



FTC consent decree with Transitions Optical attacks exclusive dealing and other vertical restraints

In the latest manifestation of its significant interest in challenging exclusionary conduct by dominant firms, the Federal Trade Commission (FTC) announced this month that it had entered into a consent order with Transitions Optical. The order addresses Transitions' exclusive dealing and other vertical arrangements, alleged to have helped Transitions maintain a monopoly position. The FTC relies explicitly on an expansive view of Section 5 of the Federal Trade Commission Act that the FTC articulated in its complaint against Intel in December 2009.

Section 5 overview

Section 5 of the Federal Trade Commission Act prohibits “unfair methods of competition ... and unfair or deceptive acts” affecting commerce. The Supreme Court has held that Congress intended Section 5 to reach a broader range of anticompetitive activity than addressed in either the Sherman Act or the Clayton Act. The relevance of Section 5 began to diminish as courts slowly expanded the scope of the Sherman Act from 1940-1970 and the Clayton Act from 1950-1972. In subsequent years, courts repeatedly struck down the FTC's attempts to bring stand-alone Section 5 cases, and the FTC ultimately resorted to tying its Section 5 claims to Sherman Act claims.

The current FTC leadership has sought to reinstate a more expansive interpretation and use of Section 5. In December 2009, the FTC brought a substantial complaint featuring stand-alone Section 5 claims against Intel. The FTC alleged that Intel engaged in anticompetitive conduct in violation of Section 5, including entering into anticompetitive arrangements with computer manufacturers, redesigning its compilers and libraries with the intent of reducing their performance when used with competing central processing units (CPUs), and engaging in various other deceptive acts and practices that deceived consumers. The complaint also outlines a request for wide-ranging relief. The matter is scheduled to be heard before an administrative law judge on September 15, 2010.

Transitions Optical

Transitions is a leading manufacturer of photochromic treatments for eyeglass lenses. According to the FTC complaint, over the past five years, Transitions enjoyed a greater than 80 percent share of the market for photochromic treatments for corrective ophthalmic lenses in the United States.¹ Transitions provides the photochromic coating on corrective lenses produced by lens manufacturers (lens casters), who sell the uncoated lenses to Transitions and then repurchase the lenses for resale to independent wholesale labs and optical retailers. Lens casters are Transitions' only direct customers.

The FTC alleged that Transitions, in response to competitive entry and in order to maintain its monopoly, improperly used its dominant market position to coerce lens casters to enter into exclusive dealing arrangements. Transitions also adopted a general policy of refusing to deal with or terminating any lens caster that did not agree to sell Transitions' photochromic lenses on an exclusive basis. The cumulative effect of these actions was that lens casters collectively accounting for 85 percent of the market entered into exclusive dealing arrangements with Transitions.

In addition, the FTC alleged that Transitions entered into exclusive and other restrictive agreements with

¹ Ophthalmic lenses are corrective lenses used in eyeglasses. Photochromic treatment allows lenses to darken when exposed to UV light (such as sunlight) and lighten when the UV light is removed. Photochromic lenses represent 18-20 percent of all ophthalmic lens sales in the United States, with a market size at the wholesale level of approximately \$630m.

downstream, indirect customers – namely the wholesale labs and retailers that purchased photochromic lenses from the lens casters – thereby foreclosing its rivals from 40 percent or more of the downstream wholesale lab and retailer distribution channels.

In the legal analysis of the case, the FTC analogized the case to a Section 2 exclusive dealing case, *United States v. Dentsply Int'l*,² focusing its findings on monopoly power and competitive harm. For instance, the FTC found that, in light of Transitions' dominant market position, the competitive impact of Transitions' exclusionary actions was to marginalize existing competitors, as evidenced by both the large percentage of the market that entered into exclusive dealing arrangements with Transitions and the inability for Transitions' competitors to gain significant market share.³ The FTC also alleged that, in addition to the harm done to existing competitors, potential entrants had been significantly deterred by Transitions' exclusionary practices. Overall, the FTC argued, Transitions' exclusionary conduct likely led to increased prices, lower output, and reduced innovation and customer choice.

Conclusion

The enforcement action is consistent with the Section 5 agenda that the current FTC leadership has articulated in numerous speeches and applied in the Intel complaint. Although no right of private enforcement exists under Section 5, it certainly cannot be ruled out that private damage actions under the Sherman Act or state antitrust laws will follow from an FTC Section 5 enforcement action. More immediately, the FTC relief is wide-ranging and restricts a range of unilateral conduct affecting vertical relationship. Under the order, the FTC prohibited Transitions from, among other things:

- adopting or implementing any agreement or policy that results in “exclusivity” with lens casters;
- entering into exclusive agreements with retailers and wholesale labs, unless the agreements:

- are terminable without cause, and without penalty, on 30 days' written notice;
 - are available on a partially exclusive basis, if requested by the customer; and
 - do not contain flat payments of monies in exchange for exclusivity;
- offering bundled product discounts to customers;
 - offering market share discounts, ie discounts based on the percentage of a customer's sales of Transitions lenses as a percentage of all photochromic lens sales;
 - offering discounts that are applied retroactively once a customer reaches a specified threshold; and
 - retaliating against a customer that purchases or sells Transitions lenses on a non-exclusive basis.

As many restrictions contained in the order last for 20 years, Transitions will be under the watchful eye of the FTC for a long time. In the current environment, firms with strong market positions are well advised to review their distribution practices with due regard to the FTC's Section 5 agenda.

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² 399 F.3d 181 (3d Cir. 2005).

³ As an example, the FTC cited Transitions' rival Corning, which had created a competing photochromic lens, SunSensors, but was unable to secure any major lens caster as a customer after Transitions terminated the first lens caster that agreed to carry Corning's product.