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Antitrust Update
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US Federal Trade Commission Consent Order Ends Exclusive Distribution Arrangement

The US Federal Trade Commission (FTC) has issued a consent order against a manufacturer and distributor of photochromic lenses condemning certain distribution policies. *In the Matter of Transitions Optical, Inc.*, FTC File No. 091 0062 (Mar. 3, 2010.) The investigation and resulting consent decree highlight the government's heightened scrutiny of vertical restraints.

Transitions, the subject of the FTC consent decree, makes optional treatments that darken certain prescription ophthalmic lenses when exposed to ultraviolet light. In order to produce photochromic lenses, the company works with lens manufacturers known as "lens casters." Lens casters are Transitions' only direct customers, and they act as distributors to wholesale or retail buyers. The process of manufacturing the lenses involves a back and forth between the lens casters and Transitions: lens casters supply the corrective ophthalmic lenses to Transitions, Transitions adds its photochromic treatment, and Transitions then sells the lenses—now photochromic—back to the lens casters. Given Transitions' 80 percent market share, the FTC Complaint alleged that Transitions possesses monopoly power in the market for photochromic treatments for corrective ophthalmic lenses in the United States.

According to the FTC, when a new producer of plastic photochromic lenses entered the market, Transitions adopted a general policy not to deal with lens casters that sold or promoted any competing products and terminated the first distributor to sell the new product. Transitions also allegedly engaged in the following "anticompetitive acts": (i) entering into exclusive agreements with certain lens casters, (ii) announcing to the industry its policy of dealing only with lens casters that sold its lenses on an exclusive basis, (iii) threatening to terminate lens casters that did not want to sell its lenses on an exclusive basis, and (iv) terminating a lens caster that developed a competing photochromic treatment to apply to its own ophthalmic lenses.

The FTC alleged that that Transitions leveraged its position in the industry to force lens casters—which could not afford to lose Transitions' photochromic lens business—not to deal with Transitions' competitors. Through its actions, the FTC claimed that Transitions successfully foreclosed its own competitors from doing business with lens casters collectively accounting for over 85 percent of photochromic lens sales in the United States.

Transitions also allegedly induced exclusive dealing through a combination of payments and rebates to indirect customers—i.e., wholesale and retail labs served by lens casters—in exchange for exclusivity, plus agreements making Transitions the "preferred" brand. The FTC charged Transitions with entering into more than 50 agreements with the largest retail chains, offering up-front payments and/or rebates to induce the chains to enter into long term exclusive agreements that were difficult to terminate. The FTC also charged that Transitions entered into more than 100 agreements with wholesale labs that appointed Transitions as the labs' "preferred" photochromic lens, and that withheld normal sales efforts for competing photochromic lenses in exchange for rebates from Transitions.

According to the FTC, Transitions' rebate incentives to induce retailers and wholesale labs to purchase more products from the Transitions line on an exclusive basis were anticompetitive because they forced potential new entrants in the industry to offer the same breadth of products as Transitions in order to be able to effectively compete.

As a whole, the FTC believed that Transitions' exclusionary practices with retailers and wholesale labs foreclosed rivals from a substantial share—as much as 40 percent or more—of the retailer and wholesale lab distribution channels. Transitions' business justifications for the exclusivity policies were unavailing to the FTC, which called each into question, and claimed that any purported justifications were substantially outweighed by the anticompetitive effects of the policies.

The FTC rejected Transitions' claim that exclusivity was justified in order to prevent free riding by competitors or to protect confidential information. In support of its position, the FTC cited several Sherman Act section 2 cases charging monopolization or attempted monopolization based on exclusive dealing, including certain cases that have been narrowed and criticized by courts and commentators in recent years. As proof that the arrangements inflated prices, the FTC cited the fact that Transitions refused to supply private label products in the United States even though it supplies them elsewhere.

The relief required by the FTC reveals a great deal about how it will treat exclusive dealing going forward. It defined customer exclusivity to include not only refraining from buying competitors' products but also providing more favorable (preferred) treatment to Transitions products. It prohibited discounts to customers contingent upon reaching benchmarks of a customer's total purchases. It precluded retroactive discounts (i.e., discounts applied to all purchases from a point in time in the past once a specific benchmark of purchases is hit.)

Significantly, the consent decree took a more aggressive stance with respect to bundled discounts, or discounts based on the customer's total purchases of photochromic lens across all product lines, even those with different materials or different ranges of correction. In the past, bundling issues have involved dissimilar products; however, the Transitions consent decree indicates that the FTC is prepared to base bundling claims on the linking of products that are more closely related. This stance, according to the FTC, protects competitors that cannot enter the market with a full line of competing products.

The consent decree offers some safe harbors for exclusive dealing arrangements, condoning them when the arrangements are terminable on 30-days' notice without cause or penalty, when they can be applied to only part of the line (i.e., not bundled) at the retailer's option, and when they are not made in exchange for a flat payment.

Because the Transitions case was settled, it provides limited insight into the defenses that could be presented in a matter of this kind. Further, it is unclear whether the FTC will apply similar sweeping condemnations to all industries going forward. Nevertheless, it provides a revealing roadmap as to how the FTC is likely to approach exclusive dealing in the future.

If you have any questions about this decision or any other matter raised in this Update, please contact your regular Mayer Brown lawyer, or one of the following lawyers.

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