Quasi Exclusive Dealing

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A firm’s discounting policies over a single product raise exclusive dealing concerns in two situations. Literally, the practices are not exclusive dealing because they do not involve a condition that the purchaser not deal in the goods of a rival, although they may create a pricing incentive for it not to do so.

First, the firm may condition a discount on an exclusive deal. Second, the firm may offer quantity discounts of such a nature that their effect is to induce customers to take all their requirements for a given product from the defendant. In addition, a firm may employ “slotting” fees or similar allowances paid by manufacturers to retailers, with the possible result that rivals have difficulty obtaining access to shelf space. In general, challenges to above cost discounting, where the engine of exclusion is price, must meet more severe structural requirements than exclusive dealing. Indeed, predatory pricing is a “monopolization” offense requiring significant market shares in at least the 60-70% range, and it would be perverse to assess stricter structural requirements in cases involving below cost pricing than in those challenging prices that are above cost.

Exclusionary Discounting and Rebate Practices

Discounts Conditioned on Exclusivity

A discount conditioned on exclusivity should generally be treated as no different from an orthodox exclusive-dealing arrangement. Section 3 of the Clayton Act expressly makes it unlawful to offer a “discount…or rebate…on the condition, agreement, or understanding that the…purchaser…shall not use or deal in the goods…of a competitor” where the required threat to competition occurs. Further, as the Supreme Court made clear in Tampa Electric, §3 of the Clayton Act condemns not merely express exclusive-dealing contracts but also contracts that have the “practical effect” of inducing exclusive dealing. Thus, antitrust policy should not differentiate between the manufacturer of widgets that explicitly imposes exclusive dealing on its dealers and the manufacturer that gives such dealers a discount or rebate for dealing exclusively in the manufacturer’s widgets.

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1 The word “defendant” describes the firm or person whose conduct is in question, even though it is purely hypothetical or has never been sued.


4 See, e.g., Brown Shoe Co., Inc., 62 F.T.C. 679, 714 (1963), rev’d, 339 F.2d 45, 47 (8th Cir. 1964), rev’d, 384 U.S. 316, 319 (1966) (shoe dealers agreeing not to deal in shoes of rivals received discounts); U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 & n.3 (1st Cir. 1993) (higher compensation for physicians agreeing to work exclusively for defendant's health maintenance organization, while compensation set at lower levels for physicians not so agreeing); Whitwell v. Continental Tobacco Co.,
To be sure, the fact that the inducement to agree to exclusive dealing is a price discount may not be completely irrelevant. For example, in explaining why a buyer has agreed to exclusive dealing the discount policy may render alternative efficiency explanations less likely—for example, that the buyer wanted an ensured source of supply that exclusive dealing tended to provide. In that case the seller would not need to offer a discount to induce the buyer to accept exclusive dealing.

Discounts conditioned on exclusivity in relatively short-term contracts are rarely problematic. In general, short-duration contracts are not troublesome to antitrust policy, provided that other switching costs are not onerous.\(^1\) Perhaps a dominant firm’s ongoing policy of offering discounts in exchange for exclusivity gives buyers incentives to stay with the same firm. But any above-cost discount can be matched by an equally efficient firm. For that reason short-term discounts should generally be regarded as no more anticompetitive than short-term absolute exclusive-dealing contracts.

Discount contracts may contain troublesome “all or none” provisions. For example, the Microsoft consent decree restrained that firm from offering discounts to manufacturers of IBM-compatible computers on the condition that the manufacturers pay the license fee for every computer that it manufactured, whether or not that computer actually contained an operating system licensed by Microsoft.\(^6\) The impact of

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\(^1\) See 11 ANITRUST ¶ 1802g.  
\(^2\) Microsoft, consent decree, 59 Fed. Reg. 42,845 (Aug. 19, 1994), eventually approved by 56 F.3d 1448 (D.C. Cir. 1995). See also Richard M. Steuer, Discounts and Exclusive Dealing, 7 ANITRUST 28 (Spring 1993), who notes that Microsoft’s discounts for exclusivity ran as high as 60 percent. Similarly, the Microsoft “per processor” license arrangement, under which computer manufacturers paid Microsoft a fee for each computer assembled, whether or not it incorporated any Microsoft software, operated as a kind of reverse discount; that is, while it did not reduce the cost to a computer manufacturer who agreed
this policy was to give computer makers the incentive, first, to agree to the fee structure in order to get the lower price; and second, to install Microsoft operating systems on all their computers once the agreement was in place. With the agreement in force, the incremental cost of installing the Microsoft operating system on a particular computer was zero, since the fee had to be paid whether or not that computer contained a Microsoft system. By contrast, using a license from any other firm would have cost the computer maker the price of that license, thus making its investment in computers with non-Microsoft operating systems greater than in those with Microsoft systems.

Such a scheme is problematic only when the defendant is a dominant firm in a position to force manufacturers to make an all-or-nothing choice. For example, suppose that Microsoft has a 90 percent share of IBM-compatible operating systems, and compatibility concerns led some 90 percent of customers to prefer a Microsoft operating system. At the same time, however, the remaining 10 percent of customers have unique needs or tastes and would prefer a non-Microsoft system such as IBM's OS-2 system. In such circumstances the computer manufacturer would be best off by serving the mix of customers that come to its door, perhaps selling 90 percent of its computers with a Microsoft system installed and the remaining 10 percent with the systems of rivals. In that case the discount policy effectively puts the manufacturer to the choice of either installing the Microsoft system on 100 percent of its computers or on none at all. Since the hardware maker cannot afford the second alternative, given Microsoft's dominance, it selects the first. The Government's Guidelines on Intellectual Property Licensing address this situation. They note that 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.”

In its 1922 United Shoe Machinery decision the Supreme Court condemned USM's policy of offering a discount on the leases of its shoe machines on the condition that the shoe manufacturer not use the machines of a competitor. As the Court explained, “[w]hile the clauses enjoined do not contain specific agreements not to use the machinery of a competitor of the lessor, the practical effect of these drastic provisions is to prevent such use.” Other courts have drawn similar conclusions about “penalty”

to use Microsoft products exclusively, it increased the costs of using a competitor's software because in that case the manufacturer would have to pay one license fee to Microsoft and a second fee to the competitor. See Microsoft, consent decree, 59 Fed. Reg. 42,845-02, 42,850 (Aug. 19, 1994) (“In effect, the royalty payment to Microsoft when no Microsoft product is being used acts as a penalty, or tax, on the OEM's use of a competing PC operating system.”).

7ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 4.1.2 (1994); these Guidelines are reprinted as Appendix C in the Supplement.

8United Shoe Machinery Corp. v. United States, 258 U.S. 451, 455, 457 (1922). The clause at issue provided for a reduced royalty “for lessees who agree not to use certain machinery on shoes lasted on machines other than those leased from the lessor.” Id. at 457.

9Id. at 457. See also Carter Carburetor Corporation v. Federal Trade Commission, 112 F.2d 722 (8th Cir. 1940), finding that a dominant carburetor maker's discount for customers agreeing not to buy competitors' carburetors violated §3. The practice prevented small rivals from obtaining any foothold in the market, even if they had a superior product and a lower price. Id. at 733. The court found it irrelevant 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 as though it
clauses that effectively require lessees or purchasers to pay a higher price if they use competing goods.\textsuperscript{10}

\textit{Quantity, Market Share, and Related Discounts and Rebates}

Somewhat different from discounts conditioned on exclusivity are discounting plans that simply give a customer a lower price for buying in larger absolute quantities or a larger proportion of its needs. Of course, only extreme quantity discount programs amount to de facto exclusive dealing, but the situation can occur.\textsuperscript{11} Suppose that the largest users of coal purchase one million tons per year, and that the defendant's discount program offers incremental and cumulative discounts in 100,000 ton increments all the way through and beyond the one million ton mark. In that case a buyer obtains the defendant's lowest price by purchasing all of its coal needs there. As a consequence that buyer purchases no coal from others.

Quantity discounts are often challenged by smaller, disfavored customers under the “secondary line” provisions of the Robinson-Patman Act.\textsuperscript{12} Such cases are not concerned with the foreclosure injuries of rival sellers, however. Quantity discounts could also constitute a form of predatory pricing, which is unlawful when structural and pricing conditions are met.\textsuperscript{13} But the quantity discount program to be challenged as unlawful exclusive dealing would necessarily have to be one that involves prices above cost, or else the program would not be sustainable.\textsuperscript{14}

\textsuperscript{10}See Chiplets, Inc. v. June Dairy Prods. Co., 89 F. Supp. 814 (D.N.J. 1950), 114 F. Supp. 129 (D.N.J. 1953) (condemning penalty clauses in leases of butter pat-making machines; penalty had to be paid when the lessee also used the machine of a rival. See 114 F. at 143. No discussion of defendant's market share.).

\textsuperscript{11}One must distinguish contracts that simply provide a discount for a single large purchase. While an exclusive dealing contract “flatly eliminates the buyer from the market for its duration,” a “fixed quantity” contract leaves open the possibility “that the buyer's needs will exceed his contractual commitment; he is free to purchase from others any excess amount that he may want.” Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 237 (1st Cir. 1983) (single large purchase at a discount not “exclusive dealing”); accord Main St. Publishers, Inc. v. Landmark Commc'ns, Inc., 701 F. Supp. 1289, 1295 (N.D. Miss. 1988).


\textsuperscript{13}See 3A Antitrust Law Ch. 7C-2 on the structural prerequisites to predatory pricing, and id., Ch. 7C-3 on the pricing requirements.

\textsuperscript{14}See Barr Labs., Inc. v. Abbott Labs., 978 F.2d 98, 105–07 (3d Cir. 1992) (discount program challenged as unlawful exclusive dealing did not involve prices below cost; as a result it was not predatory pricing); see also W. Parcel Serv. v. UPS of Am., Inc., 190 F.3d 974 (9th Cir. 1999) (distinguishing volume discounts from exclusive dealing; former are “not exclusive dealings” and are “legal under antitrust law,” citing Fedway Associates. v. United States Treasury, 976 F.2d 1416, 1418 (D.C. Cir. 1992)). Cf. Virgin Atl. Airways, Ltd. v. British Airways PLC, 257 F.3d 256 (2d Cir. 2001)
Most quantity discount programs are undoubtedly designed to reflect the reduced costs of larger transactions. As such, they are clearly competitive and antitrust should encourage them. But suppose that a discounting program is clearly in excess of anything justified by significant savings. For example, suppose that the program gives incremental discounts stretching up to very large volumes and permits the aggregation of all purchases over a lengthy period, say one year. In order to qualify for the maximum discount, the buyer will then make all its purchases from that seller during the one-year period; any division between two sellers would reduce the discount.

One approach to such schemes is to treat them as exclusive dealing contracts, with the contract period equal to the period over which purchases can be aggregated for purposes of measuring the size of the discount. For example, suppose that a coal seller gives an additional 1 percent discount off the entire purchase price for each incremental 1,000 tons of coal purchased—a 1 percent discount if the purchase totals 1,000 tons, a 2 percent discount if the purchase totals 2,000 tons, and so on. Further, for purposes of computing the discount, the seller permits the purchaser to aggregate all purchases made within a calendar year. As a result, switching coal suppliers at any time within the year forces a retroactive decrease in the discount of coal that has been purchased to that point.

Note first that this arrangement should generally have no greater anticompetitive effect than an outright exclusive dealing arrangement of one year’s duration. If exclusive dealing under equivalent structural conditions and subject to equivalent defenses were lawful, the discount arrangement should be lawful as well. But the competitive impact must in fact be less because any equally efficient rival can take the customer by bidding a better price and even compensating the customer for the loss of the discount from the defendant—assuming, as we have, that the defendant’s program results in above-cost prices at all discount levels. Further, if a rival cannot match the price even when it is above cost, that suggests that the quantity discount program is efficient in the sense that the larger-volume transaction imposes lower per-unit costs than a smaller transaction would. For these reasons we suggest that discounts attached merely to the quantity of goods purchased, and not to exclusivity itself, be treated as lawful, and not be subjected to the laws of exclusive dealing.² The exception is when the discounted price is below cost, in which case it would be subject to the ordinary rules governing predatory pricing.³

Some decisions involve situations where the defendant aggregates the discount across two or more related products, while the plaintiff produces only one or a subset of these products. These “bundled” discounts are often treated by the courts as unilateral

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² See Barr Labs, 978 F.2d at 110–11 (doubting whether “exclusive dealing” applied to an arrangement where pharmaceutical purchasers received a discount for purchasing a large quantity of defendant’s products and also promised to sell its products where they were able to do so, although they also continued to sell the products of rivals).

³ See generally 3A Antitrust Law Ch. 7C.
exclusionary practices. However, they have also been treated as tying arrangements and subjected to somewhat different legal tests under §1 of the Sherman Act. In appropriate circumstances such multi-product discount programs can exclude an equally efficient rival that produces only one product, for the latter would need to give a much larger discount in order to compensate customers for the loss of discount on products that it did not sell.

One important difference between discounts offerings and exclusive dealing relates to the relative ease with which rivals can make competing offers. Traditional tying and exclusive dealing are typically long-term contractual arrangements. The buyer can purchase the good subject to the exclusive agreement only by breaching its contract or else by giving up something else in which it has made a significant investment. For example, a franchise tying or exclusive dealing agreement typically requires the franchisee or dealer to purchase the supplier’s good exclusively. The buyer can purchase the good from rivals only by giving up its franchise or dealership, which may be far more valuable to the dealer than the value of any savings from an alternative purchase, particularly if the dealer has significant costs invested in its dealership.

The result is that an equally efficient producer of the excluded product cannot steal the sale simply by offering a somewhat lower price. For example, the pizza franchisees in Queen City or the tooth product dealers in Dentsply could not profit by purchasing cheaper pizza dough or tooth-filling materials from a rival seller because any gains from

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16See 3A ANTITRUST ¶ 749 in the main text and Supplement. See Cascade Health Solutions v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008); LePage’s, Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003) (en banc), cert. denied, 542 U.S. 953 (2004). SmithKline Corporation v. Eli Lilly and Company, 427 F. Supp. 1089 (E.D. Pa. 1976), aff’d, 575 F.2d 1056 (3d Cir.), cert. denied, 439 U.S. 838 (1978), which condemned the defendant’s discount program that aggregated three drugs, only one of which was produced by the plaintiff. The defendant produced drugs A, B and C. B and C were high-profit, high-volume drugs in which the defendant faced little competition. However, the defendant produced A in competition with the plaintiff’s similar drug, A’. The defendant then launched a rebate program that gave hospitals and other large purchasers a 3 percent rebate above all others provided they purchased a stipulated minimum quantity of the aggregate of its three drugs. In order to obtain the rebate, many hospitals had to take the defendant’s A, and because the rebate extended across high-volume B and C, the defendant promised a very large discount. In order to give an equivalent discount on its single drug A’, the plaintiff would have to cut its price by as much as 35 percent. SmithKline, 575 F.2d at 1060–62. While the facts resembled tying, the court found that the “agreement” requirement had not been met, but it condemned the arrangement under §2 of the Sherman Act. See also Erik Hovenkamp & Herbert Hovenkamp, Exclusionary Bundled Discounts and the Antitrust Modernization Commission, 53 ANTITRUST BULL. 517 (2008); Erik Hovenkamp & Herbert Hovenkamp, Complex Bundled Discounts and Antitrust Policy, 57 BUFF. L. REV. 1227 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1344536 (concerning bundles with variable proportions and bundles containing more than two products).

4 On the tying arrangement test and comparison of the §1 and §2 approaches, see 10 ANTITRUST ¶ 1758.

lower prices would almost certainly not be enough to compensate them for the loss of their dealerships or franchises.\textsuperscript{S2} For these reasons issues of contract duration and “switching” costs are relevant in cases involving exclusive dealing. They tell us something about the likelihood that rivals will be able to compete against the defendant’s arrangement.

By contrast, the discount conditioned on exclusivity places the buyer in a much different position: when it purchases from a rival it loses the discount, but not its dealership or franchise. If Domino's merely offered its franchisees a 10 percent discount if they committed to purchasing all of their pizza dough from their franchisor, then any rival would have been able to steal the franchisees’ trade simply by meeting or beating the discounted price. Because the franchise itself is not at risk, an equally efficient rival should be able to steal the sale as long as the fully discounted price is above cost. As a result, the “duration” of a discount program is no longer than the time it takes for a rival to match the discount.

This analysis applies to all situations in which the discount covers to a single product, or where the discount applies to multiple products but at least one significant rival makes the same set of products. In all such cases an equally efficient rival could steal the sale and – given that there is no exclusive dealing – the buyer would not suffer a penalty by accepting the rival's offer other than the loss of the transaction with the dominant firm. The analysis necessarily also applies to quantity and “market share” discounts.\textsuperscript{S3} Further, a discount that requires the purchaser to take less than 100 percent of its product from the seller excludes less than a discount conditioned on exclusivity.

We therefore question the conclusion by the district court in \textit{Natchitoches} that a discount practice foreclosing 32 to 39 percent of a market for medical disposal containers might have violated the Sherman Act, even though the fully discounted price was not shown to be below any measure of cost.\textsuperscript{S4} Not only were the discounts conceded to be above cost, but the plaintiff in this case was a hospital purchaser alleging a monopoly overcharge as damages. In that case equally efficient rivals accounting for more than 60 percent of the market could easily have obtained the sales


\textsuperscript{S3}E.g., Concord Boat Co. v. Brunswick Corp., 207 F.3d 1039 (8th Cir.), \textit{cert. denied}, 531 U.S. 979 (2000) (refusing to condemn above-cost market share discounts because purchasers were free to walk away at any time and purchase from a rival).

\textsuperscript{S4}Natchitoches Parish Hosp. Serv. Dist. v. Tyco Intern., Ltd., No. 1:05-CV-12024-PBS, 2009 WL 4061631 (D. Mass. Nov. 20, 2009). The court also gave weight to claims that the defendant acted anticompetitively by monitoring the purchasing practices of hospitals for compliance; but it is unclear why ensuring that one is complying with a contract should be regarded as anticompetitive. Finally, the market shares covered by these arrangements was found to be in the range of 32%-39%, which is too low for effective foreclosure, given that the arrangements were not exclusive dealing at all but rather market share discounts, and also were not predatory pricing. \textit{See} ¶d.
simply by bidding a less monopolistic price.\textsuperscript{55}

By contrast, in \textit{Allied Orthopedic} the Ninth Circuit rejected claims challenging the defendant's discount programs under both §§1 and 2 of the Sherman Act.\textsuperscript{56} The product in question was pulse oximetry devices, which collect information about a hospital patient's heart and blood oxygen and transmits this information to a screen. Tyco pioneered technology that made it less costly for hospitals to upgrade and add additional features to their pulse oximetry systems. Tyco sold these devices to hospitals principally through group purchasing organizations (GPOs), and many of the sales were "sole source," which means that Tyco's product was the only one on the GPO contract.\textsuperscript{57} The pricing was also subject to market share, or "loyalty," discounts which gave purchasers a lower price if they agreed to purchase a specified minimum percentage of their pulse oximetry needs from Tyco. However, hospitals were not required to purchase exclusively from Tyco and, for that matter, were not required to purchase exclusively through the GPO contract at all. They were free to purchase elsewhere; although they could lose Tyco's discount if they purchased more than a specified percentage elsewhere. Finally, even Tyco's fully discounted prices were not alleged to be below cost; to the contrary, the plaintiffs were purchasers seeking damages for overcharges on the theory that the prices contained an element of monopoly markup. Tyco had at least two rivals, Masimo and GE.

The district judge had found that these arrangements did not violate the antitrust laws because the contractual arrangement did not prohibit hospitals from purchasing from one of the competitors; they were free "at any time" to switch. In affirming the court found it "significant that the market-share discount and sole-source agreements in this case did not contractually obligate Tyco's customers to purchase anything from Tyco. Rather, the agreements provided only for substantial discounts to customers that actually purchased a high percentage of their sensor requirements from Tyco."\textsuperscript{58} In this particular case at least one of the rivals was selling generic sensors at a lower price than Tyco's price and the expert "never explained why price-sensitive hospitals would adhere to Tyco's market-share agreements when they could purchase less expensive generic sensors instead."\textsuperscript{59} The plaintiff's expert:

postulated that if a hospital chose to purchase a competitor's monitor, that hospital could lose Tyco's discounts on the sensors it continued to need for its installed base of Tyco monitors.

\textsuperscript{55}Even if one believed that the Sherman Act should reach exclusion of less efficient rivals, in this case the court cited no evidence of scale economies, nor any evidence that rivals were in fact less efficient than the plaintiff.

\textsuperscript{56}Allied Orthopedic Appliances, Inc. v. Tyco Health Care Grp., LP, 592 F.3d 991 (9th Cir. 2010). See also Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000) (approving market share discounts on boat motors sold to boat manufacturers).

\textsuperscript{57}\textit{Allied Orthopedic}, 592 F.3d at 995 (“Under Tyco's sole-source agreements, a GPO agreed that it would not enter into a purchasing contract with any other vendor of pulse oximetry products, and Tyco in return offered a deeper discount. Like Tyco's market-share discount agreements, the sole-source agreements at issue here did not contractually obligate GPO members to purchase anything from Tyco.”).

\textsuperscript{58}\textit{Id.} at 996.

\textsuperscript{59}\textit{Id.}
 Nonetheless, even such a hospital could simply begin to purchase less expensive generic sensors for its remaining Tyco monitors. We thus agree with the district court that on the facts of this case, something more than the discount itself is necessary to prove that Tyco's market-share discount agreements forced customers to purchase its sensors rather than generics.\textsuperscript{S10}

In sum, “any customer subject to one of Tyco’s market-share discount agreements could choose at any time to forego the discount offered by Tyco and purchase from a generic competitor,” and this fact substantially negated the foreclosure claim.\textsuperscript{S11}

The same reasoning largely applied to the “sole source” agreements with group purchasing organizations (GPOs). Under those arrangements the GPO placed only a single supplier’s product on a GPO contract for hospital purchase, but nothing required the hospital to purchase exclusively through that particular contract. Only one of the GPO contracts at issue forbade a hospital from being a member in any other GPO at the same time.\textsuperscript{S12} However, even this particular GPO’s arrangement did not prohibit the hospitals from purchasing from the vendors completely outside the GPO arrangement.

The court also spoke briefly of its previous \textit{Masimo} decision, which had condemned some market-share and sole-source arrangements under the Sherman Act.\textsuperscript{S13} In that case, however, the facts were that a particular Tyco patent was still in effect that effectively required customers to purchase Tyco sensors for their installed base of Tyco monitors. This fact had given Tyco additional tying-like leverage and served to justify the lower court’s conclusion of illegality. But the patent had since expired and the monitors and sensors were not technologically independent of one another.\textsuperscript{S14}

While loyalty discounts have seemed troublesome to some,\textsuperscript{5} most of them are undoubtedly beneficial, bringing lower output and higher prices. Perhaps problematically, their greatest value lies in markets with high fixed costs, which of course are also markets that are structurally more conducive to market dominance. The markets for such things as medical and computer devices, where such discounts frequently occur, are typically characterized by high fixed costs for innovation and production and frequently they also have relatively short production runs as a result of relatively quick obsolescence. In that setting the price that a firm can bid is critically

\textsuperscript{S10}Id. at 997.
\textsuperscript{S11}Id.
\textsuperscript{S12}Allied Orthopedic, 592 F.3d at 997, speaking of the HealthTrust GPO.
\textsuperscript{S13}Id. at 997 & n.2 (referring to Masimo Corp. v. Tyco Health Care Grp., No. 07-55960, 350 Fed. Appx. 95, 2009 WL 3451725, 2009 U.S. App. LEXIS 23765 (9th Cir. Oct. 28, 2009)).
\textsuperscript{S14}See 3A \textsc{Antitrust} ¶ 749e.
sensitive to its expectations about output. For example, if fixed development costs for a device are $1,000,000 and variable production costs are $100, the firm’s breakeven point is $1,100 per unit if 1000 units are sold over the product’s life. However, they fall to $200 if the firm sells 10,000 units, and to $110 if the firm sells 100,000 units. The firm very likely cannot control for market wide swings in demand; however, it can maximize its output by inducing customer loyalty. In this setting a market share discount effectively “shares” with the customer the costs of lower as opposed to higher output. To the extent customers buy more they can expect prices to be lower, because costs will be lower too. To be sure, in concentrated markets this practice may force lower output and thus higher unit costs on rivals. But even the monopolist should be able to reduce its own costs without concern about the impact on rivals. Further, equally efficient rivals can attain similar efficiencies for themselves. In some extreme cases the market may not have room for the high output of two or more rivals, but antitrust should not be brought to bear to protect smaller rivals by imposing inefficiently low rates of output at consumers’ expense.7

Slotting Allowances and Related Purchases of Distribution Services

Some discounts take the form of payments that producers pay up front to grocers or other retailers, effectively for access to the retailer’s shelf space.18 For example, a


7 The FTC’s case against Intel Corp. ended in a consent decree limiting Intel’s right to use market share or related discounts. See In re Intel Corp. V.A. (FTC # 9341) (Aug. 4, 2010) (consent order), available at http://www.ftc.gov/os/adjpro/d9341/100804inteldo.pdf; see id. at IV.A.7. The provision permits Intel to offer a discount on those units sold in excess of a certain percentage, but not a discount on all purchases if total sales exceed a specified percentage. For example, under the decree Intel may offer a 3% discount on all purchases in excess of 100,000 units. However, it may not offer a 3% discount on all purchases, provided that the purchaser takes at least 100,000 units. This provision is intended to make it easier for a rival to match Intel’s prices on a unit by unit basis, rather than also requiring the rival to compensate Intel for loss of discount on foregone sales. A later provision in the decree permits Intel to match any discount that it reasonably believes is being offered by a rival. Id. at IV.B.3.


Slotting allowances may also violate the Robinson-Patman Act when they create discounts that are not functionally available to all wholesale purchasers. As such, they are typically dealt with as a form of “indirect” price discrimination. See 14 ANTITRUST ¶ 2322b; see, e.g., Hygrade Milk & Cream Co. v. Tropicana Prods., Inc., 1996 WL 257581, 1996-1 Trade Cas. ¶ 71,438 (S.D.N.Y. May 16, 1996) (denying summary judgment).
grocer may wish to allocate scarce display space to only two of the three major brands of prepared baby food. While the grocer feels that it must carry Gerber, the major brand, smaller rivals Heinz and Beech-Nut are forced to compete with each other for the second spot by offering the retailer an “allowance”—payment for access to the grocer's shelf space.\textsuperscript{19} Most typically, the size of the allowance is “fixed”—that is, it does not vary with the number of units sold, although it may be proportioned to the amount of shelf space that the item in question requires.

Slotting allowances are rarely anticompetitive except in the unusual case when they are paid by a dominant firm for complete or substantial exclusivity.\textsuperscript{20} In most cases the allowances are paid to retailers in order to induce them to carry and display a product whose prospects are uncertain to the retailer. This could be a new and untested product, but it could also be a product whose historical demand is flat or declining or that faces entry from new rivals or brands. In such cases the allowance signals that the manufacturer or distributor of the good in question has greater confidence about its sales prospects than the retailer has, perhaps because the retailer has less information.

\textit{See also} NicSand, Inc. v. 3M Co., 507 F.3d 442 (6th Cir. 2007) (en banc). Although much of that decision concerns the merits of slotting-like practices, the court dismissed the complaint for lack of standing. See 2 ANTITRUST ¶ 348 in the Supplement.

\textsuperscript{19}These were the facts of \textit{Federal Trade Commission v. H.J. Heinz Company}, 246 F.3d 708, 712 (D.C. Cir. 2001), which refused to approve a merger between the second and third firms in the market, in part because it would have eliminated the competition between them for the second spot. As the D.C. Circuit described the situation:

\begin{quote}
At the wholesale level Heinz and Beech-Nut both make lump-sum payments called “fixed trade spending” (also known as “slotting fees” or “pay-to-stay” arrangements) to grocery stores to obtain shelf placement. Gerber, with its strong name recognition and brand loyalty, does not make such pay-to-stay payments. The other type of wholesale trade spending is “variable trade spending,” which typically consists of manufacturers' discounts and allowances to supermarkets to create retail price differentials that entice the consumer to purchase their product instead of a competitor's.
\end{quote}

\textit{Id.} at 712.

The district court incorrectly concluded that slotting fees should be disregarded because there was no evidence that they resulted in lower prices to consumers. See \textit{F.T.C. v. H.J. Heinz Co.}, 116 F. Supp. 2d 190, 197–98 (D.D.C. 2000), \textit{rev'd}, 246 F.3d 708 (D.C. Cir. 2001). But the difficulty of tracing a discount hardly indicates an absence of competitive significance. Rather, the competition was for scarce shelf space, and a high slotting allowance was effectively the winner's willingness to assume a great amount of the risk of poor sales. (To the extent it is relevant, H.H. was consulted by one of the merging firms).

\textsuperscript{20}In \textit{Conwood Company, L.P. v. United States Tobacco Company}, 290 F.3d 768 (6th Cir. 2002), \textit{cert. denied}, 537 U.S. 1148 (2003), the Sixth Circuit condemned the defendant's program of giving a .3 percent price discount to retailers in exchange for their “providing USTC [the defendant] with sales data, and participating in USTC promotion programs, and/or giving the best placement to USTC racks and POS,” even though the discounts were not conditioned on exclusivity at all. The court did not require any showing of anticompetitive effects or, for that matter, that the practice was even capable of excluding anyone. Now did it explain why rivals who themselves had extraordinarily high margins could not match a discount of less than \([\text{fraction numer}="1" \text{denom}="2"]\) percent. (To the extent it is relevant, H.H. was consulted by the defendant).
about the good’s prospects.

The special characteristic of the “fixed” slotting allowance that gives it this risk-transferring property is that it is a discount that diminishes as the volume of goods sold increases. To illustrate, suppose a grocer is somewhat unsure about the resale prospects of Brand X, a new breakfast cereal. Many brands of cereal compete for limited grocer shelf space, and the grocer must have some means of selecting among them. Brand X offers the grocer $100 a month for 18 inches of shelf space, which is the amount necessary to display Brand X. If the grocer accepts this deal and sells 1,000 boxes of Brand X monthly from this space, the discount amounts to only 10 cents per box. If it sells only 100 boxes monthly, however, the discount amounts to $1.00 per box; and if the cereal is a real flop, and sells only 10 boxes monthly, the discount comes out to a prohibitive $10.00 per box. By paying this allowance the manufacturer effectively assures the grocer that the manufacturer’s product will be in the successful, high-volume category.

To be sure, one can imagine an extreme case in which an upstream monopolist uses slotting allowances or equivalent payments to purchase all, or at least most, of a grocer’s shelf space, thus denying access to rivals. Such a case must be analyzed under exclusive-dealing principles, considering both possible benefits and potential anticompetitive effects.21

### Market Share and Foreclosure Requirements

The discussion of exclusive dealing suggests that minimum market shares in the range of 30 to 40 percent are required for condemnation.8 These numbers presume outright exclusive dealing and contracts of sufficiently long duration.9 When the restraint in question excludes less and rivals are in a stronger position to bid business away from the defendant, then foreclosure percentages must accordingly be higher. Importantly, the exclusionary power of loyalty and related discounts is critically dependent on scale economies. Further, foreclosure percentages in the lower range suggest that other rivals can more readily meet the defendant’s prices. Overreaching is particularly likely if there are other firms who are nearly as large as the defendant and thus in a position to make similar discount offers. As a result the structural

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21 See 11 Herbert Hovenkamp, Antitrust Law, Ch. 18 (3d ed. 2011). Slotting allowances have been characterized as a barrier to entry to the extent they operate as an “entrance fee,” or “sunk” cost that must be paid by new firms entering the market. Willard K. Tom, David A. Balto & Neil W. Averitt, Anticompetitive Aspects of Market Share Discounts and Other Incentives to Exclusive Dealing, 67 ANTITRUST L.J. 615, 639 & n.36 (2002). But such fees are sunk only to the extent that any short-term rental fees are sunk. For example, a slotting allowance paid quarterly for shelf space access might resemble a three-month nonrefundable lease on a business van. If the business fails during that period, the unused portion of the lease will not be returned to the lessee. But costs that are sunk over such short-term time horizons are rarely significant entry barriers. For example, even the farmer who fertilizes his field in the spring will probably not be able to recover the cost of “unused” fertilizer in the case of a midsummer crop failure.

8 See 11 ANTITRUST ¶ 1821c.
9 Id. at ¶ 1821d3.
requirements for “quasi” exclusive dealing practices that fall short of actual exclusive dealing, including market share and similar discounts where price is the engine of exclusion, should be the same as those for monopolization cases generally. Indeed, if the discounted prices were below cost and challenged as predatory pricing,\(^\text{10}\) the structural requirements for monopolization would generally apply. It would be quite perverse to require greater market dominance in the case of above cost discounts than the law currently applies to below cost pricing.

\(^{10}\) See 3A Antitrust Law, Ch. 7C.