

# AN FTC GUIDE TO DEALINGS IN THE SUPPLY CHAIN

## EXCLUSIVE DEALING OR REQUIREMENTS CONTRACTS

**EXCLUSIVE DEALING OR REQUIREMENTS CONTRACTS** between manufacturers and retailers are common and are generally lawful. In simple terms, an exclusive dealing contract prevents a distributor from selling the products of a different manufacturer, and a requirements contract prevents a manufacturer from buying inputs from a different supplier. These arrangements are judged under a rule of reason standard, which balances any procompetitive and anticompetitive effects.

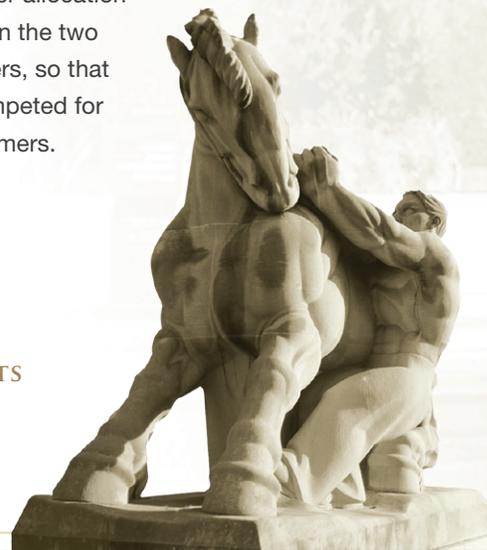
**MOST EXCLUSIVE DEALING CONTRACTS** are beneficial because they encourage marketing support for the manufacturer's brand. By becoming an expert in one manufacturer's products, the dealer is encouraged to specialize in promoting that manufacturer's brand. This may include offering special services or amenities that cost money, such as an attractive store, trained salespeople, long business hours, an inventory of products on hand, or fast warranty service. But the costs of providing some of these amenities—which are offered to consumers before the product is sold and may not be recovered if the consumer leaves without buying anything—may be hard to pass on to customers in the form of a higher retail price. For instance, the consumer may take a “free ride” on the valuable services offered by one retailer, and then buy the same product at a lower price from another retailer that does not offer high-cost amenities, such as a discount warehouse or online store. If the full-service retailer loses enough sales in this way, it may eventually stop offering the services. If those services were genuinely useful, in the sense that the product plus the services together resulted in greater sales for the manufacturer than the product alone would have enjoyed, there is a loss both for the manufacturer and the consumer. As a result, antitrust law generally permits nonprice vertical restraints such as exclusive dealing contracts that are designed to encourage retailers to provide extra services.

On the other hand, a manufacturer with market power may potentially use these types of verti-

cal arrangements to prevent smaller competitors from succeeding in the marketplace. For instance, exclusive contracts may be used to deny a competitor access to retailers without which the competitor cannot make sufficient sales to be viable. Or on the supply side, exclusive contracts may tie up most of the lower-cost sources of supply, forcing competitors to seek higher-priced sources. This was the scenario that led to FTC charges that a large pharmaceutical company violated the antitrust laws by obtaining exclusive licenses for a critical ingredient. The FTC claimed that the licenses had the effect of raising ingredient costs for its competitors, which led to higher retail drug prices.

In some situations, exclusive dealing may be used by manufacturers to reduce competition between them. For example, the FTC challenged exclusive provisions in sales contracts used by two principal manufacturers of pumps for fire trucks. Each company sold pumps to fire truck manufacturers on the condition that any additional pumps would be bought from the manufacturer that was already supplying them. These exclusive supply contracts operated like a customer allocation agreement between the two pump manufacturers, so that they no longer competed for each other's customers.

**ANTITRUST LAW GENERALLY PERMITS NONPRICE VERTICAL RESTRAINTS SUCH AS EXCLUSIVE DEALING CONTRACTS THAT ARE DESIGNED TO ENCOURAGE RETAILERS TO PROVIDE EXTRA SERVICES.**



For discussion of exclusive licensing arrangements involving intellectual property rights, see *Antitrust Guidelines for the Licensing of Intellectual Property*.

**Q:** I AM A SMALL MANUFACTURER OF HIGH-QUALITY FLAT-PANEL DISPLAY MONITORS. I WOULD LIKE TO GET MY PRODUCTS INTO A BIG BOX RETAILER, BUT THE COMPANY SAYS IT HAS AN AGREEMENT TO SELL ONLY FLAT-PANEL DISPLAY MONITORS MADE BY MY COMPETITOR. ISN'T THAT ILLEGAL?

**A:** Exclusive distribution arrangements like this usually are permitted. Although the retailer is prevented from selling competing flat-panel display monitors, this may be the type of product that requires a certain level of knowledge and service to sell. For instance, if the manufacturer invests in training the retailer's sales staff in the product's operation and attributes, it may reasonably require that the retailer commit to selling only its brand of monitors. This level of service benefits buyers of sophisticated electronics products. As long as there are sufficient outlets for consumers to buy your products elsewhere, the antitrust laws are unlikely to interfere with this type of exclusive arrangement.

