network (that the network will not be adversely affected).

Another way that exclusivity can deter innovation is by controlling critical inputs to the development of new products. An example of this is provided by the enforcement action by the DOJ Antitrust Division and forty state attorneys general against the Primestar Direct Broadcast Satellite joint venture in 1994.[46] One alternative to cable broadcasting is direct broadcast satellites (DBS). Several DBS ventures were formed in the late 1980s, but were not successful in securing a very large number of subscribers.

Primestar, formed during this period, was a joint venture of subsidiaries of seven of the largest cable multiple systems operators ("MSOs") in the United States and a subsidiary of General Electric Company.[47] Together, the MSOs served more than 50% of the nation's cable subscribers. In addition, two MSO defendants, Time Warner and Viacom, controlled critical subscription television programming, including such popular services as Home Box Office, Cinemax, Showtime, The Movie Channel, MTV, Nickelodeon, Comedy Channel, E! Entertainment Television, and others.[48]

The government alleged that Primestar deterred the entry and growth of other DBS ventures by its exclusive control of these critical programming assets. The joint venture prohibited joint venture members from making their programming available to any other DBS competitor unless it was also made available to the joint venture at terms no less favorable. The government alleged that this "most favored nations" provision made it more difficult for other potential DBS competitors to obtain necessary programming. Ultimately, these provisions delayed the entry and growth of alternative DBS networks. The government settled the case once Primestar eliminated the most favored nations provision.

C. *Procompetitive Effects of Network Exclusivity*

In the non-network context, exclusive dealing is often regarded as

---

46 *See* United States v. Primestar Partners, L.P., No. 93 Civ. 3919 (S.D.N.Y. filed June 9, 1993); New York v. Primestar Partners, L.P., No. 93 Civ. 3868 (S.D.N.Y. filed June 9, 1993); *see also* David J. Saylor, *Programming Access and Other Competition Regulations of the New Cable Television Law and the Primestar Decrees: A Guided Tour through the Maze*, 12 CARDOZO ARTS & ENT. L.J. 321 (1994).

47 Saylor, *supra* note 46, at 362. The seven MSOs were Tele-Communications, Inc.; Time Warner, Inc.; Continental Cablevision, Inc.; Comcast Corporation; Cox Enterprises, Inc.; Newhouse Broadcasting Corporation; and Viacom, Inc.

48 *See id.* at 361. Various MSO defendants also held substantial interests, individually and collectively, in other programming suppliers, including Turner Broadcasting (the supplier of Cable News Network, Turner Network Television and other services), The Discovery Channel, Lifetime and Black Entertainment Television. *See id.*

procompetitive. Exclusivity rules in networks can provide many competitive benefits, especially in terms of promoting network competition, encouraging promotional services by preventing free-riding, reducing supply and demand uncertainty, and recovering network investments.

1. Promoting Network Competition

Network exclusivity rules can be procompetitive, particularly where there is network competition. In 1980, Mastercard's exclusivity rule for its Canadian licensees was challenged in *National Bank of Canada v. Interbank Card Ass'n*.[49] Mastercard (Interbank) was a late entrant into the Canadian credit card scene and, like VISA, had an exclusivity rule for its Canadian members. When a Mastercard bank merged with a VISA bank, Mastercard invoked the rule and gave the bank a choice: either withdraw from VISA or cease being a member of Mastercard. Mastercard subsequently terminated the bank from its network and this litigation followed.

The district court upheld the exclusivity rule, focusing extensively on the efficiency rationale for restricting membership. The rule was adopted when Mastercard entered the market. The exclusivity rule was necessary to protect the original members' start-up costs in the venture and was for a limited period of time (i.e., eight years based on anticipated recovery of start-up costs). Moreover, the court noted that the "underlying purpose of the exclusivity provision was to enhance competition in the Canadian credit card market by introducing a new product, Master Charge [Mastercard]."[50] Thus, in Canada, unlike in the United States, membership in Mastercard and VISA has remained quite distinct. Because of the distinct membership, competition between Mastercard and VISA, at the network level, is far more vibrant in Canada than in the United States.[51]

---

49 507 F. Supp. 1113 (S.D.N.Y. 1980), *aff'd*, 666 F.2d 6 (2d Cir. 1981).

50 *Id.* at 1123. The Second Circuit affirmed the district court opinion in part on the merits and in part on grounds that appellant failed to demonstrate a link between the behavior complained of and anticompetitive consequences to United States commerce. *See* National Bank of Canada v. Interbank Card Ass'n, 666 F.2d 6 (2d Cir. 1981).

51 *See* Baker, *supra* note 2, at 1065-68 (describing how credit card competition is more aggressive in Canada than in the United States); *see also* David A. Balto, *The Next Antitrust Challenge for Payment Systems: Does Duality Harm Competition?*, 49 CONSUMER FIN. L.Q. REP. 98 (1995); *Why are Those Canadian Issuers Smiling?*, CREDIT CARD MGT., Dec. 1991, at 26. In October 1998, the Justice Department filed suit against VISA and Mastercard charging that duality was an unlawful restraint of trade. *See* Complaint for Equitable Relief for Violations of 15 U.S.C. § 1, United States v. Visa U.S.A., Inc. (S.D.N.Y. Oct. 7, 1998) (No. 98-civ.7076), *available at* <http://www.usdoj.gov/atr/cases/indx57.htm> (visited Mar. 5, 1999).

Another environment where network exclusivity appears to have enhanced competition is point of sale (POS) debit. There, because of an antitrust challenge by a group of state attorneys general, there are two exclusive national POS networks: Maestro and Interlink. *See* New York v. VISA U.S.A., Inc., 1990-1 Trade Cas. (CCH) ¶ 69,016 (S.D.N.Y. 1990). Because of the exclusivity arrangements, both networks compete aggressively for bank members, leading to improvements in network competition. *See VISA's Dominance Seems a Debit-Card Liability*, WALL ST. J., June 6, 1996, at B1 (describ-

As *National Bank of Canada* illustrates, exclusivity may serve an important role in ensuring that a network's members dedicate their undivided efforts to the promotion of the network.[52] Where there is multiple network membership, it may be difficult for an individual network to enlist a network member to promote the network's product aggressively. The problem of divided member loyalties may be particularly important for a new network entrant. It may also be important if an incumbent network attempts to differentiate itself from competing networks. Thus, exclusivity can play an important role in stimulating the activities of the members of the network.

The problem of divided loyalties, however, may not justify an absolute exclusivity provision, especially one imposed by a dominant network. For example, the National Football League ("NFL") had a rule that prevented owners of NFL franchises from owning other sports franchises. The NFL claimed the rule was necessary to ensure the undivided loyalty of the owners in competing against other sports leagues. The North American Soccer League challenged the NFL rule claiming, in part, that the ban on cross-ownership deterred the development and growth of alternative leagues.[53] The U.S. Court of Appeals for the Second Circuit struck down the rule because: (1) the NFL had grown in spite of a history of cross-ownership; and (2) to the extent there were concerns about divided loyalties, these could be addressed by more limited restrictions, such as an information firewall, or restricting the participation of owners of competing franchisees in league affairs.

Like the district court in *National Bank of Canada*, the Second Circuit observed that an exclusivity rule could be justified if used by a new entrant, or a competitor of a dominant firm: "circumstances could exist that might justify a ban by a weak league as necessary to protect it against seri-

---

ing how banks play off VISA and Mastercard in the POS market); David A. Balto, *Can the Promise of Debit Cards Be Fulfilled?*, 53 BUS. LAW. 1093 (May 1998).

For a general discussion of the history and effect of exclusivity rules by payment system joint ventures, see David A. Balto, *Banking Networks and Exclusivity: The Next Antitrust Challenge*, 19 J. RETAIL BANKING SERVICES 41 (1997).

52 As the INTELLECTUAL PROPERTY GUIDELINES recognize in an analogous context, a technology licensing arrangement that "prevents the licensee from dealing in other technologies may encourage the licensee to develop and market the licensed technology or specialized applications of that technology." U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 4.1.2 example 8 (1995), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,132, at 20,742-43 (Apr. 6, 1995) [hereinafter INTELLECTUAL PROPERTY GUIDELINES]. Similarly, statement 8 of the Health Care Guidelines, observes that exclusivity can be procompetitive "in some circumstances [since it] may help a network serve its subscribers and increase its physician participants' incentives to further the interests of the network." 1996 HEALTH CARE GUIDELINES stmt. 8.B.2 step 2, *supra* note 33, at 20,819; *see also* Richard M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101, 124-27 (1983) [hereinafter Steuer] (discussing the procompetitive effects of limiting distributors to a single brand or avoiding problem of divided loyalties).

53 *See* North Am. Soccer League v. NFL, 670 F.2d 1249, 1261 (2d Cir. 1982).

ous competitive harm by a cross-owner who threatened to misuse his position in that league to favor a stronger competing league."[54]

2. Encouraging Promotional Services by Preventing Free-riding

Exclusive dealing may also give networks an incentive to provide promotional services to dealers by preventing them from using promotional facilities provided by one network to promote competing networks' products.[55] With exclusive dealing, networks may provide financing, sales promotion materials, and other aids to increase dealer sales, knowing that the increased sales will accrue to themselves. Networks are more likely to provide these output-enhancing services if other suppliers cannot easily benefit from them.[56]

For example, assume one network invests heavily in advertisement and other product promotion. Another network does very little promotion, but instead offers its dealers a higher commission. In this setting, there may be an opportunity for the dealer to "bait and switch": Take the customer of the heavy promotion network and send the customer's transaction on the higher commission network. Courts have upheld exclusivity rules that have addressed this form of free-riding.[57] Because of the threat of free-riding, networks may be inhibited from investing in differentiation, because those investments may be misappropriated by members participating in competing networks. Thus, exclusivity arrangements can actually enhance the opportunities for network competition.

Interstate van line networks grappled with this free-riding dilemma in *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*[58] *Rothery* involved rules which required that any Atlas Van Lines order received by one of its carrier agents be transported under the operating authority of Atlas.[59] Interstate van lines employ independent moving companies as carrier agents throughout the country. These carrier agents execute a contract with the van line agreeing to adhere to standard operating procedures and uniform rates. Interstate van lines provide, among other things, equipment, facilities, training, and a clearinghouse for settlement of accounts among its

---

54 *Id.* at 1258.

55 *See* Howard P. Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1, 6 (1982); *see also* Steuer, *supra* note 52, at 124-29.

56 Another potential procompetitive purpose for exclusive dealing is the protection of trade secrets. *See* Steuer, *supra*, note 52, at 130-32. Trade secrets provided to dealers are easier to safeguard if the dealers do not also service other suppliers. A supplier's ownership interest in a trademark may also be easier to protect if dealers do not also advertise competing trademarks. *See id.*

57 *See, e.g.*, American Floral Servs., Inc. v. Florists' Transworld Delivery Ass'n, 633 F. Supp. 201 (N.D. Ill. 1986) (upholding pirate order rules that prevented florists from free-riding on promotional investments of florist networks).

58 792 F.2d 210 (D.C. Cir. 1986).

59 *Id.* at 213.

agents. As important, the van line engages in national advertising that may be vital in bringing the consumer to the agent.

The partial deregulation of the moving industry in 1979 made it easier for the carrier agents to obtain their own interstate authority and compete against the van lines through their own operations. Thus, the agents could offer consumers lower-priced service through their own service to consumers who were attracted to the agent because of the van line's advertising. In this way, the carrier agents could free-ride on the efforts of the van line, while cutting prices to attract business that otherwise would have gone to the van line.

In response to this threat, Atlas imposed a rule that required its carrier agents, if they chose to take their own orders, to do so only through a separately owned enterprise using its own operating authority; the new entity could not use the facilities or services of Atlas, nor could it use the Atlas name. The plaintiffs charged that this rule constituted a *per se* unlawful group boycott.[60]

The U.S. Court of Appeals for the D.C. Circuit upheld the restraint. The court, in an opinion by Judge Robert Bork, relied heavily on the procompetitive aspect of the restraint, which addressed the free-riding problem. Atlas provided a wide range of other services for its carrier agents, including a clearinghouse, training, sales programs, and screening of affiliated firms that provided origin and destination services. Rothery benefited from its association with Atlas in dealing with customers for its own profit. Indeed, Rothery conceded at trial that it benefited from association with Atlas' "national image."[61]

The D.C. Circuit acknowledged the effect of free-riding:

> To the degree that a carrier uses Atlas' reputation, equipment, facilities, and services in conducting business for its own profit, the agent enjoys a free ride at Atlas' expense. The problem is that the van line's incentive to spend for reputation, equipment, facilities, and services declines as it receives less of the benefit from them.[62]

Thus, absent the separate facility restrictions, Atlas' incentives to invest in the network would have deteriorated. The court suggested that, in response to such deterioration, the network could collapse or Atlas might choose to eliminate agents altogether and vertically integrate. With these restrictions in place, Atlas retained the incentives to invest and "provide services at optimal levels, confident that it will be paid for those services."[63]

Atlas' exclusivity policy was notable for its limited scope. Rather than imposing an absolute ban on activity outside the network, Atlas sim-

---

60 *See id.*

61 *Id.* at 221.

62 *Id.*

63 *Id.* at 223.

ply required agents to use a separate facility. Although this may seem like needless duplication, the rule protected the incentives of Atlas' members to engage in network promotion.

3. Reducing Supply and Demand Uncertainty

Exclusivity arrangements may also facilitate distribution of the network's product through its dealers. A network may be faced with an uncertain downstream market. Exclusive dealing permits a network and its dealers to share the risk of demand uncertainty, by providing networks with an ensured outlet in which their product will be vigorously promoted and by providing dealers with an ensured source of supply. Long-term, flexible contracts can minimize the risks for both the network and its members in dealing with these uncertainties. For example, a gasoline refiner may use exclusivity agreements with its dealers to overcome the uncertain demand of gasoline markets.[64]

In *Standard Oil Co. v. United States*,[65] an older case on exclusive dealing contracts, the Supreme Court described a number of ways in which exclusive dealing facilitates distribution and minimizes costs and risks. The Court stated that exclusive dealing contracts

> may well be of economic advantage to buyers as well as to sellers, and thus indirectly of advantage to the consuming public. In the case of the buyer, they may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand. From the seller's point of view, [they] may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and . . . offer the possibility of a predictable market.[66]

An example of this in the joint venture context is provided by *Sewell Plastics, Inc. v. Coca-Cola Co.*[67] In *Sewell Plastics*, a group of Coca-Cola bottlers in the southeastern United States formed a joint venture to manufacture plastic bottles. All of the venture members signed supply contracts under which they agreed to purchase 80% of their bottle requirements from the venture for five years. The court held that the exclusivity contracts were a reasonably justified means of ensuring sufficient demand to get the venture off the ground.[68]

---

64 *See generally* 11 HOVENKAMP, *supra* note 23, ¶ 1811, at 121-30.

65 *See* Standard Oil Co. v. United States, 337 U.S. 293, 306-07 (1949).

66 *Id.* at 306-07 (citations omitted). In *Standard Oil*, the Court found that Standard Oil's practice of requiring gas stations to deal exclusively with it created "such a potential clog on competition" that it violated Section 3 of the Clayton Act. *Id.* at 314.

67 720 F. Supp. 1196, 1218-20 (W.D.N.C. 1989), *aff'd in part, remanded in part*, 912 F.2d 463 (4th Cir. 1990).

68 The venture was further protected by a most favored nations provision that gave the venture the opportunity to meet any better price a member might receive from a competing bottler. The court

4. Recovering Network Investments

Networks often involve significant up-front costs for research and development or network facilities. Networks may be unable to make these investments without some level of ensured demand. Exclusivity agreements may facilitate these investments and the creation of network facilities, because demand uncertainties are reduced. As Gregg Frasco explains:

> Exclusive dealing is sometimes needed to ensure that the benefits generated by a capital investment in a particular brand of a product accrue to the party making that investment. In the absence of exclusive dealing, competing brands can free-ride on certain types of capital investments and thereby reduce or destroy the incentive to make such investments. Both consumer welfare and competitive processes can thereby be harmed.[69]

A non-network example provides a useful illustration. In the 1920s, GM entered into a long-term exclusive dealing arrangement with Fisher Body. The contracts were necessary to provide incentives for Fisher to make large, specialized investments in a plant and equipment. With these agreements in place, Fisher could be confident that it could recover these investments.[70]

Moreover, exclusivity arrangements may actually stimulate the network to invest in product differentiation, product improvement, and innovation.[71] Where a network "shares" dealers with other networks, the incentive to engage in differentiation may be dampened, absent some form of exclusivity.

Finally, as described below, where substantial network competition exists, or where the exclusivity arrangements are of short duration, it is unlikely that an exclusivity rule poses much of a competitive risk. Where market power is absent, alternative networks should be able to find sufficient distribution outlets to provide a competitive alternative.

---

found the provision justified since "there was no significantly less restrictive means available to protect [the venture] from the perceived and ultimately actual threat of selective pricing to key member bottlers by a single established supplier such as Sewell in order to prevent the formation or disrupt the operation of [the venture]." *Id.* at 1219; *see also* Belcher Oil Co. v. Florida Fuels, Inc., 1991-1 Trade Cas. (CCH) ¶ 69,375 (S.D. Fla. 1990) (upholding exclusive collective buying arrangement that ensured survival of new entrant in upstream market).

69 GREGG FRASCO, EXCLUSIVE DEALING: A COMPREHENSIVE CASE STUDY 4 (1991).

70 *See* Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited*, 4 J.L. ECON. & ORG. 199 (1988); *see also* United States v. General Dynamics Corp., 415 U.S. 486 (1974) (noting that long term exclusive contractual commitments necessary for coal producers to invest in new mining capacity and were required to obtain financing).

71 *See* Steuer, *supra* note 52, at 127-30; Howard Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982) (describing how exclusive dealing permits the supplier to provide greater support to its dealers, safe in the knowledge that those dealers will not be using the support to sell someone else's products).

II. ANTITRUST ENFORCEMENT AND NETWORK EXCLUSIVITY

Unfortunately, antitrust enforcers, regulators, and the courts have not always been able to fully appreciate the competitive concerns from exclusivity. Too often the antitrust telescope has failed to focus accurately or in a timely manner on the potential anticompetitive risks of exclusivity. Sometimes, efforts to remedy exclusivity have solved only part of the problem. Here are three examples.

A. *Missing the Boat: Consumer Wire Transfer Networks*

Consumer wire money transfers are one-way transfers, typically between two consumers. Consumer wire money transfer networks are similar to ATM networks in structure. The network consists of a computer switch, operating rules, a system to settle payments, and a network mark.[72] The network enters into arrangements with "wire transfer agents," which include a wide variety of retail outlets including grocery stores and check cashing outlets.

Until 1979, Western Union was a regulated monopolist in the wire transfer market. At that time, the Federal Communications Commission ("FCC") deregulated Western Union based on the expectation that technological advancement had reduced the barriers to entry. The Commission stated: "We are confident that the public will be served by allowing multiple entry in these markets."[73] Those expectations were overly optimistic, and entry was neither easy nor timely. One important element overlooked by the FCC was long-term exclusivity arrangements between Western Union and its agents.

In the mid-1980s, Citibank attempted to enter the wire transfer market, but entry was stifled by Citibank's inability to: (1) develop a minimum viable scale nationwide network of money transfer agents; and (2) establish name recognition and customer acceptance of its services through large-scale advertising and promotion. Long-term exclusive agent contracts utilized by Western Union made acquiring a sufficient agent network difficult. To build brand name recognition, substantial investment would be required over a number of years. Citibank's attempted entry failed after several years of significant losses.[74]

Successful entry finally occurred in the late 1980s, however, when MoneyGram, which was originally owned by American Express, was able

---

72 Approximately 20-25% of consumer wire money transfer users do not have banking relationships. For those consumers with limited or nonexistent banking relationships consumer money transfers offer the only means to transfer money quickly from one person to another.

73 *See* Graphnet Sys., Inc., 71 F.C.C.2d 471, 515 (1979).

74 *See* Jeffrey Kutler, *Citicorp Express and Western Union Escalate War of the Wires*, AM. BANKER, Nov. 18, 1987, at 6.

to overcome these barriers. MoneyGram had a unique advantage because it could rely on the American Express travel offices and its network of money order agents for a base of agents. In addition, MoneyGram could rely on a valuable trade name, American Express.[75] Even then, entry was both difficult and costly. After several years of losses, MoneyGram overcame the barriers to entry and introduced competition into an environment in which a monopolist had dictated annual price increases.[76] MoneyGram ultimately secured about a 10% market share.

Even though MoneyGram appears to have successfully overcome the barriers to entry, exclusivity provisions have remained the norm. Other potential network entrants have complained about the effect of these exclusivity provisions on their ability to enter this market.[77]

There are two lessons from the example of consumer money wire transfer services. First, a competitive market will not necessarily arise simply because technological barriers have fallen. Here, both name recognition and a minimum viable scale of agents remained as critical barriers. Second, even though entry into the downstream market (wire transfer agents) may have seemed simple, assembling a minimum viable scale network of agents with adequate coverage was not. Had these exclusivity provisions been effectively addressed when Western Union was deregulated, more vigorous network competition, like that in the floral services market, may have arisen.

B. *Enforcement-But Too Late*

When ATM networks were created, they generally adopted similar organizational structures. They were non-profit joint ventures, which permitted their members to belong to other networks. In part, that structure was used to avoid antitrust risks: It was believed that a non-profit, broad membership structure would inhibit the incentives to exercise market power.[78] Non-exclusivity was perceived as important because the more networks that an ATM is connected to, the more valuable it appears to consumers. Moreover, nonexclusivity lowered barriers to entry and fostered the development of rival networks.

---

75 American Express, which had launched Money Order sales in 1882, already had a large base of agents for its money order product.

76 When MoneyGram entered, it priced domestic transfers with a value of $300 or less at $9; at the time Western Union priced these transfers at between $13 to $29. Western Union brought an antitrust suit charging that MoneyGram's pricing was predatory. The suit was unsuccessful. *See* Western Union Fin. Servs. v. First Data Corp., 25 Cal. Rptr. 2d 341 (Cal. Ct. App. 1993).

For a more extensive discussion of the competitive impact of MoneyGram's entry see David A. Balto, *Payment Systems and Antitrust: Can the Opportunities for Network Competition be Recognized?*, FED. RESERVE BANK OF ST. LOUIS REV., Nov./Dec. 1995, at 19.

77 *See* Petition of Orlanda Valuti, First Data Corp., 60 Fed. Reg. 52,188 (F.T.C. 1995).

78 *See* Rule, *supra* note 29, § 25.03.

One network, the MAC network in Pennsylvania, adopted a distinctly different structure from the other networks.[79] It is a for profit network with limited ownership. The network entered into vertical arrangements with its member banks, licensing its trademark and services. Unlike most of the other ATM networks, it prohibited its bank members from belonging to other ATM networks. The exclusivity provision had a three-year duration and could be terminated only upon 180 days notice. During the infancy of the network, this rule was probably procompetitive because it gave the network an additional incentive to engage in promotion. In addition, because exclusivity eliminated the threat of free-riding, it encouraged MAC to invest in product differentiation.

Competitive problems arose when the MAC network began acquiring neighboring networks in the mid-Atlantic states, creating and then enhancing its monopoly position. The enforcement agencies (the Federal Reserve Board and the DOJ Antitrust Division) silently acquiesced in the formation and growth of the monopoly. In 1988, a competing network, The Treasurer, challenged MAC's acquisition of the Cashstream network and claimed that MAC's exclusivity rule violated the antitrust laws. The district court rejected both challenges. As to MAC's exclusivity rules, the court held that the rules were permissible because they "were and are intended to structure . . . distribution of network services, to provide a return to [the network] for its prior and continuing activities in developing, maintaining and promoting the [ATM] network and to prevent free-riding by competitors on [the network's] efforts."[80] It also held that the rules were unlikely to result in any competitive harm because the banks could easily enter into alternative arrangements to create new networks. Finally, it noted that MAC faced competition from the national ATM networks, PLUS and CIRRUS.

The court's assessment of the lack of competitive harm was shortsighted. Once MAC acquired the remaining competing networks, it acquired a monopoly position in several mid-Atlantic states, and that position was solidified by the network's exclusivity rules. These rules created an almost impervious barrier to competitive entry, since if a bank wanted to join a competing network it would have to withdraw all of its ATMs from MAC. Since withdrawing from MAC would mean that a bank's cardholders would have access to relatively few ATMs in these states, few

---

79 MAC was originally formed and owned by Philadelphia National Bank. It is now owned by Electronic Payment Services (EPS), a joint venture of four bank holding companies: CoreStates Financial Corp., Banc One Corp., PNC Bank Corp., and Society Corp. The MAC network has approximately a 90% market share in Pennsylvania and a dominant position in adjacent mid-Atlantic states. The MAC network is the largest in the U.S. and with more than 13,000 ATMs, handles about 92 million transactions each month for 27 million cardholders.

80 The Treasurer, Inc. v. Philadelphia Nat'l Bank, 682 F. Supp. 269, 280 (D.N.J.), *aff'd mem.*, 853 F.2d 921 (3d Cir. 1988).

banks chose to align with competing networks. In turn, other neighboring networks, such as the NYCE network in New York, were unable to enter into MAC's area. Ultimately, MAC exercised its market power by charging its members supracompetitive fees.[81]

Ironically, MAC dropped its exclusivity rule not because of regulatory challenge, but because of competitive necessity in another market. MAC wanted to enter into the point-of-sale debit card market in the northeast U.S., where the NYCE network had used exclusivity rules. MAC challenged NYCE's exclusivity rules, and the two networks settled the dispute by agreeing to eliminate them on both networks.[82]

Even though the explicit ban no longer existed, MAC used other rules to create de facto exclusivity.[83] One rule required banks either to obtain ATM processing from MAC or to provide ATM processing in-house (which is prohibitively expensive for many smaller banks, thrifts, and credit unions). In effect, the rule required all but the largest bank members to obtain ATM processing from MAC. The rule also prohibited banks from using independent third party processors, such as EDS, to drive their ATMs. As the "operator" of the ATMs, MAC effectively determined whether a bank could connect with another network's ATMs. In practice, MAC rarely permitted such interconnection, at least to its strongest network competitors.[84]

In 1994, the Antitrust Division brought suit to challenge this rule, alleging that it effectively made it impossible for smaller banks to belong to rival networks while also belonging to MAC. The complaint alleged that by preventing banks from obtaining ATM processing from others, MAC effectively prevented these banks from participating in other ATM networks.[85] Moreover, MAC's rules made it substantially more difficult for other networks to enter into MAC's area of dominance, thereby excluding competitors and maintaining MAC's monopoly position. The case was settled with a consent decree that requires MAC to open its network to independent ATM processors on a non-discriminatory basis.[86]

Whether the decree adequately "solved" the competitive problem is an open question. The consent decree received a tremendous amount of adverse commentary; many competing networks stated that the proposed decree would permit MAC to achieve the same objective through a variety

---

81 *See* United States v. Electronic Payment Servs., Inc. 59 Fed. Reg. 24,711 (D. Del. 1994) (proposed final judgment and competitive impact statement), *and* 59 Fed. Reg. 44,757 (D. Del. 1994) (public comments and government response).

82 *See* BuyPass Corp. v. New York Switch Corp., No. 93-CV-3201 (E.D. Pa. filed June 15, 1993).

83 *See* Alexander Raskovich, Some Antitrust Issues in ATM Networks: Network Growth and Operating Rules, Remarks Before the ABA Antitrust Section (May 24, 1996).

84 *Electronic Payment Servs.*, 59 Fed. Reg. at 24,713.

85 *Id.* at 24,711.

86 *See id.*

of other types of exclusionary conduct.[87] For example, rather than attempting to collect monopoly profits through a switch fee, MAC can attempt to recover comparable profits through the use of a royalty fee. In addition, as described below, the Federal Reserve Board staff raised concerns over the sufficiency of the relief when it examined the EPS-National City Bank merger.[88]

The results of the decree have been mixed. On the one hand, new third-party processors have entered the market. Two years after the decree was entered, about 5% of MAC ATMs are operated by third-party processors who were excluded from the market prior to the decree.[89] On the other hand, there has been relatively little entry by competing regional networks. Consequently, MAC's monopoly position in the "branded regional ATM access" market seems secure.

One interesting aspect of the case is that the exclusivity rules did not create an absolute barrier to membership in alternative networks. In fact, the vast majority of MAC members belonged to the national ATM networks: PLUS and CIRRUS. However, the Antitrust Division found that this alternative distribution mechanism was distinctly inferior. In its Competitive Impact Statement, the Antitrust Division observed that these networks were "typically more expensive, and . . . provide[d] only a subset of the transactions available through regional ATM networks."[90]

The MAC case demonstrates the difficulty of intervening in a timely fashion. When MAC was created or entered new markets, the exclusivity provision may have been procompetitive because it ensured the commitment of the bank members to the promotion of the network. Once MAC acquired a dominant position, however, the exclusivity provision solidified and protected that dominance. The irony here is that had the courts and the antitrust enforcers more carefully scrutinized the impact of exclusivity, especially in the context of the acquisitions of other networks, the practice might have been prohibited earlier and MAC might never have acquired such a dominant position in the market. Thus, the Antitrust Division enforcement action might have been unnecessary.

C. *The Elusive Remedy: CRS Networks*

Computer reservations systems (CRS) enable travel agents to secure

---

87 *See Electronic Payment Servs.*, 59 Fed. Reg. at 44,757.

88 *See infra* notes 129-31 and accompanying text.

89 *Impact on Networks*, BANK NETWORK NEWS, Jan. 13, 1997, at 6. The *EPS* case may also be an example of where the remedy was insufficient to "kick start" the market and fully restore competition. *See* Salop & Romaine, *supra* note 6, at 667. Since the anticompetitive effects stemmed from permitting the network mergers which gave the MAC network its dominant position, perhaps the correct remedy would have been some form of structural relief such as breaking up the network.

90 *Electronic Payment Servs.*, 59 Fed. Reg. at 24,718.

current flight and fare information and book flights. All CRS networks are owned by the airlines, and the two dominant systems, Sabre (owned by American) and Apollo (owned by United), have over 77% of the market. These networks have had a dominant position for almost two decades, and the durability of their power is in part due to the effective use of exclusivity arrangements and the failure of the regulators and the courts to remedy these arrangements effectively.[91]

CRS networks emerged in the mid-1970s. At the time, they were regulated by the Civil Aeronautics Board. Consumers interact with CRS networks only through travel agents. Therefore, to solidify their market position the emerging CRS networks entered into exclusive dealing arrangements with travel agents. These arrangements were intended to recover certain fixed costs such as the initial investment in network facilities and the cost of providing a computer to the agent.[92]

CRS networks became something of a regulatory boondoggle, as the Department of Transportation (DOT) proposed revised regulations three times in a decade: in 1983, 1989, and 1991. One issue in each proceeding was the exclusivity rules of the dominant networks, which were perceived as abusive practices because they left an inadequate number of remaining agents for smaller networks to compete effectively. In 1984, the DOT attempted to solve the competitive problem by limiting the duration of the contracts to five years.[93]

The DOT did not bargain on the ability of the dominant CRS networks to impose de facto exclusive arrangements through penalty contractual arrangements, however. While United's and American's leases were written for five years, almost none actually expired at the end of that period. The airlines imposed a stiff liquidated damage provision, that required the agent to pay 80% of the remaining rental payments and lost booking fees if it terminated the contract early. Both airlines constantly solicited agents to renew their contracts prior to their expiration. Moreover, the airlines required the agents to sign a new five-year contract whenever installing or replacing a new piece of equipment.[94]

Travel agents and the smaller airlines challenged these restrictive lease practices both in court and before the DOT.[95] The courts rejected these claims, holding that the CRS networks lacked monopoly power and

---

91 *See* Marj P. Leaming, *Enlightened Regulation of Computerized Reservations Systems Requires a Conscious Balance Between Consumer Protection and Profitable Airline Marketing*, 21 TRANSP. L.J. 469 (1993).

92 Computer Reservation System (CRS) Regulations, 57 Fed. Reg. 43,780, 43,780-837 (Dep't Transportation 1992) (final rule).

93 *See id.* at 43,780, 43,822.

94 *See id.* at 43,822.

95 *See* United Air Lines, Inc. v. Austin Travel Corp., 867 F.2d 737 (2d Cir. 1989).

the contractual practices at issue were not penalties.[96] Yet a strong case can be made that the courts' analyses were short-sighted.[97]

Eventually the travel agents and the small airlines were somewhat more successful. In 1992, as Congress appeared on the verge of enacting legislation to require divestiture of the CRS networks, the DOT finally acted. It amended its rules to limit the duration of contracts to three years and eliminate the stipulated damage provisions.[98]

Of course the CRS situation was the only one of these cases where the exclusivity provisions were actually regulated by an agency. The agency failed to perceive the entry-forestalling nature of the exclusive dealing contracts and the ability of the CRS networks to find innovative means to extend the exclusivity provisions. Moreover, although the agency understood the need to permit the networks to recover their up front costs, it was overly generous in permitting the networks to extend the period of exclusivity arrangements.

These examples suggest that antitrust enforcement has a mixed record in grappling with issues of exclusivity. Too often, enforcers have been willing to accept the appearance of a simple solution to a complex competitive problem. Yet in each of these examples, exclusivity enabled a network to exercise market power. Thus, antitrust enforcers and the courts must search for a more sophisticated approach for analyzing exclusivity in network settings.

III. STANDARDS FOR ANTITRUST ANALYSIS OF EXCLUSIVITY

Few, if any, antitrust decisions deal directly with network exclusivity. Exclusive dealing jurisprudence itself is somewhat dated. The last Supreme Court decision on this issue is over 30 years old.[99] In *Tampa Electric Co. v. Nashville Coal Co.*,[100] the Supreme Court articulated the modern structure of analysis of exclusive dealing arrangements by focusing on qualitative factors, beginning with a three-pronged inquiry. First, courts determine the relevant product market (i.e., the types of products or services involved) "on the basis of the facts peculiar to the case."[101] Second, courts define the relevant geographic market and evaluate the degree of

---

96 *See id.* at 742.

97 *See* Joseph F. Brodley & Ching-to Albert Ma, *Contract Penalties, Monopolization Strategies and Antitrust Policy*, 45 STAN. L. REV. 1161 (1993).

98 *See* Computer Reservation System (CRS) Regulations, 57 Fed. Reg. at 43,825.

99 Actually, the last case to discuss exclusive dealing was *Jefferson Parish Hops. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984), although the practice at issue was a tying arrangement.

100 365 U.S. 320 (1961). When the opinion was issued commentators recognized the difficulty of using it as a guide to exclusive dealing analysis. *See* Derek C. Bok, *The Tampa Electric Case and the Problem of Exclusive Dealing Agreements Under the Clayton Act*, 1961 SUP. CT. REV. 267, 283 ("[*Tampa Electric*'s] great weakness lies in its vagueness as a prescription for future cases.").

101 *Tampa Elec.*, 365 U.S. at 327.

foreclosure in terms of this market. Finally, courts determine whether the exclusive dealing contracts constitute a "substantial share" of the relevant market.[102]

In evaluating the "substantiality" of the market foreclosure in any given case, the Court reasoned:

> it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved . . . and the probable immediate and future effects which preemption of that share of the market might have on effective competition therein.[103]

The standard that has emerged, then, requires proof of substantial market foreclosure in addition to a demonstration of possible immediate and future effects on competition.[104] *Tampa Electric* further suggests that this analysis should be balanced against any possible efficiencies or competitive benefits that result from the exclusivity.[105]

Critics, however, have argued that this standard is overly vague. Ameliorating the problem somewhat, the Court in *Jefferson Parish Hospital District No. 2 v. Hyde*[106] provided additional guidance regarding the application of the standard outlined in *Tampa Electric*. In a concurring opinion authored by Justice O'Connor, the Court noted specific factors that should be examined in determining whether the agreements foreclose "a substantial share of the line of commerce affected" so as to effectively lessen competition.

> [E] xclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal. When the sellers of services are numerous and mobile, and the number of buyers is large, exclusive-dealing arrangements of narrow scope pose no threat of adverse economic consequences. [107]

Justice O'Connor found that exclusive dealing arrangements involving 30% of the relevant line of commerce did not foreclose a significant fraction of the relevant market and therefore did not constitute an unreasonable restraint of trade.

Lower courts generally have followed the *Tampa Electric* approach, typically requiring proof of a significant impact on competition in the relevant market to establish the illegality of an exclusivity agreement. Once substantial foreclosure in the relevant market is found, courts will examine the additional factors articulated in the *Tampa Electric* opinion in evaluating possible anticompetitive effects. Courts have looked at numerous mar-

---

102 *Id.*

103 *Id.* at 329.

104 *See id.*; U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 597 (1st Cir. 1993).

105 *Tampa Elec.*, 365 U.S. at 334.

106 466 U.S. 2 (1984).

107 *Id.* at 45 (citations omitted).

ket conditions in applying the rule-of-reason analysis, but focused primarily on three factors emphasized in *Tampa Electric*: (1) the percentage of the market foreclosed; (2) the ease of entry into the foreclosed market; and (3) the duration and terminability of the exclusive contracts.[108]

The ultimate issue in an exclusivity case is the degree of foreclosure.[109] Although the courts have not articulated any consistent bright line tests, generally when the contracts at issue involve less than 30% of the market, no violation is found.[110] This result is based on the assumption that in such cases there should be more than adequate alternatives, in terms of either supply or distribution, for competitors. On the other hand, where a more substantial portion of the market is foreclosed by exclusivity agreements, courts have found that anticompetitive effects are likely. Specifically, the cases indicate that foreclosure may be sufficient when it is greater than 50%.[111]

The FTC opinion in *Beltone* described how exclusive dealing arrangements can erect barriers to entry: "We are concerned primarily with restraints that may increase the costs of entry and reduce opportunities for new entrants to distribute their products [or to obtain suppliers], making it more difficult to open up less-than-competitive markets."[112] The Commission analyzed ease of entry into the relevant market in *Beltone*: "[Other]

---

108 *See, e.g.*, *infra* notes 149-154 and accompanying text.

109 *See U.S. Healthcare*, 986 F.2d at 596 ("In any event, under *Tampa [Electric]* the ultimate issue in exclusivity cases remains the issue of foreclosure and its consequences."); Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1162 (9th Cir. 1997), *cert. denied*, 119 S.Ct. 46 (1998).

110 Historically, violations have not been found when less than 10% of the relevant market (either in terms of sales or outlets) has been foreclosed. *See, e.g.*, Satellite Television & Associated Resources, Inc. v. Continental Cablevision, 714 F.2d 351, 357 (4th Cir. 1983) (foreclosure of 8% of households); TAM, Inc. v. Gulf Oil Corp., 553 F. Supp. 499, 505-06 (E.D. Pa. 1983) (7% of sales; 5% of outlets); Beltone Elecs. Corp., 100 F.T.C. 68, 209-18 (1982) (foreclosure of 7-8% of dealers accounting for 16% of sales). *Cf.* 1985 VERTICAL RESTRAINTS GUIDELINES § 4.1, *supra* note 17, at 20,582 (no challenge to arrangements accounting for less than 10% of the market). While foreclosure of 10% to 30% of the market was in a gray area before *Jefferson Parish* (*see, e.g.*, Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291, 1301-02 (9th Cir. 1982) (long-term foreclosure of 24% of market unlawful)), the concurring opinion in *Jefferson Parish*, finding exclusive dealing lawful without detailed analysis when 30% of the market was foreclosed, may foretell higher market share thresholds as a prerequisite to finding exclusive dealing unlawful. *See, e.g.*, Gonzales v. Insignares, 1985-2 Trade Cas. (CCH) ¶ 66,701, at 63,335 (N.D. Ga. 1985) (summary judgment for defendant; only 40% of consumers affected). *Cf.* Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1233 (8th Cir. 1987) (rejecting purely quantitative test and applying test "which takes into account not only the market share of the firm but the dynamic nature of the market in which the foreclosure occurs," and finding foreclosure insubstantial).

111 *See, e.g.*, United States v. Dairymen, Inc., 758 F.2d 654 (6th Cir. 1985) (finding 40% foreclosure sufficient to impose liability); *see also* United States v. Microsoft Corp., 1998 U.S. Dist. LEXIS 14231, at *61 (D.D.C. Sept. 14, 1998) (suggesting 40% may be sufficient); Oltz v. St. Peter's Community Hosp., 656 F. Supp. 760, 763 (D. Mont. 1987) (84% sufficient), *aff'd*, 861 F.2d 1440 (9th Cir. 1988); Kuhler Co. v. Briggs & Stratton Corp., 1986-1 Trade Cas. (CCH) ¶ 67,047, at 62,416 (E.D. Wis. 1986) (62% sufficient); *cf.* Servicetrends v. Siemens Med. Sys., 870 F. Supp. 1042, 1065 (N.D. Ga. 1994) (32-38% market foreclosure not per se legal).

112 Belltone Elecs. Corp., 100 F.T.C. 68 (1982).

firms have recently entered the market or grown vigorously, in part at the expense of the older firms. The new entrants have experienced little difficulty in finding [suppliers or] distributors."[113]

The duration of the contracts is another important factor in assessing the foreclosure effects of exclusivity. Exclusivity contracts with short terms and specific provisions for short notice of termination generally are presumed to be lawful.[114] Where contracts are either short-term or terminable on short notice, vigorous competition for the contracts emerges when contracts expire and terms must be renegotiated. If buyers are able to turn to alternative suppliers within a short period of time, sellers are less likely to use exclusive dealing contracts to raise prices. Longer contracts are more likely to tie up the market for unreasonable periods, making it difficult for actual or potential competitors to secure the suppliers needed to compete effectively.[115]

The Justice Department has identified the potential dangers of long-term exclusive contracts:

> In general, the longer the term of a vertical restraint (especially if such a term cannot be justified by the need to encourage investment) the more likely it is that the restraint is exclusionary . . . . [A]n exclusionary effect is more likely where large suppliers' [or distributors'] exclusive dealing contracts have very long terms and assess major financial penalties against dealers who change suppliers [or distributors].[116]

No standard rule dictates how long a contract term may endure legally or how long a termination requirement is permissible; instead, courts examine

---

113 *Id.* at 210. *See also* Willard K. Tom, Deputy Director, FTC, Anticompetitive Aspects of Exclusive Dealing and Related Practices, before the American Bar Ass'n, Antitrust Section (Apr. 15, 1999).

114 *See Omega*, 127 F.3d at 1163-64; Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 395 (7th Cir. 1984) (noting that contracts terminable in less than one year are presumed to be lawful); *see also* HOVENKAMP, *supra* note 38, at 390-91 ("[A] market saturated with exclusive dealing contracts could be fiercely competitive, if the contracts were for short term and the parties bid vigorously for the contracts themselves.").

115 *See Twin City Sportservice*, 676 F.2d at 1304. There the court found that the magnitude and considerable length of the defendants' exclusive contracts had a detrimental effect on competition: "They have locked up a large portion of the concession franchise market for many years, placing a significant amount of potential concession business beyond the grasp of any competitors." *Id.* The court further noted that the length of the contracts was unnecessary to recapture investments made in the contracts. *See* L. G. Balfour Co. v. FTC, 442 F.2d 1, 23 (7th Cir. 1971) (upholding the Federal Trade Commission's order invalidating 3-year exclusive dealing contracts with high schools as anticompetitive and unfair methods of competition); Great Lakes Carbon Corp., 82 F.T.C. 1529, 1668-69 (1973) (invalidating exclusive output contracts of seven to twenty year duration in the petroleum coke industry where plants in the industry recovered their costs within a five year period; five-year exclusive output contracts would be permissible for new facilities and three-year exclusive output contracts would be permissible for existing facilities).

116 1985 VERTICAL RESTRAINTS GUIDELINES § 4.223, *supra* note 17, at 20,586; *see also* U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 (1st Cir. 1993) (recognizing that even a contract terminable on 30 days notice may have anticompetitive effects if a reimbursement penalty were imposed on doctors who moved from exclusive to nonexclusive status).

the surrounding business environment and, consequently, the actual effect the contracts have on competition.[117] "It is the totality of reasons for such a term, and its actual impact on competition, that are decisive."[118] Conversely, the longer the term of an exclusive contract, the more closely courts and law enforcement agencies should scrutinize it.[119] Another important factor is whether the exclusive agreements have staggered expiration dates. If all contracts expired simultaneously it might be conceivable to organize a mass defection from the incumbent network. That becomes an appreciably more difficult task where contract expirations are staggered.[120]

Terminability of contracts is also a factor in evaluating the reasonableness of exclusive dealing arrangements. Theoretically, contracts that are easily terminated present less of a threat to effective competition. Some courts have found exclusive contracts terminable in less than a year to be presumptively lawful.[121] In a recent exclusive distribution case, Judge Easterbrook explained the impact of a short duration on exclusivity:

> [W]ith year-long contracts, the entire market is up for grabs. A new entrant can sell to a twelfth of the [market] in the first month, a sixth of [the market] by the end of the second month, and so on; competition for the contract makes it possible to have the benefits of exclusivity and rivalry simultaneously.[122]

---

117 The shorter the agreement is, the less likely it is to be found unlawful. *Compare Twin City Sportservice*, 676 F.2d at 1307-08 (contracts in excess of 10 years invalid), *and Great Lakes Carbon*, 82 F.T.C. at 1668-69 (7 to 20 years unjustified), *with* Thompson Everitt, Inc. v. National Cable Advert., L.P., 57 F.3d 1317, 1324-25 (4th Cir. 1995) (upholding one year exclusivity contract), Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 237-38 (1st Cir. 1983) (two-year effective limit upheld), United States v. Charles Pfizer & Co., 246 F. Supp. 464, 470-71 (E.D.N.Y. 1965) (one year upheld), *and* 1985 VERTICAL RESTRAINTS GUIDELINES § 4.223, *supra* note 17, at 20,585-86 (one-year arrangements unlikely to exclude competitors from market).

118 Tri-State Rubbish, Inc. v. Waste Management, Inc., 998 F.2d 1073, 1080 (1st Cir. 1993).

119 Recent Antitrust Division enforcement actions have resulted in consent decrees that permit exclusive dealing arrangements of exclusive contracts of one or two year duration. *See* Mary Lou Steptoe & Donna L. Wilson, *Developments in Exclusive Dealing*, ANTITRUST, Summer 1996, at 25, 27.

120 *See* Salop & Romaine *supra* note 6, at 638, n. 58.

121 Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 394-95 (7th Cir. 1984) (agreements terminable in less than a year "presumptively lawful"); *see* Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1163 (9th Cir. 1997) (finding agreements' short duration and easy terminability to "negate substantially their potential to foreclose competition"), *cert. denied*, 119 S.Ct. 46 (1998); Satellite Fin. Planning v. First Nat'l Bank, 633 F. Supp. 386, 397 (D. Del. 1986) (exclusive dealing contract terminable upon 180 days' notice); Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403, 412 (5th Cir. 1962) (upholding restrictive contract terminable without cause upon six months' notice); Beltone Elecs. Corp., 100 F.T.C. 68, 210 (1982) (dealer could terminate on 30-days notice). *But see* United States v. Dairymen, Inc., 1983-2 Trade Cas. (CCH) ¶¶ 65,651 & 65,704 (W.D. Ky. 1983) (requirements contracts covering large percentage of market enjoined even though 30 days to 1 year in duration), *aff'd*, 750 F.2d 654 (6th Cir. 1985); *see also* 11 HOVENKAMP, *supra* note 23, ¶ 1821d3, at 167-68.

122 Paddock Publications, Inc. v. Chicago Tribune Co., 103 F.3d 42, 47 (7th Cir. 1996). This analysis may be misplaced in network markets. As Salop explains, once a network monopoly is in

In *Microsoft*, the consent decree limited the duration of Microsoft's license agreements with OEMs to one year, and OEMs had the option to renew a license for another year on the same terms.[123] This restriction was designed to:

> ensure that vendors of competing operating systems will have regular and frequent opportunities to attempt to market their products to OEMs. Absent such opportunities, Microsoft's competitors might be unable to reach the level of market penetration needed for profitable operation in a reasonable period of time, even if they are offering products that are deemed superior by those customers who have an opportunity to buy them.[124]

Even the possibility of termination with short notice may not reverse anticompetitive results in the market, however.[125] In *U.S. Healthcare*, the First Circuit noted that even a thirty-day terminability clause could have the effect of frustrating a competitor's efforts to have access to the services of doctors that are essential to the function of the competitor's business.[126]

IV. ADAPTING THE ANTITRUST ANALYSIS OF NETWORK EXCLUSIVITY

As the preceding examples suggest, analysis of network exclusivity under the usual antitrust analytical model may often fall short of the mark. In order to gauge more carefully the competitive effects of network exclusivity, there are four issues that need further consideration: (1) market definition, (2) market power, (3) the role of de facto exclusivity, and (4) free-riding.

A. *Careful Scrutiny of Market Definition*

Antitrust analysis typically begins with defining the relevant product and geographic markets. Network industries often pose difficult questions of relevant market definition. One of the most complex is differentiating between the technological aspects of the network and the value of network relationships.

ATM networks illustrate the importance of this issue. To oversimplify, there are several aspects to an ATM network: a set of rules, a network mark, and a network computer switch. In the case involving the

---

place it will be difficult to dislodge. Consumer expectations reinforce the strength of the network monopoly. Thus, "[b]idding for the exclusives will not take place on a level playing field." Salop & Romaine *supra* note 6, at 637.

123 *See* United States v. Microsoft Corp., 1995-2 Trade Cas. (CCH) ¶ 71,096 (D.D.C. 1995).

124 *Id.* at 42,851.

125 *See* U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 (1st Cir. 1993).

126 *See id.* at 596. The Antitrust Division has challenged exclusive dealing arrangements even where there were relatively short termination provisions. United States v. Topa Equities, (V.I.), Ltd., 59 Fed. Reg. 67,728 (D.V.I. 1994) (30-day notice of termination); United States v. Greyhound Lines, Inc., 60 Fed. Reg. 53,202 (D.D.C. 1995) (30 day notice of termination).

MAC network discussed earlier,[127] one network challenged the exclusivity rules of the dominant ATM network. The district court rejected the claim largely on its analysis of relevant market, which it defined as "electronic data processing to all ATMs *plus* all of those institutions which have unaffiliated ATM systems and those institutions which do not currently have ATMs but have the capacity to install them and utilize market technology to its fullest."[128] In other words, the market included all firms capable of performing the electronic communication function performed by an ATM network. Since that definition included numerous providers of computer services, the competitive effect of the exclusivity seemed inconsequential.

In more recent cases, including the Antitrust Division's enforcement action in EPS,[129] there has been greater attention to the value of the network mark or network relationships in defining the relevant market. In a recent ATM merger, the Federal Reserve Board looked at the impact of network competition by defining three markets: (1) network access (access to an ATM network identified by a common trademark or logo displayed on ATMs and ATM cards); (2) network services (the switching functions for the network); and (3) ATM processing (the data processing and telecommunications facilities used to operate, monitor, and support a bank's ATMs).[130]

This more precise market definition provides a better tool for analyzing the effect of exclusivity. Under the definition of the district court in the MAC case, the exclusivity arrangements would seem to have a marginal competitive effect since banks would have numerous alternatives for processing transactions. But a network consists of more than just the back room processing. A bank needs more than transaction processing; it requires access to a large number of alternative ATMs and a network mark to identify that access. If the court had used the more precise market definition, the exclusivity arrangements would have probably faced condemnation.

---

127 The Treasurer, Inc. v. Philadelphia Nat'l Bank, 682 F. Supp. 269 (D.N.J.), *aff'd mem.*, 853 F.2d 921 (3d Cir. 1988); *see also infra* notes 79-81 and accompanying text.

128 *Treasurer*, 682 F. Supp. at 279.

129 *See* United States v. Electronic Payment Servs., Inc. 59 Fed. Reg. 24,711 (D. Del. 1994) (proposed final judgment and competitive impact statement), *and* 59 Fed. Reg. 44,757 (D. Del. 1994) (public comments and government response).

130 Banc One Corp., 81 FED. RESERVE BULL. 491, 494 (1995). According to the Board, *network access* includes: (1) the right to "brand" ATMs and ATM cards with the trademark or logo of the ATM network; (2) the ability of the ATM cardholder with an account at one member depository institution to initiate withdrawal and other account transactions at an ATM owned by another depository institution that is a member of the same network; and (3) minimum standards for network performance and products offered through the network. *See id.* at 494.

Similarly, the Board defined *network services* as including the switching functions performed by the ATM switch and gateway services with other networks. Finally, the Board defined *ATM processing* as including the provision of terminal driving, transaction routing and authorization, and account reconciliation services. *Id.*

Another issue relevant to market definition in network industries is the potential for changes in technology. Some commentators have suggested that, where alternative technologies exist and are cost-competitive with the traditional network, these alternatives should be part of the market.[131] Suggestions of radical change to the competitive environment based on technological change are frequently made in antitrust investigations. But like the reports of Mark Twain's death—they are frequently exaggerated.

For example, in the investigation of the merger between Time Warner and Turner Broadcasting Corp., one consideration was whether the emergence of new delivery systems, such as direct broadcast satellite networks (DBS), could alleviate concerns over the exercise of market power and should be included in the product market along with cable services.[132] In that case, Commissioner Azcuenaga suggested that relief was unnecessary because DBS was a viable alternative. The Commission majority rejected that contention, observing that the role of DBS was relatively minor:

> [T]o suggest that these technologies one day may become more widespread does not mean they currently are, or in the near future will be, important enough to defeat anticompetitive conduct. Alternative technologies such as DBS have only a small foothold in the market, perhaps a 3% share of total subscribers. Moreover, DBS is more costly and lacks the carriage of local stations. It seems rather unlikely that the emerging DBS technology is sufficient to prevent the competitive harm that would have arisen from this transaction.[133]

B. *Analysis of Market Power*

One of the most complicated issues in any network case is the analysis of market power. In non-network cases, the courts typically focus on the share of the market that is subject to the exclusivity arrangement and determine whether that share is so significant to raise competitive concerns. As suggested above, antitrust violations have been found where more than 40% of the market was foreclosed.

Several aspects of networks may suggest a more cautious approach to market power in network industries. First, networks may involve substantial investments by their members. These investments may effectively lock network members into the network and create substantial exit costs. For example, a member of an ATM network may need to reissue cards and rebrand ATMs in order to join a new network.

---

131 *See* Margaret Guerin-Calvert, Networks and Network Externalities: What the Antitrust Lawyer Needs to Know Concepts and Theory, Address Before the ABA Antitrust Section (Apr. 10, 1997).

132 *See* Time Warner Inc., 123 F.T.C. 171 (1997).

133 *Id.* at 209 (1997) (separate statement of Chairman Pitofsky, and Commissioners Steiger and Varney). More recent analysis suggest that DBS and other technological alternatives have yet to have any significant competitive effect in the market. *See* Geraldine Fabrikant, *The Lure of Cable*, N.Y. TIMES, Sept. 15, 1997, at D6.

Second, the installed base of a network may make the market power of a network more significant than the mere number of members. The installed base refers to the customer base of the network and generally is used to indicate that consumers' initial purchase decisions represent an investment in a particular form of equipment or product. The installed base may be important especially where there are significant switching costs.

Third, although alternative networks may exist, their existence should not be dispositive as to whether the network imposing exclusivity has market power. Alternative networks may be more costly or less efficient in the presence of the restriction. For example, in the *EPS* case the defendants argued that MAC's exclusivity rules did not have a significant competitive effect because the network members also belonged to the national ATM networks (PLUS and Cirrus). These were rejected as an alternative:

> National ATM networks exist, but these are by design networks of last resort, used only where the two banks involved in a transaction do not both belong to any one regional ATM network. National ATM network transactions are typically more expensive, and those networks provide only a subset of the transactions available through regional ATM networks.[134]

Similarly, in an arbitration proceeding involving an ATM network, the arbitrator concluded that the a regional ATM network had market power because "existing subnetworks, regional networks and national networks do not presently provide a reasonable substitute for the [switching] service [the regional network] provides to its members."[135]

Fourth, the use of a market share threshold may be somewhat misleading, because in the network context, certain inputs or distributors may be far more significant than their individual market share. An example of this is provided in the FTC challenge of the proposed 1996 merger between Rite Aid and Revco, the two largest pharmacy chains in the U.S.[136] The challenge was premised on the theory that it would have permitted the merged firm to raise prices to Pharmacy Benefit Management networks (PBM) by combining the two firms that otherwise could have served as

---

134 *Electronic Payment Servs.*, 59 Fed. Reg. at 24,718-19. The Federal Reserve Board has taken a similar position. *See Banc One Corp.*, 81 FED. RESERVE BULL. at 494 n.21; *see also, Microsoft*, 1998 U.S. Dist. LEXIS at *61 (exclusivity agreements excluded the "largest and most popular" internet service providers).

135 *In re* First Texas Sav. Ass'n, 55 Antitrust & Trade Reg. Rep. (BNA) 340, 355 (Aug. 25, 1988). Other regional networks were found to be only potential alternatives for Texas ATM owners and "substantial barriers" (including the national networks' antiduality membership rules, the preference by banks for local networks and the fact that PULSE was very efficient and well-established) were said to impede competition from the national networks, PLUS and CIRRUS. *Id.* at 353-54.

136 *See* FTC Press Release, *Rite Aid Abandons Proposed Acquisition of Revco After FTC Sought to Block Transaction* (Apr. 24, 1996) <http://www.ftc.gov/opa/1996/9604/ritenogo.htm>; FTC Press Release, *FTC Will Seek to Block Rite Aid/Revco Merger* (Apr. 17, 1996) <http://www.ftc.gov/opa/1996/9604/riterevc.htm>.

anchors to the network in several metropolitan areas.[137] PBMs generally seek to have at least one large pharmacy chain in a metropolitan area to "anchor" their PBM network. Replacing this chain with a series of independent pharmacies is far more costly and less efficient. Carrying this example a step further, a PBM may be able to exercise market power by entering into exclusive arrangements with the largest chain pharmacy, even if the share of the market is not necessarily suggestive of the existence of market power.[138]

Fifth, because of the effects of network externalities, the market power inquiry should focus on the effect of exclusivity on creating or enhancing barriers to entry. Network externalities can increase the costs of exit and creating alternative networks. Many networks exhibit positive network externalities, that is, the network grows in value as the number of firms in the network increases.[139] ATM networks exhibit a positive externality: Large networks yield increased convenience to consumers, thus increasing the network's value to the consumer.[140] Yet these network externalities may increase the costs of creating competitive alternatives. As Justice Department economist Alexander Raskovich has observed:

> The value to belonging to a network lies in the potential for interchange with other members. A financial institution that is dissatisfied with a regional [ATM] network's price or service quality may not gain by unilaterally leaving to join another regional network that offers better terms. Doing so could sever interconnection with the institutions with whom the institution typically interchanges transactions, or require a more roundabout and costlier interchange with them through national networks. A financial institution would prefer to leave as part of a coalition of defecting institutions that have frequent interchange with one

---

137 *See* George S. Cary, Deputy Director for Mergers, Bureau of Competition, FTC, Staying Ahead of the Merger Wave, Remarks at the 15th Annual Corporate Counsel Institute (Dec. 12, 1996) ("[I]f the largest two competitors merge, leaving only smaller less cost effective competitors, the merged entity can . . . withhold its participation in the network except at higher prices than each would have been willing to participate at premerger. The network simply will not get enough participation at a low price because higher-cost stores will not participate; the network will therefore have to increase the price it is offering in order to induce the participation of the large merged chain, or higher cost competitors.").

138 The exclusivity arrangements between Boeing and several large airlines may be another example of where particular customers may be far more significant than their individual market shares. After Boeing announced its proposed acquisition of McDonnell Douglas, it entered into 20-year exclusive contracts with Continental, Delta, and American Airlines. Although the three airlines accounted for only about 11% of the global commercial aircraft market, these airlines represented a sizeable portion of airlines that can serve as "launch" customers for aircraft manufacturers, that is, airlines that can place orders large enough and have sufficient market prestige to serve as the first customer for a new airplane. *See In re* Boeing Co./McDonnell Douglas Corp., No. 971-0051 (F.T.C. 1997), *available at* <http://www.ftc.gov/opa/1997/9707/boeingsta.htm> (visited Mar. 30, 1999) (statement of Chairman Robert Pitofsky, and Commissioners Janet D. Steiger, Roscoe B. Starek III & Christine A. Varney). Because of these concerns, the European Union required Boeing to rescind the exclusivity arrangements.

139 *See, e.g.*, Carl Shapiro, *Exclusivity in Network Industries*, 7 GEO. MASON L. REV. 673 (1999).

140 *See* The Treasurer, Inc. v. Philadelphia Nat'l Bank, 682 F. Supp. 269, 272 (D.N.J.), *aff'd mem.*, 853 F.2d 921 (3d Cir. 1988).

> another. The broader the coalition the better. But such coordinated action is difficult to accomplish, and the difficulties multiply with the size of the potential coalition.[141]

Raskovich observes that, because of the difficulty of organizing a coalition, a network may have market power.[142]

Raskovich's observations have significant, real-world support. Indeed, there have been few ATM networks created in the past two decades. Although there are no technological barriers to the creation of new ATM networks, the difficulty in creating a new coalition of members has created a substantial barrier. As one commentator observed:

> New entry into the "branded ATM network" market has been virtually nonexistent anywhere in the country. It requires a critical mass of cards and ATMs. Participating institutions have a lot of reasons to be concerned about having to switch from one network to another – in part because it involved reissuing cards and re-assigning ATMs, and perhaps more important, re-educating customers.[143]

Raskovich's observations suggest that the critical inquiry in evaluating network exclusivity is not simply market share or other measures of market power, but rather the impact of exclusivity on entry by alternative networks. This should be the primary approach to evaluating market power. Factfinders should focus on the requirements for entry and whether exclusivity provides a significant obstacle to effective entry. As Salop observes, because of network effects entry barriers are higher and "monopoly power in [network] markets tends to be more durable because it is more immune from erosion by natural marketplace forces . . . ."[144]

A recent network exclusivity case considered by the Canadian Competition Tribunal, suggests how entry can be an important preliminary issue in evaluating market power. The Tribunal began with an assessment of the impact of exclusivity provisions on barriers to entry.[145] The Tribunal

---

141 Alexander Raskovich, Some Antitrust Issues in ATM Networks: Network Growth and Operating Rules, Remarks presented to the ABA Conference on Cutting Edge Issues in Network Industries 13 (May 24, 1996). On customer disorganization as a source of market power, see Eric B. Rasmussen et al., *Naked Exclusion*, 81 AM. ECON. REV. 1137 (1991).

142 Richard Gilbert and Carl Shapiro make a similar observation:

> [T]he dangers associated with exclusive dealing provisions in the presence of multiple, uncoordinated buyers are especially great in markets subject to network externalities. In these markets, commitments by today's buyers to patronize the incumbent seller, and agreements which raise the costs of switching to alternative suppliers, can be especially effective in deterring entry by incompatible technologies.

Richard Gilbert & Carl Shapiro, Antitrust Issues in the Licensing of Intellectual Property: The Nine No-No's Meet the Nineties (Brookings Papers on Microeconomics 1997) [hereinafter Gilbert & Shapiro].

143 Donald L Baker, *Shared ATM Networks, the Antitrust Dimension*, 41 ANTITRUST BULL. 399, 408-09 (1996).

144 *See* Salop & Romaine, *supra* note 6, at 663. They conclude that because of these economic factors the liability standard for monopolization claims should be more restrictive in network markets.

145 D & B Cos. of Canada, Ltd., CT-94/1, at 80 (Aug. 30, 1995) ("[W]e must establish what the conditions of entry would be without the exclusives and, then, determine how the anti-competitive acts

condemned five-year agreements between A.C. Nielsen and various drug and grocery retailers providing A.C. Nielsen with exclusive access to store scanner data. The Tribunal found that the lengthy duration of the contracts along with staggered contract expiration dates created a formidable entry barrier for alternative providers of scanner data, and that these exclusives "constitute a prima facie barrier to entry."[146]

C. *Realistic Assessment of De Facto Exclusivity*

As described earlier, the courts have often determined that a joint venture network is unlikely to be able to exercise market power if it does not require exclusivity. For example, in *NaBanco* a processor of credit card transactions for merchant banks alleged that VISA's interchange fee, set by VISA's board of directors, constituted *per se* illegal horizontal price-fixing.[147] The district court rejected that characterization since the fee was not mandatory (i.e., banks could enter into alternative arrangements), and instead analyzed the restraint under the rule of reason. As the court observed: "A practice is not unlawful per se where as in this case, there is no legal, practical or conspiratorial impediment to making alternate arrangements."[148]

The court rejected NaBanco's contention that VISA had market power in a narrowly defined market of credit card processing, instead defining the market broadly as all payment systems.[149] Once it determined that VISA did not have market power, it upheld the fee based on the fact that VISA's merchant and card-issuing members were able to "bypass" the VISA network, i.e., they were free to negotiate separate interchange arrangements with each other.[150] The Eleventh Circuit upheld the decision on similar grounds.[151]

---

altered the prospects for economically feasible entry . . . .") (on file with author).

146 *Id.* at 82. A somewhat similar approach to foreclosure was proposed by Judge Posner in *Roland Machinery Co. v. Dresser Industries, Inc.*, 749 F.2d 380, 394 (7th Cir. 1984). Posner suggested that "a plaintiff must prove . . . that [an exclusive dealing arrangement] is likely to keep at least one significant competitor of the defendant from doing business in a relevant market. If there is no exclusion of a significant competitor, the agreement cannot possibly harm competition." *Id.* The arrangement in *Roland Machinery* easily survived scrutiny under this standard, because a competitor of the defendant had established a significant presence in the market despite the defendant's nationwide practice of exclusive dealing. *Id.*

147 *See, e.g.*, National Bancard Corp. v. VISA U.S.A., Inc., 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592 (11th Cir. 1986).

148 *Id.* at 1254-55 (citing Broadcast Music Inc. v. CBS, 441 U.S. 1, 24 (1979)).

149 *See id.* at 1257. For a discussion of *National Bancard*'s analysis of product market issues, see Dennis W. Carlton & Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 ANTITRUST L.J. 643 (1995) and David S. Evans & Richard Schmalensee, *Economic Aspects of Payment Card Systems and Antitrust Policy Toward Joint Ventures*, 63 ANTITRUST L.J. 861 (1995).

150 *National Bancard*, 596 F. Supp. at 1254-55 (stating that there were no legal, practical, or conspiratorial impediments for members to make alternative arrangements).

151 *See* National Bankcard Corp. v. VISA U.S.A., Inc., 779 F.2d 592, 594, 602, 605 (11th Cir.

Although the district court's ultimate conclusion that the interchange fee should be upheld may be justified, its focus on the lack of exclusivity was short sighted. Actually very few, if any, banks entered into alternative arrangements outside of the VISA system. Bypass of the VISA system appeared to be at most a theoretical alternative. If the joint venture set a price at the monopoly level, there would be little incentive for individual VISA members to bypass the interchange fee system.[152]

A better approach would be for the court to determine whether nonexclusivity made a practical difference; in other words, whether members actually bypassed the network. This approach would have been particularly sound in cases like *BMI* and *NaBanco*, where the ventures were very large and there was a significant threat of the exercise of market power. The antitrust agencies utilized this approach in analyzing exclusivity in health care joint ventures. The *Health Care Policy Statements* caution that some arrangements that appear to permit participating providers to contract individually may nevertheless prove to be exclusive in operation. The *Statements* identify five factors to consider in evaluating whether a network is "non-exclusive in fact and not just in name": (1) whether there are "viable competing networks or managed care plans" in the market; (2) whether members in the network actually participate in other networks or contract individually; (3) whether network members earn substantial revenue outside the network; (4) the absence of any indications of significant departicipation from other networks; and (5) the absence of any indications of coordination among the members of the network.[153]

Under this approach, nonexclusivity probably would not have been dispositive in *NaBanco*. There were very few banks that entered into alter-

---

1986).

152 A similar criticism could be made of the decisions of the courts in *BMI* and their reliance upon nonexclusivity as the critical factor in upholding the blanket license. There seemed to be little question that BMI and the other licensing group possessed market power—there were only two licensing groups. While nonexclusivity would typically suggest that the exercise of market power would be ephemeral, it is difficult to see how it would change the analysis of the competitive effects of the blanket licensing agreement. Although composers remained free to sell individual licenses, the Court's opinion implies that buyers are not interested in them and that individual composers are not, in any event, able to compete effectively with BMI and ASCAP. As Professor Clark Havighurst has observed: "As a practical matter, however, [the ability of composers to enter into individual licenses] was highly inefficient. It also did little to offset the market power of the societies, especially since the composers were not free to license their works through competing agents." *Hearing on "Health Care Reform Issues: Antitrust, Medical Malpractice Liability, & Volunteer Liability" Before the House Comm. on the Judiciary*, 104th Cong. (1996) (statement of Prof. Clark C. Havighurst).

If individual composers were unable to compete with their joint venture, nonexclusivity would not deter or mitigate the collective exercise of market power by the joint venture. Not only does nonexclusivity seem irrelevant in determining whether joint price-setting is per se illegal, but it must also be examined more closely before it is used to justify the creation of a joint venture with significant market power. If economic circumstances make competition against the joint venture unlikely, nonexclusivity is either illusory or irrelevant.

153 1996 HEALTH CARE GUIDELINES, *supra* note 33, at 20,815.

native arrangements. Although another competing network existed—Mastercard—this network had almost identical rules and an identical fee schedule. In fact, to the extent there were alternative arrangements between banks, those arrangements largely ceased to exist in the 1980s.

Absent evidence of significant participation outside of the network, courts and antitrust enforcers should look critically for evidence of arrangements that create de facto exclusivity. For example, penalty contracts, discounts, rights of first refusal, or "most favored nation" provisions may create strong incentives that may effectively replicate exclusive arrangements.[154] Absent evidence that network members have both the incentive and ability to participate in alternative networks, the network should be treated as exclusive.

1. De Facto Exclusivity—Is a Written Agreement Necessary?

Although some courts require that exclusivity provisions be explicit in a written agreement,[155] most courts will treat as exclusive an agreement

---

154 For a description of various arrangements that create de facto exclusivity, see Gilbert & Shapiro, *supra* note 142 (describing penalty provisions, loyalty incentives, and market share incentives as de facto exclusivity mechanisms). For a lengthy discussion of the use of discounts to create defacto exclusivity arrangements, see William K. Tom, Deputy Director, FTC, Anticompetitive Aspects of Exclusive Dealing and Related Practices, Before the American Bar Ass'n, Antitrust Section (Apr. 15, 1999).

A recent Justice Department enforcement action suggests how different contractual provisions can be used to create de facto exclusivity. IBM and Storagetek ("STK") were competitors in the sale of disk storage subsystems for mainframe computers. They entered into an arrangement in which IBM became the distributor for STK's production. The agreement effectively imposed significant penalties upon STK if it failed to meet certain volume goals. The Justice Department challenged the agreement as a de facto exclusivity agreement and the case was resolved with the elimination of the contractual incentives and penalties that compelled exclusivity. *See* United States v. IBM Corp., 63 Fed. Reg. 1499 (D.D.C. 1998) (proposed final judgment and competitive impact statement).

As the previous discussion of the *Primestar* enforcement action suggests, most favored nations provisions can create de facto exclusivity arrangements. *See supra* notes 46-48 and accompanying text; *see also* RxCare of Tenn., Inc., 121 F.T.C. 762 (1996) (consent agreement final June 1996) (most favored nations provision created de facto exclusivity arrangement); David A. Balto, *Cooperating to Compete: Antitrust Analysis of Health Care Joint Ventures*, 42 ST. LOUIS L.J. 191, 235 (1998) (explaining how most favored nations provision can be used to create exclusivity); Anthony J. Dennis, *Most Favored Nation Contract Clauses Under the Antitrust Laws*, 20 U. DAYTON L. REV. 821, 848 (1995).

155 *See, e.g.*, Stitt Spark Plug Co. v. Champion Spark Plug Co., 840 F.2d 1253, 1257-58 (5th Cir. 1988) (noting seller's incentives to encourage distributors to engage in exclusive dealing did not establish such a practice where there were no sanctions for selling competing products and no showing that distributors agreed not to sell competing products); *see also* United Air Lines, Inc. v. Austin Travel Corp., 867 F.2d 737, 742 (2d Cir. 1989) (required minimum usage of 50%); Empire Volkswagen, Inc. v. World-Wide Volkswagen Corp., 814 F.2d 90, 97-98 (2d Cir. 1987) (requirement that competing makes of automobiles be sold from a different facility).

In their analysis of certain non-price vertical restraints, some courts have questioned whether an alleged restraint is, in fact, an exclusive dealing arrangement (*i.e.*, an agreement whereby the buyer agrees to purchase *all* of his requirements from a particular seller to the exclusion of *all* other sellers). *See, e.g.*, Barr Lab., Inc. v. Abbott Lab., Inc., 978 F.2d 98, 110 n.24 (3d Cir. 1992); Kellam Energy,

that, even if not explicit, establishes incentives or penalties that as a practical matter causes the parties to act on an exclusive basis.[156] Where appropriate, courts have found an implied exclusivity agreement from surrounding circumstances.[157] This is especially important in network contexts where other provisions, such as penalties or discounts, may create de facto exclusivity arrangements.[158]

Inc. v. Duncan, 668 F. Supp. 861 (D. Del. 1987); Empire Volkswagen, Inc. v. World-Wide Volkswagen Corp., 627 F. Supp. 1202 (S.D.N.Y. 1986), *aff'd*, 814 F.2d 90 (2d Cir. 1987). Even in these cases, however, the dispositive issue is whether or not the agreement(s) in question result in net anticompetitive effects, not whether the restraint in question fits the classical model of an exclusive dealing arrangement. *See Barr Lab.*, 978 F.2d at 111 (affirming summary judgment for defendant after assuming existence of exclusive dealing contracts, but finding no evidence of anticompetitive effects); *Kellam Energy*, 668 F. Supp. at 886 (granting summary judgment for defendant after finding neither an exclusive dealing arrangement nor a significant anticompetitive effect); *Empire Volkswagen*, 814 F.2d at 97-98 (same); *see also* Concord Boat Corp. v. Brunswick Corp., 21 F. Supp. 2d 923, 934 (E.D. Ark. 1998) ("[R]egardless of whether the conduct at issue fits perfectly within a previously determined category of unlawful conduct, the fundamental concern is whether the conduct, in light of its requisite effects, can reasonably be found to violate Sections 1 and 2 of the Sherman Act."). *Cf.* Perington Wholesale, Inc. v. Burger King Corp., 631 F.2d 1369, 1374 (10th Cir. 1980) ("The agreement need not specifically require the buyer to forego other supply sources if the practical effect is the same.") (citing United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922)).

156 The concept of de facto exclusivity arrangements is not novel. Several courts have held that the existence of an agreement between a supplier and its dealers that the dealers will carry only that supplier's goods may be implied from surrounding circumstances. *See* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 326 (1961); *see also* Barnosky Oils, Inc. v. Union Oil Co., 665 F.2d 74, 86 (6th Cir. 1981) ("The absence of an express exclusivity requirement . . . does not foreclose [the] claim"); Dillon Materials Handling, Inc. v. Albion Indus., 567 F.2d 1299, 1302 (5th Cir.) ("[t]he existence of such an agreement or understanding, of course, must be evaluated in light of all the circumstances peculiar to the case at hand").

One leading antitrust treatise has taken different positions on this issue. The Third Edition of ANTITRUST LAW DEVELOPMENTS observed that "[m]ere incentives offered by the seller to engage in exclusive dealing are ordinarily not sufficient" to demonstrate exclusive dealing. ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 176 (3d ed. 1992). In contrast, the Fourth Edition advises that "[p]roof of an express agreement is not required, as courts will infer an exclusive dealing arrangement from the surrounding circumstances." ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 221 (4th ed. 1997).

157 *See* Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 392-93 (7th Cir. 1984) ("In order to prevail on its [Clayton Act] section 3 claim, [plaintiff] will have to show . . . that there was an agreement, though not necessarily an explicit agreement, between it and [defendant] that it not carry a line of [products] competitive with [defendant's]"; it is enough that the defendant "forced dealers into a tacit understanding not to handle a competitor's goods") (citations omitted).

158 The Intellectual Property Guidelines recognize the potential for such arrangements: "[e]xclusivity may be achieved by an explicit dealing term in the license or by other provisions such as compensation terms or other economic incentives." INTELLECTUAL PROPERTY GUIDELINES § 4.1.2, supra note 52, at 20,742. The *Guidelines* also note that the

> Agencies will focus on the actual practice and its effects, not on the formal terms of the arrangement. A license denominated as non-exclusive (either in the sense of exclusive licensing or in the sense of exclusive dealing) may nonetheless give rise to the same concerns posed by formal exclusivity. A non-exclusive license may have the effect of exclusive licensing if it is structured so that the licensor is unlikely to license others or to practice the technology itself. A license that does not explicitly require exclusive dealing may have the effect of exclusive dealing if it is structured to increase significantly a licensee's cost when it uses competing technologies.

Id. § 4.1.2, at 20,742-43.

In *Tampa Electric*, the Supreme Court reasoned that the existence of an exclusive dealing arrangement need not be expressly stated by the terms of a contract. Rather, exclusive dealing can be found "even though a contract does 'not contain specific agreements not to use the [goods] of a competitor,' if 'the practical effect . . . is to prevent such use.'"[159] Lower courts have been willing to infer an agreement to deal exclusively where a seller causes buyers to purchase its products exclusively by: (1) refusing to deal with distributors who handle competitors' products (a practice not explicitly presented in this case) or (2) granting special benefits solely to buyers that deal exclusively with the supplier or, viewed alternatively, imposing penalties upon buyers who fail to deal exclusively.[160]

For example, in *Beltone Electronics Corp.*,[161] the FTC found that Beltone had engaged in exclusive dealing even though the firm had not entered into express exclusive dealing contracts and 6% to 7% of the sales of Beltone dealers were of non-Beltone brands. The firm established sales goals for dealers which "simply could not be met unless a dealer devoted his full efforts to promoting Beltone sales."[162] Beltone also "used the failure to meet [sales goals] as a device for terminating or threatening to terminate dealers who breached its exclusivity policy."[163] The Commission concluded that Beltone "used pressure to achieve [its sales goals] in order to induce dealers to patronize Beltone products exclusively" and that it "imposed restrictions effectively amounting to . . . exclusive dealing."[164]

In a case in which the Antitrust Division challenged a license which divided territories, the Division observed that the agreement, while non-exclusive on its face, was de facto exclusive. *See* United States v. S.C. Johnson & Son, Inc., 59 Fed. Reg. 43,859 (N.D. Ill. 1994); *see also* Joseph Kattan, *Perspectives on the 1995 Intellectual Property Guidelines*, ANTITRUST, Summer 1995, at 11.

The FTC has also brought cases challenging de facto exclusivity arrangements. *See* Hale Prods., Inc., 61 Fed. Reg. 40,225 (F.T.C. 1996) (proposed consent agreement, analysis to aid public comment and separate statement of Chairman Pitofsky, and Commissioners Varney and Steiger); Waterous Co., Inc., 61 Fed. Reg. 40,229 (F.T.C. 1996) (proposed consent agreement, analysis to aid public comment and separate statement of Chairman Pitofsky, and Commissioners Varney and Steiger); Montana Associated Physicians, Inc., 61 Fed. Reg. 56,682 (F.T.C. 1996) (proposed consent decree), *approved*, 62 Fed. Reg. 11,201 (F.T.C. 1997) (final consent decree approved).

159 Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 326 (1961) (quoting United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922)); *see also* Barnosky Oils, Inc. v. Union Oil Co., 665 F.2d 74, 86 (6th Cir. 1981) ("[t]he absence of an express exclusivity requirement . . . does not foreclose [the] claim"); Dillon Materials Handling, Inc. v. Albion Indus., 567 F.2d 1299, 1302 (5th Cir.) (noting that "[t]he existence of such an agreement or understanding, of course, must be evaluated in light of all the circumstances peculiar to the case at hand").

160 *See* White & White, Inc. v. American Hosp. Supply Corp., 540 F. Supp. 951, 1027-28 (W.D. Mich. 1982) (collecting cases), *rev'd on other grounds*, 723 F.2d 495 (6th Cir. 1983).

161 100 F.T.C. 68, 192 (1982).

162 *Id.* at 183.

163 *Id.*

164 *Id.* at 192. The Commission nonetheless dismissed the complaint, finding that Beltone's low market share was inconsistent with foreclosure of competition, particularly given new entry and destabilizing growth by competitors. *See id.* at 218.

2. Penalty Contract

De facto exclusivity may also be imposed through a penalty contract.[165] A penalty contract imposes a charge on the buyer if it wishes to buy from more than one source. The courts have inferred the existence of an exclusive dealing arrangement from a seller's imposition of a penalty on a buyer for using competing products. For example, in *United Shoe Machinery Corp. v. United States*, the Supreme Court struck down, under Section 3 of the Clayton Act, a series of restrictions in the lease of shoe manufacturing machinery.[166] United Shoe's leases did not explicitly prohibit shoe manufacturers from using alternative machinery, although their "practical effect . . . [was] to prevent such use."[167] The leases prohibited the manufacturers from using United's machines on shoes partially made with the machines of United's competitors and required them to take all additional needed machinery for certain kinds of work from United or lose all United machines. One provision, known as the "factory output clause," required the lessee to pay United a royalty for any shoes manufactured on competing machinery. The Court held that these provisions had the effect of foreclosing competition and thus violated Section 3, even absent an express exclusivity provision.[168]

3. Discounts

More difficult questions are raised where the inducement for exclusivity is a discount rather than a penalty. In several older cases, the courts have treated "discounts" as creating de facto exclusivity arrangements. In *United States v. Brown Shoe Co.*,[169] the Supreme Court, relying on Section 5 of the FTC Act, affirmed a Commission decision condemning a distribution system that relied on economic incentives to persuade retail outlets to deal exclusively with a single manufacturer. Likewise, in *Carter Carburetor Corp. v. FTC*,[170] the Eighth Circuit affirmed a Commission order

165 For an extensive description of the use of penalty contracts, see Brodley & Ma, *supra* note 97.

166 United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922).

167 *Id.* at 457.

168 *See id.* at 456; *see also* Oxford Varnish Corp. v. Ault & Wiborg Corp., 83 F.2d 764 (6th Cir. 1936) (finding exclusive dealing arrangement in contract under which licensees paid royalty of one cent per foot when materials were purchased from the licensor, and three cents a foot when materials were purchased from competitors); Chiplets, Inc. v. June Dairy Prods. Co., 89 F. Supp. 814, 817 (D.N.J. 1950) (finding exclusive dealing arrangement where lease required lessees of machines designed to form pats of butter to pay a penalty to the lessor if they used competing machines).

169 384 U.S. 316 (1966). Section 3 of the Clayton Act explicitly makes it unlawful to lease, sell or make a contract to sell a product, to "fix a price" for a product, or to fix a "*discount* from, or *rebate* upon, such price, on the condition, agreement, or understanding that the . . . purchaser thereof shall not use or deal in the goods . . . of a competitor" of the seller, where the effect may be to substantially lessen competition. 15 U.S.C. § 14 (1988) (emphasis added).

170 112 F.2d 722 (8th Cir. 1940). Professors Areeda and Hovenkamp recognize that the use of

against a supplier found to have violated Section 3, even though the supplier did not impose any express prohibition against purchasing the goods of its competitors. The supplier, the "dominant" manufacturer of carburetors, provided a preferential discount to customers who did not buy competing products. The court reasoned that it was "immaterial" that customers were not required "to affirmatively promise in express terms" not to handle competing goods: "The condition against handling the goods of competitors was made as fully effective [through the use of discounts] as though it had been written in and affirmatively agreed to in express terms in the contracts."[171] The court expressed concern that "practices of a dominant . . . manufacturer which are designed to and do prevent a new manufacturer from obtaining a foothold in the . . . field" could prevent a new manufacturer from "marketing a superior product at an equal or lower price."[172]

Some decisions have been less sympathetic to claims that discounts create de facto exclusivity arrangements. For example, in *Barry Wright Corp. v. ITT Grinnell Corp.*,[173] the court held that a system of discounts by a near monopolist were not exclusionary. The First Circuit, in an opinion by then-Judge Breyer, held that discounts could not be exclusionary so long as the prices were above total cost. The court explained that "a legal precedent that prevents a firm from unilaterally cutting its prices risks interference with one of the Sherman Act's most basic objectives: the low price levels that one would find in well-functioning markets."[174] The *Barry Wright* decision was also written in a context of some fairly specialized

---

discounts to impose de facto exclusive dealing may be an exclusionary practice. In discussing *Aspen Skiing*, they note:

> it clearly would have been illegal for Ski Co. to sell lift tickets only to skiers who agreed not to purchase from Highlands. The price structure adopted by Ski Co. [offering a discounted weekly ticket] might be thought to have a similar practical effect. That would explain liability without any need for a showing of essential facility.

3A PHILLIP AREEDA & HERBERT HOVENKAMP, *supra* note 23, ¶ 772c1, at 186-87.

171 *Carter Carburetor*, 112 F.2d at 732.

172 *Id.* at 733; *accord* Concord Boat Corp. v. Brunswick Corp., 21 F. Supp. 2d 923, 933 (E.D. Ark. 1998) (crediting, inter alia, evidence that defendant's discount program precluded its only rival from achieving minimum efficient scale); Champion Spark Plug Co., 50 F.T.C. 30, 47-49 (1953) (discussing practice of granting "a special low price in consideration for [distributors] purchasing Champion spark plugs for all their requirements" imposed exclusive dealing); *see also* SmithKline Corp. v. Eli Lilly & Co., 427 F. Supp. 1089, 1122 (E.D. Pa. 1976) (noting the practical effect of discount purchasing scheme was to compel customers to purchase all of their requirements so that they would qualify for rebates; finding violation of Section 2), *aff'd*, 575 F.2d 1056 (3d Cir. 1978); United States v. Bausch & Lomb Optical Co., 1951 Trade Cas. (CCH) ¶ 62,883 (N.D. Ill. 1951) (consent decree prohibiting system of discounts and rebates used to enforce exclusive dealing); United States v. Linde Air Prods. Co., 83 F. Supp. 978, 984 (N.D. Ill. 1949) (leading supplier of welding rods provided a discount in return for the customers' agreements not to buy competing rods; the discount "indirectly" imposed an exclusive dealing arrangement); Richard M. Steuer, *Discounts and Exclusive Dealing*, ANTITRUST, Spring 1993, at 28.

173 724 F.2d 227 (1st Cir. 1983).

174 *Id.* at 231.

facts, however, and it may turn out to be best viewed as a response to those specialized facts rather than as an across-the-board rejection of theories of de facto exclusivity.[175]

In *U.S. Healthcare*, the First Circuit grappled with whether a financial incentive may be sufficient to create de facto exclusivity.[176] U.S. Healthcare, an HMO, sought to enter the New Hampshire managed care market. The defendant, Healthsource, was the only non-staff-model HMO operating in New Hampshire and had enrolled approximately 5% of the population of the state. Many contracted physicians were stockholders in the company, and 87% of them signed exclusive contracts under which they agreed not to serve any other HMO. Those who signed exclusive contracts received a higher reimbursement rate.[177]

The court dealt with the issue of whether the financial incentives created an exclusivity arrangement. It rejected the argument that a mere price differential might not create an exclusivity arrangement because of the lack of a "continuing promise not to deal," since the agreement was part of a contract and subject to Section 1.[178] The court suggested that the differential reimbursement rate could create competitive problems. It observed that a 30-day termination provision might forestall competitive entry "especially if a reimbursement penalty were visited on doctors switching back to non-exclusive status."[179] Ultimately, U.S. Healthcare's claim failed because U.S. Healthcare failed to demonstrate that it could not offer the doctors a sufficient financial incentive to defect from exclusive status.[180]

---

175 The situation in *Barry Wright* actually differed from truly troublesome incentives to exclusive dealing in two important respects. First, the plaintiff's theory involved uniform, above-cost, but nonetheless allegedly predatory pricing, which the court was naturally reluctant to condemn, rather than the structured and differentiated pricing that concentrates discounts on just a customer's marginal purchase decisions, which is something that could be condemned with less risk of chilling hard competition. *See id.* at 235-36. Second, in *Barry Wright* there was no evidence of actual anticompetitive effects, and several reasons (e.g., the limited period of the contracts; the large size of the allegedly victimized buyer) to think such effects unlikely. *See id.* at 237-38. *Barry Wright* would not seem to preclude action where these two circumstances are different. *Cf.* Tom, supra note 113.

176 U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589 (1st Cir. 1993).

177 *See id.* at 592 (recounting origin and motivation behind exclusivity clause). Healthsource was planning a public offering of its stock and was aware that HMOs from nearby states were interested in moving into New Hampshire. The main concern was that after Healthsource went public, many of the doctor-owners would sell their stock in Healthsource and join multiple HMOs to increase their patient volume. In response to this perceived threat, Healthsource offered a new contract option to its physicians, whereby they could receive a 14% increase in reimbursement if they agreed not to serve any other HMO. Ultimately, nearly 87% of Healthsource's physicians opted for exclusivity.

178 *Id.* at 595-96, n.3.

179 *Id.* at 596.

180 A more difficult question is whether financial ownership might cause a de facto exclusivity arrangement. For example, in *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1409 (7th Cir. 1995), *cert. denied*, 516 U.S. 1184 (1996), the Seventh Circuit relied in part on the lack of exclusivity in finding that a doctor-owned clinic and its subsidiary HMO, which enrolled nearly 90% of all HMO subscribers in the region, did not possess market power. The court observed that although the Marshfield Clinic employed all of the physicians in Marshfield and several other

More recently, in *Concord Boat Corp. v. Brunswick Corp.*,[181] a district court found liability under Section 2 of the Sherman Act for a market share discount program that the court treated as a de facto exclusivity arrangement. The defendant, Brunswick, was the dominant seller in the relevant market for stern drive boat engines.[182] Brunswick offered discounts based on the percentage of inventory that its customers, both boat manufacturers and retail engine dealers, filled with its engines. The discounts were highest when customers purchased a large share of inventory from Brunswick, in general, beginning at a 60% threshold. Most customers were required to purchase 70% to 80% of their inventory from Brunswick in order to receive a certain discount, although some dealers were required to purchase 100%. None of the agreements, however, obligated the buyer to purchase a specific share (i.e., they were not requirements contracts); nor did any of the agreements restrict buyers to purchasing only from defendant (i.e., they were not exclusive dealing contracts). Brunswick also increased the available discounts where buyers adhered to the market share requirements for a significant period of time (e.g., three years). Brunswick also offered volume discounts which did not contain a market share component; together, the three discount programs reached approximately 15%.[183]

The court upheld the jury's finding that the defendant's conduct was exclusionary as a matter of law. The court credited testimony of the plaintiffs' expert, who characterized the defendant's discounting program as effectively "buying from the purchaser a barrier to entry" and imposing a tax on buyers' purchases from the only other competing engine manufacturer.[184] The plaintiffs introduced evidence that, in 1996, sales to manufacturers under the Brunswick plan accounted for 38% of manufacturer purchases, and that Brunswick's captive production accounted for an additional 40%. Brunswick thus foreclosed 78% of the market at the manufac-

---

towns, these physicians nevertheless would be willing to serve other HMOs because they were not under exclusive contract to the HMO. But as one commentator observes,

> [t]he mere absence of an exclusive contract, however, does not mean that a physician is willing to provide services to an HMO entering the market in response to a price increase by an existing HMO. Many of [the HMO's] physician members held an ownership interest in the HMO. These physicians had an economic incentive not to join competing HMOs because the success of other HMOs might threaten that of [the HMO].

Mark L. Glassman, *Can HMOs Wield Market Power? Assessing Antitrust Liability in the Imperfect Market for Health Care Financing*, 46 AM. U. L. REV. 91, 120 (1996); *see also* Piraino, *supra* note 43, at 65 ("Regardless of whether they have entered into an express non-competition agreement, the partners to a joint venture will have a natural inclination to avoid competing with the joint venture. Direct competition is contrary to the partners' interest because it reduces the profits of their own affiliate.").

181 21 F. Supp. 2d 923 (E.D. Ark. 1998).

182 The court credited evidence introduced at trial demonstrating that defendant Brunswick possessed a 75% to 80% market share of the relevant market. *See id.* at 926.

183 *See id.* at 928.

184 *See id.* at 931 (quoting plaintiff's expert Dr. Robert Hall).

turer level.[185] In addition, the plaintiffs introduced evidence that approximately 25% of dealer purchases were made under the Brunswick plan.

The plaintiffs also introduced (1) evidence that it was necessary to offer some Brunswick products, and they could not switch entirely to another supplier; (2) evidence that the discount programs prevented the only remaining competitor in the market from achieving minimum efficient scale; (3) Brunswick documents that were "riddled with acknowledgments of the anticompetitive nature of these agreements"; and (4) a consultant's report suggesting that Brunswick's pricing policies created "meaningful barriers to entry."[186] The court rejected Brunswick's argument that the agreements were not comprehended by the Sherman Act because they were not technically exclusive dealing contracts; rather, the court explained, there was "no doubt that such practices were within the purview of the Sherman Act, regardless of their alleged non-exclusivity because they are the de facto equivalent of exclusive dealing."[187] The court's decision seems reasonable and correct in light of the facts of this case.

Similarly, competition authorities in the European Union[188] and Canada have challenged discounts that create exclusivity arrangements. The Canadian Competition Tribunal, for example, condemned the NutraSweet Company's use of discounts on its aspartame sweetener and advertising allowances to customers who agreed to use only NutraSweet brand aspartame in their products and display the NutraSweet "swirl" logo on their packaging.[189] The Tribunal held that NutraSweet violated prohibitions against exclusive dealing and abuse of a dominant position in the Canadian Competition Act. It found that customers effectively were being presented with an "all-or-nothing" choice, because unless they took the discounts, which amounted to an effective discount of 40%, it would be prohibitively expensive to buy *any* quantities from NutraSweet, and they would have to fill their entire demand from another supplier. As a consequence, new suppliers could not succeed unless they immediately could become sufficiently "established" so that customers would be willing to entrust them with all of their needs.[190] The Tribunal concluded that given NutraSweet's

185 *See id.* Alternatively, this evidence could be construed to suggest that 63.33% of all non-captive manufacturer sales were made under the Brunswick discount plan.

186 *Id.* at 931-32 (emphasis omitted).

187 *Id.* at 933.

188 *See* TetraPak II, [1992] 1 CEC (CCH) 2,145, 2,172, 2,180 (1991); Hoffmann-LaRoche v. Commission, 1979 E.C.R. 461; *see also* Eleanor Fox, *Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity, and Fairness*, 61 NOTRE DAME L. REV. 981, 1010 (1986) (describing EU cases).

189 Director of Investigation & Research v. The NutraSweet Co., Competition Trib., No. CT-89/2 (Oct. 1990) (on file with author).

190 *Id.* at 70.

large market share, the discounts were exclusionary and resulted in a substantial lessening of competition.[191]

In *Microsoft*, the Antitrust Division grappled with whether to challenge a system of volume discounts that created a strong inducement for near exclusive arrangements.[192] The volume discounts were set at levels that made it very unattractive for customers to purchase operating systems from competitors. The discounts had the potential for significant anticompetitive effects because of the large installed base of Microsoft operating system users, which meant that a computer manufacturer had to rely on Microsoft for some purchases of operating systems. The Antitrust Division, however, did not place further limits on Microsoft's ability to structure volume discounts. In the Competitive Impact Statement, it stated:

> While the Department recognizes that volume discount pricing can be and normally is pro-competitive, volume discounts can also be structured by a seller with market power (such as Microsoft) in such a way that buyers, who must purchase some substantial quantity from the monopolist, effectively are coerced by the structure of the discount schedule (as opposed to the level of the price) to buy all or substantially all of the supplies they need from the monopolist. Where such a result occurs, the Department believes that the volume discounts structure would unlawfully foreclose competing suppliers from the marketplace—in this case, competing operating systems—and thus may be challenged.[193]

The Division chose not to proscribe Microsoft's volume discounts, but did "communicate to Microsoft its concern" and stated that it would investigate again should Microsoft adopt an anticompetitive volume discount structure in the future.[194]

Ultimately, all forms of inducements to create de facto exclusivity arrangements need careful analysis—a per se approach is not appropriate. Inducements such as discounts can often be procompetitive, especially where they lead to lower prices to consumers. On the other hand, these inducements may raise entry barriers and the costs of current rivals. Thus, the courts and antitrust enforcers should adopt a refined and careful approach to these issues, similar to the approach in *Concord Boat*, that analyzes the effect on these inducements on entry barriers and the ability of rivals to effectively compete.

---

191 *Id.* at 47, 91, 97-98; *see also* In re Laidlaw Waste Sys. Ltd., Canadian Competition Tribunal, Jan. 20, 1992 (on file with author).

192 *See* United States v. Microsoft Corp., 59 Fed. Reg. 42,845(D.D.C.) (proposed final judgment and competitive impact statement), *and* 59 Fed. Reg. 59,426 (D.D.C. 1994) (response of United States to public comments), *denying consent decree*, 159 F.R.D. 318 (D.D.C.), *rev'd*, 56 F.3d 1148 (D.C. Cir.), *on remand*,1995-2 Trade Cas. (CCH) ¶ 71,096 (D.D.C. 1995) (entry of final judgment).

193 *Id.* at 42,854; *see also* Richard M. Steuer, *Counseling Without Case Law*, 63 ANTITRUST L.J. 823 (1995).

194 Under what conditions discounts should be challenged is beyond the scope of this article. For a description of approaches to this issue, see Gilbert & Shapiro, *supra* note 142.

D. *A Structured Analysis of Free-riding*

As noted earlier, one important efficiency of exclusivity arrangements is to deter free-riding.[195] To illustrate how courts analyze these claims, two examples are presented: florist service networks and professional basketball broadcasts.

1. Floral Service Networks

The Justice Department's 1956 enforcement action enabled florists to belong to any of a number of networks and several networks competed on a nationwide basis.[196] The networks took different approaches to competition. Some engaged in extensive national advertising and because of that offered relatively lower fees to the network members. Others took more of a "no name" generic approach; since they engaged in little product promotion, they could offer higher fees to florists. Because of these different strategies, the high value networks were concerned about the no name networks free-riding on their promotion efforts.

This conflict came to a head in *American Floral Services v. Florists' Transworld Delivery Association.* [197] American Floral Services (AFS) challenged the routing rules of two of its leading competitors, FTD and Teleflora. Routing rules specify to florists which network a transaction must be sent through. FTD was the dominant florist network with a market share exceeding 65%. AFS, unlike the defendant networks, did relatively little advertising; rather, it chose to compete by offering a "rebate" to sending florists. AFS could therefore "pirate" the order from another network if the sending florist sent the FTD or Teleflora order through AFS, thereby "free-riding" on the promotional efforts of FTD and Teleflora.[198]

In response, FTD promulgated "pirate order rules" that required that an FTD catalog order received by a member be transmitted and filled by FTD's wire service and clearinghouse, unless the customer indicated that he wanted the transaction routed to an alternative network. The rule did not prohibit the sending florist from suggesting the use of the product of any competing network. Teleflora had a similar rule that required routing to Teleflora without the customer override. AFS alleged that both rules constituted per se illegal boycotts under Section 1.

FTD claimed that a joint venture had the power to impose these pirate order rules because it engaged in substantial promotion, and that AFS was

---

195 *See infra* Part I.C.2.

196 Shapiro, *supra* note 139.

197 American Floral Servs., Inc. v. Florists' Transworld Delivery Ass'n, 633 F. Supp. 201, 219-20 (N.D. Ill. 1986).

198 *Id.* at 206-07.

free-riding on this promotion. The court analogized the situation to a bank's advertising for IRAs. One bank might advertise a lot and this might prompt consumers of other banks to seek IRAs at those banks. But

> [t]his does not mean the advertising banks have a right to interfere with the business of the nonadvertising banks to claim deposits "rightfully theirs." And by the same token, FTD and Teleflora have no right to prevent such purely collateral benefits of their advertising from rubbing off on AFS, their competitor. To that extent AFS is correct in arguing prevention of the free-rider effect will not support a restriction on interbrand competition under the rule of reason. [199]

The district court upheld both rules since their purpose was to eliminate the threat of free-riding by the sending florists, who "double dip" by using the FTD or Teleflora designs "while at the same time collecting the AFS rebate."[200] Thus, the routing rules were not "impermissible restrictions on interbrand free-riding," but rather "legitimate agreements ancillary to the cooperative agreements between florists and FTD or Teleflora."[201]

2. Professional Basketball Telecasts

Exclusivity arrangements in the context of professional basketball television broadcasts fared less well. A sports league may market its television rights in a single package to a television network. When it does so, questions will arise about its ability to restrict individual members of the league from competing with the joint venture's product. In *Chicago Professional Sports L.P. v. National Basketball Ass'n*,[202] the Seventh Circuit invalidated an NBA rule that restricted the number of basketball games that individual teams could broadcast on cable superstations to twenty (in an eighty-two-game season).

Judge Frank Easterbrook's opinion focused on whether there were any procompetitive justifications for the telecast limitation. The NBA argued that teams that sold broadcast rights to superstations had appropriated viewers from the league's broadcasts and thereby reduced the league's revenues from the sale of broadcast rights to the networks. These funds, it argued, were needed for revenue sharing to maintain the competitive balance within the league. The court rejected this justification because it believed that free-riding could be controlled through means that were less restrictive of competition:

> What gives the name free-riding is the lack of charge. . . . Where payment is possible, free-riding is not a problem because the "ride" is not free. . . . The league may levy a charge for

199 *Id.* at 219.
200 *Id.*
201 *Id.* at 219-20.
202 961 F.2d 667 (7th Cir. 1992).

> each game shown on a superstation, or require the club to surrender a portion of its revenues. Major league baseball does exactly this and otherwise allows its teams access to superstations. . . . Avoidance of free-riding therefore does not justify the NBA's 20-game limit.[203]

Although the court recognized that a system of revenue pooling and pass-over payments could produce the same limitation in output mandated by the twenty-game rule, it believed that such a system would be less restrictive than a direct limitation on output in competition with the venture.[204]

What do these cases suggest? First, free-riding must be properly identified and defined. Free-riding exists only where "one firm misappropriates an investment made by another firm in a way that reduces the victim's incentives (or the incentives of similarly situated firms) to invest."[205] So in *AFS* and *Rothery* the free-riding threat was that the network would have little incentive to engage in product promotion if the network members could use the fruits of that promotion to benefit themselves rather than the network.

Free-riding does not occur simply because network members participate in alternative networks. In the AFS example, the mere fact that a florist decides to send transactions through AFS (an alternative network offering a higher reimbursement rate) does not constitute free-riding. It is only free-riding if, in engaging in bypass, the florist somehow misappropriated an investment of FTD or Teleflora and reduced the incentive of these networks to invest in the first place.

Second, where there is a significant threat of free-riding, the restriction must be carefully tailored to solve the competitive concern. An absolute ban on participating in an alternative network, as in the *NASL* case, should not survive antitrust scrutiny. Such a ban probably will be overbroad unless the potential for free-riding is so severe that it threatens the competitive significance of the network.

---

203 *Id.* at 675 (emphasis in original); *see* General Leaseways v. National Truck Leasing Ass'n, 744 F.2d 588, 592 (7th Cir. 1984) (rejecting argument of trucking association that territorial restrictions were necessary to prevent association members from exploiting the association's services by expanding into other member's territories and demanding more services than it provided, because the association members had chosen to charge each other for services); *see also* Premier Elec. Constr. Co., v. National Elec. Contractors Ass'n, 814 F.2d 358 (7th Cir. 1987) (mandatory fee assessment on nonmembers of association not justified by free rider concerns); United States v. Microsoft Corp., 1998-2 Trade Cas. (CCH) ¶ 72,261 (D.D.C., 1998) (noting Microsoft could avoid free-riding problem by assessing a fee rather than extracting exclusionary rights).

204 Ultimately the district court approved a system in which the Chicago Bulls shared part of the revenues from the broadcasts with the rest of the league. *See* Chicago Professional Sports L.P. v. National Basketball Ass'n, 1995-2 Trade Cas. (CCH) ¶ 71,253 (N.D. Ill. 1995). The court held that the league was entitled to a fee based on the net revenue received from the broadcasts to that part of the nation not in the Bulls' local broadcast area.

205 HOVENKAMP, *supra* note 38, at 19-20.

A more limited exclusivity provision (or other alternatives to prevent free-riding) will be preferable.[206] Where a charge can be assessed for free-riding, such a charge will be less restrictive of competition as in the *Chicago Professional Sports* case. If the concern is free-riding on promotion, then behavioral rules can be adopted so that consumers are not deceived, as in *Rothery*. If there is a need to recover network investments, exclusivity should be clearly limited to the period of time necessary to recover those investments.

An example of a limited, focused exclusivity rule was the one in the *National Bank of Canada* case discussed earlier. In that case, Mastercard's exclusivity rule was upheld in part because it was limited and focused on overcoming the barriers to entry and network development. The exclusivity rule was adopted when Mastercard entered the market; it was necessary to protect the original members' start-up costs in the venture; and it was for a limited period of time (i.e., eight years).[207] A more extensive exclusivity rule may not have been found to have been reasonably related to the efficiency goals of the venture.

One area where regulators have provided more focused guidance on the appropriate duration of exclusivity involves the review of exclusive programming arrangements between programmers and cable operators by the Federal Communications Commission (FCC). After the *Primestar* case,[208] Congress amended the Cable Act to require that the FCC approve exclusivity rules as consistent with the public interest.[209] The FCC has approved exclusivity arrangements where "the duration of the exclusivity

---

206 *See* Sullivan v. NFL, 34 F.3d 1091, 1103 (1st Cir. 1994) (claimed benefits of a restraint "cannot outweigh its harm to competition, if a reasonable, less restrictive alternative to the policy exists that would provide the same benefits" as the challenged policies); *see also* Joseph Kattan & David A. Balto, *Analyzing Joint Ventures' Ancillary Restraints*, ANTITRUST, Fall 1993, at 13.

207 *See* National Bancard Corp. v. VISA U.S.A., Inc., 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592 (11th Cir. 1986); *see also supra* notes 147-142 and accompanying text.

208 *See* United States v. Primestar Partners, L.P., No. 93 Civ. 3919 (S.D.N.Y. filed June 9, 1993); New York v. Primestar Partners, L.P., No. 93 Civ. 3868 (S.D.N.Y. filed June 9, 1993); *see also supra* notes 46-48 and accompanying text.

209 Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (codified at 47 U.S.C. §§ 521-59 (1994)); *see also* James W. Olson & Lawrence J. Spiwak, *Can Short-term Limits on Strategic Vertical Restraints Improve Long-term Cable Industry Market Performance?*, 13 CARDOZO ARTS & ENT. L.J. 283 (1993).

> In order to determine whether an exclusive contract is in the public interest, the Commission must consider the following five factors:
>
> (A) The effect of such exclusive contract on the development of competition in local and national multichannel video programming distribution markets;
>
> (B) The effect of such exclusive contract on competition from multichannel video programming distrib)ution technologies other than cable;
>
> (C) The effect of such exclusive contract on the attraction of capital investment in the production and distribution of new satellite cable programming;
>
> (D) The effect of the exclusive contract on diversity of programming in the multichannel video programming distribution market; and
>
> (E) The duration of the exclusive contract.

47 U.S.C. § 548(c)(4) (1994).

is tailored to the minimum period of time reasonably necessary to develop and firmly establish the programming service through assured financing, promotion, and marketing."[210] For example, in *Cablevision Industries Corp.* the FCC rejected an eight-year exclusivity provision for the Sci-Fi cable network because Sci-Fi was an established programming service with over 16 million subscribers.[211] In contrast, in *New England Cable News*, the FCC approved a seven-year exclusivity period for a new regional cable news service.[212]

Insofar as less restrictive arrangements, such as the compensation scheme in *Chicago Professional Sports* or the alternative facility rule of *Rothery*, can be effective in achieving those efficiencies, more absolute restrictions on competition may not survive antitrust scrutiny. As Professor Hovenkamp observes:

> In general, the underlying question to be asked is, assuming the venture as a collective has market power, will the venture's own members be able to force competition in price or innovation through competition outside the venture. A practicable free rider fix that permits members to compete from outside should always be preferred to one that does not.[213]

CONCLUSION

There are no simple answers in analyzing the effect of network exclusivity. In many settings, such rules could be procompetitive, assuming that the exclusivity rule is reasonably related to the efficiencies sought by the network. In the joint venture context, exclusivity rules may be particularly problematic. As the Supreme Court decisions in *BMI* and *NCAA* suggest, ensuring that individual members of a network are free to increase output is central in evaluating the competitive conditions of a network and carefully tailored to achieve those efficiencies. Thus, careful antitrust scrutiny is warranted where exclusivity provisions are involved.

---

210 Cablevision Indus. Corp., 10 F.C.C.R. 9786 (1995).

211 *See id.*

212 *See* New England Cable News, 9 F.C.C.R. 3231 (1994).

213 HOVENKAMP, *supra* note 38, at 23.

Reprinted with permission from the George Mason Law Review. Original at 77 Geo. Mason L. Rev. 523 (1999).