Exclusivity: The Right and

It's not anticompetitive, *per se*

By Gordon Schnell

With the recent indictment by New York State Attorney General Eliot Spitzer of James Zimmerman, former head of Federated Department Stores, the retail industry has received a stark wake-up call on the risks associated with exclusive dealing. Zimmerman's indictment follows on the heals of Spitzer's successful challenge to an exclusive-dealing arrangement among Federated (owner of Macy's and Bloomingdale's), May Co. (owner of Lord & Taylor and Filene's), Lenox and Waterford Wedgwood for the sale of Lenox china and Waterford crystal. The parties paid a substantial fine (roughly $3 million) and entered into an antitrust consent decree to settle Spitzer's charges.

While entering into exclusives with key suppliers has been a hallmark of retail trade for generations, merchants may now be wary of relying on the prevalence of this industry practice in negotiating exclusives going forward. And for good reason. Spitzer has made a name for himself by exposing industry practices that, while pervasive, are questionable in their legality and their ultimate effect on consumers.

The potential pitfalls associated with exclusive-dealing arrangements principally arise out of Section 1 of the Sherman Act, which prohibits agreements or conspiracies that unreasonably restrain trade. An exclusive deal between a retailer and supplier does not in and of itself violate this proscription. On the contrary, for more than 80 years the Supreme Court has recognized as paramount a company's right to choose with whom it wants to deal.

Furthermore, while exclusivity will obviously diminish competition on an intra-brand basis (competing sellers of the same brand), it actually can foster competition on an inter-brand basis (competing brands). In particular, exclusivity allows the chosen seller to expend considerable resources on selling the product without fear that competing sellers will get a free ride on these efforts. Suppliers can greatly benefit from having a limited number of distributors committed to selling their brand. That is why exclusivity deals typically involve promotional obligations on the part of the seller. Exclusivity also can provide the supplier with greater control over how and where the brand is sold. All of this can lead to stronger competition among rival brands.

The area where exclusivity can lead to trouble is when it becomes the centerpiece of a directed effort by a group of retailers or suppliers to suppress competition from one or more of their competitors. That is exactly what happened in the Lenox/Waterford deal. According to Spitzer, Federated and May Co. secured the exclusive deal for the purpose of preventing Bed Bath & Beyond from selling the Lenox/Waterford products. Such a scheme epitomizes the classic group boycott—two or more sellers getting together to persuade or coerce a key supplier to stop dealing with the sellers' competitor to suppress competition from that seller.

But not all group boycotts violate the antitrust laws. And in the context of retail trade, the line that separates those that do from those that don't can be particularly murky. The trick for retailers is to make sure their arrangements fall outside of the purview of per se antitrust review. As long as they do, it's a pretty safe bet that their exclusives will escape antitrust attack. For

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Wrong Way

those that don't, however, antitrust liability is virtually assured.

The per se trap: Under per se review, a court will not engage in any detailed analysis of the competitive effects of or justifications for the group boycott. Anticompetitive harm is presumed. A plaintiff need only demonstrate the existence of the boycott and of the attributes that make it fall within the per se rubric. There are essentially three: (1) The boycott is horizontal (e.g., encompassing two or more competitors) as opposed to vertical (e.g., covering entities at different levels of the distribution chain); (2) It was designed to suppress price competition; and (3) It involves firms with market power or control over a critical source of supply. If a horizontal boycott contains either of the latter two features, it almost certainly will end up on the wrong side of the per se line.

A boycott that involves concerted, rather than independent, action by competitors is bound to lead to trouble. Under most circumstances, it is perfectly permissible for a retailer to threaten to drop a supplier if it deals with a competing retailer. This is generally true even in the context of several retailers making these threats—as long as they are made independently. Where this conduct often will cross the line is when the retailer threats are coordinated in some fashion, either explicitly or implicitly.

The courts consistently have demonstrated a zero-tolerance policy for restraints that interfere with free and open price competition. After all, the antitrust laws are ultimately about protecting consumers. And nothing hurts consumers more than restricting their ability to obtain the lowest prices possible. So, an exclusive deal that involves any agreement on price rarely will pass muster. In the horizontal context, this is true even when there is no explicit agreement on what the actual price will be. The mere suggestion of pricing foul play—such as competitors consorting to frustrate discount competition—is likely sufficient to elicit per se review, not to mention the ire of certain regulators.

The 'rule of reason' safe harbor: When safely outside the confines of per se review, the antitrust risk retailers face from entering into exclusive deals diminishes sharply. Indeed, there is likely little risk at all. That is because the "rule of reason" will apply. Under this more relaxed form of antitrust review, the courts will perform an exhaustive market analysis of the arrangement and the reasons for its formation. A group boycott will fail this test only if: (1) It has no business justification other than to harm competition (or there exists an alternative arrangement less restrictive of competition), and (2) It actually has harmed competition. In the retail setting, the presence of both of these factors is highly unlikely.

There are a number of legitimate, if not procompetitive, reasons for a supplier to limit the number of sellers through which it distributes its products. This is especially so in retailing where consumer purchases often are based on nothing more than brand image and reputation, and the general customer experience of shopping at a particular store. Any retailer/ supplier effort to manage these consumer hot buttons is entirely reasonable and should not be penalized—unless, of course, it merely is a ruse to harm competition.

Conclusion: Edgy retailers should relax. Spitzer's strike against Zimmerman and the Lenox/Waterford deal is not likely to be the opening round of Spitzer's next industry purge. But it should give retailers pause the next time they are considering an exclusive deal with their suppliers. Just remember this: Don't involve your competitors or competing suppliers; don't talk about your pricing; don't target a discounter; and don't deal with dominance. Stay away from these per se flash points and fear not the wrath of the angry regulator, nor the errant antitrust scuffle. ■

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The 'Per Se' Review

Under per se review, courts will presume a boycott causes anticompetitive harm if the boycott is horizontal—encompassing two or more competitors; and:

a The boycott is designed to suppress price competition.

OR

b The boycott involves firms with market power.