AntitrustConnect Blog

Successful Mousetrap Builders Beware – Your Sales Contract Just Might Be "De Facto Exclusive Dealing"

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Say you built a better mousetrap, the world beat a path to your door and now you have a high share of the mousetrap market. Let's further assume that your customers find "the cost of switching [to another mousetrap] prohibitive" through no actions of yours. What else must you do to be accused of entering into a de facto exclusive dealing arrangement that might be anti-competitive? According to an opinion last month in *Pro Search Plus v. VFM Leonardo* (2013-2 Trade Cases ¶78,599; 2013 WL 6229141 (C.D. Cal.)), the answer is "nothing." While it is just a denial of a motion to dismiss by one district court, the opinion and its reliance on the heavily-criticized *ZF Meritor v. Eaton* (696 F.3d 254 (3d Cir. 2012)) case show the difficulties of counseling successful companies on their distribution strategies.

VFM Leonardo provides "production, collection, management and distribution [of] digital photo and rich media for" hotel websites and global electronic reservation systems used by online travel agencies such as Expedia and Orbitz. According to the complaint by its competitor, Pro Search Plus, VFM Leonardo has shares above 70% in the markets for such content and the technology platform to distribute it. VFM Leonardo has agreements with all the major purchasers of these products. None of those agreements explicitly require the buyers to purchase only from VFM Leonardo; in fact, some reference the right of the buyers to continue purchasing from other suppliers. Nonetheless, Pro Search Plus contends that such arrangements violate various antitrust laws under various theories, including that they amount to anticompetitive exclusive dealing.

Exclusive dealing agreements can violate Sherman Act Sections 1 or 2 or Clayton Act Section 3 if, on balance, they are anticompetitive. One requirement for a successful claim, however, is that there be such an agreement – either an express or a de facto one inferred from the surrounding circumstances. Those "surrounding circumstances", however, have always included some actions by the defendant in addition to selling a popular product. For instance, an agreement that the buyer purchase all of its needs from the seller (see *Taggart v. Rutledge*, 657 F. Supp. 1420 (D. Mont. 1987) or buy all of the supplier's output (see *Geneva Pharmaceuticals v. Barr Corp.*, 386 F. 3d 485 (2d Cir. 2004) could be de facto exclusive dealing even if no provision of the agreement explicitly prevents purchases from competitors. Similarly, a pricing policy such as a loyalty discount could provide such a substantial disincentive to purchase from a competitor (see *Concord Boat v. Brunswick*, 207 F. 3d 1039 (8th Cir. 2000) that it could create an exclusive arrangement.

In this case, the court found that Pro Search Plus had successfully pleaded a de facto exclusive agreement because VFM Leonardo's success made dealing with it "an economic necessity and …

the cost of switching prohibitive." The court explicitly relied on *Eaton* and two earlier opinions from the same district court: *Blue Sky Color of Imagination v. Mead Westvaco Corp.*, 2010 WL 4366849 (C.D. Cal. 2010) and *Masimo Corp. v. Tyco Health Care Group*, 2004 WL 5907538 (C.D. Cal. 2004). But in all those cases, the defendants took actions beyond selling a popular product. In *Eaton*, the defendant (at least according to the majority opinion) threatened to stop supplying the product completely, not just recoup its discounts, if the buyer's purchases were not sufficient to qualify for the loyalty discounts. In *Blue Sky* and *Masimo*, bundled pricing schemes and loyalty discounts created sufficient incentives to create de facto exclusive dealing.

Admittedly, Pro Search Plus does allege in its most recent complaint that VFM Leonardo "strong-arm[ed]" a hotel chain into dropping Pro Search Plus and switching to an exclusive arrangement with VFM Leonardo. The court mentions this allegation, but does not seem to rely on it for its "de facto" determination. Of course, a court must accept a plaintiff's allegations as true when considering a motion to dismiss, and it is possible that the court will rule for VFM Leonardo after factual questions, such as the effective length of the agreements and the ease of their termination, are answered. To obtain such satisfaction, however, VFM Leonardo will need to go through the time and expense of discovery.

So how should one advise the hypothetical mousetrap builder who wants to avoid the expense of discovery in such lawsuits? Obviously, do not include explicit exclusivity provisions in any long-term sales agreements. Perhaps stop selling to new customers after your share reaches a certain level or explicitly inform customers of their ability to buy from particular competitors? Neither step seems consistent with the competition that antitrust laws are supposed to encourage. Because the United States Supreme Court chose not to review the *Eaton* case and discuss these and other issues, lower courts will continue to struggle with these questions – and mousetrap builders will need to spend time with their antitrust lawyers after the world beats a path to their door.