

**Exclusionary Contracts:
Case Study for Graduate Industrial Organization:**

Canada (Director of Investigation and Research) v. The D & B Companies of Canada Ltd. (1995), 64 C.P.R. (3d) 216 (Comp.Trib.) (“Nielsen”)

Nielsen is a Canadian case, from 1995, involving the market for “market tracking services”. The products supplied in the market were (and are) a combination of software and information that allowed tracking of market shares, estimation of demand elasticities and responsiveness of demand to product promotions, and so on.

Market tracking involves collecting data, over time, on product movement to produce an estimate of total market size and direction of growth for each product category being tracked and to indicate the relative performance or market share of a particular brand or item within the product category. Each different flavour, size or format within a brand is considered an item. As part of a market tracking service, data may also be collected on "causal" factors which explain the observed changes in product movement. Causal factors include price, promotions, feature advertising, in-store displays, etc. Market tracking enables manufacturers and retailers to plan more effectively the marketing and merchandising of their products based on previous trends. (*Nielsen*: 21)

In the provision of this information, Nielsen, wholly owned by D&B, had a monopoly in Canada in 1985. Nielsen was threatened with the entry into the market by Information Resources Incorporated (IRI). IRI is a U.S. firm from Chicago which competed with Nielsen in the U.S. market, with approximately equal market shares at the time.

The downstream buyers of these information products are mainly manufacturers of grocery products.

The key inputs required are raw scanner data provided by the major grocery chains, 11 chains in Canada in 1985. The supply chain from input (raw data) suppliers upstream to buyers of marketing information downstream flows in the opposite direction of the main products in the retail grocery sector: grocery products.

Conditional upon the same raw data inputs, the Nielsen and IRI products were very similar. Some important product differentiation arises, however, due to the fact that Canadian subsidiaries of U.S. firms prefer the product adopted by the U.S. parent because of complementarities in using the same software and informational products.

In the upstream market, scanner data from grocery chains in the same regions were presumably functional substitutes, but evidence indicated a strong complementarity in that a national data set, made up of data from all regions, was the product that Nielsen and IRI judged to be of the highest value. In short, the market was characterized by strong complementarity *upstream* in raw data inputs and strong substitutability *downstream* between the information products. Finally, we can think of Nielsen as the incumbent in the market because it was established in the broad market for market-tracking services, although the scanner-based information products were still in development in the mid-1980's.¹

The case involved a challenge by the Canadian competition authority, the Director of Investigation and Research (now called the Commissioner of Competition), of two sets of Nielsen contracts:

Upstream Contracts: With the threat of IRI's entry starting in 1985, Nielsen entered into 5 year exclusive contracts with all of the upstream grocery suppliers of scanner data in 1986. These contracts that contained liquidated damage clauses and prohibited the sale of scanner data to any other party.

Downstream Contracts Nielsen also entered into long-term (3 or more year) contracts with a set of downstream buyers (grocery product manufacturers) as soon as IRI's intentions to enter the market became clear. Until this change in contracts, Nielsen's downstream contracts had been evergreen contracts that were terminable on 8 month's notice (in those contracts entered as evidence).² The Director's successfully challenged both sets of contracts before the Canadian Competition Tribunal. The Tribunal nullified the terms of the downstream contracts and the exclusivity restrictions in the upstream contracts.³

¹Nielsen introduced the full scanner-based information product in 1988, after the main events on which the case focussed.

²*Nielsen*, p.62.

³Significantly, as we shall discuss, the Tribunal did not nullify the entire upstream contracts.

Questions

1. Why would a firm such as Nielsen, threatened by potential entry into its market, strike long term exclusive contracts with upstream suppliers?
2. One possible response to question 1 might be that these contracts allowed Nielsen to maintain a monopoly – and monopsony – position in the market. This answer is incomplete. Suppliers of scanner data are harmed in the future by having only one buyer of the data downstream. How can the suppliers of raw data be induced to enter contracts that are to their detriment?
3. Why would Nielsen increase the term of its contracts with downstream buyers of market information, as soon as the intention of IRI to enter the market became clear?
4. What is the optimal stipulated damage in these contracts?
5. Why would Nielsen not have offered long term contracts already, when the probability of entry was much smaller but still positive?
6. Nielsen targeted only some downstream firms in offering longer term contracts. Which ones, and why?
7. Why would Nielsen offer *both* long term contracts downstream and exclusive contracts upstream? Is one of these sets of contracts not enough to ensure continued monopoly?
8. Nielsen had a clear first-mover advantage in setting downstream contracts. It did not have a first-mover advantage, in setting upstream contracts: instead, Nielsen and IRI could, with some approximation, be considered as bidding simultaneously for the rights to upstream inputs. Why in general might upstream contracts be the outcome of a game with simultaneous offers, whereas downstream contracting *must* involve a first-mover advantage for the incumbent?
9. The proposal to sign up retailer data suppliers exclusively was the outcome of negotiations that were initiated by the Retail Council of Canada, a trade association of the upstream suppliers. Why would these upstream suppliers gain from a monopoly downstream?

10. Does the ability of upstream suppliers of data to capture monopoly rents depend upon the substitutability of Nielsen's and IRI's products? Or does it depend upon the *symmetry* of demand functions downstream?
11. Under what conditions will the outcome of a bidding game for the rights to upstream inputs (with the option to include in the bid a higher price for exclusive rights) result in a monopoly – a single firm winning all of the simultaneous bidding games?
12. Is such a monopoly the only configuration that could be considered anticompetitive?
13. Why did Nielsen rely on exclusionary contracts both upstream *and* downstream? Would one set not be sufficient to maintain a monopoly?
14. Consider the following statement, from the CEO of Nielsen (p. 66 of *Nielsen*):

“After we did our retailer deals five years ago, we recognized that we were vulnerable because virtually all of these agreements expired around the same time. We set ourselves a goal then to pursue a practice that would result in our retailer and distributor contracts expiring at different times. This would make it much more difficult for any competitor to set up a service unless he was prepared to invest in significant payments before he had a revenue stream.” (*Nielsen*, p.66)

How does staggering contract dates deter entry with lower cost to the incumbent?
15. Why would selected suppliers of raw scanner data (in this case, Safeway and Steinberg) agree to contract-ending dates that resulted in staggering – when staggering was clearly to their disadvantage in dampening future competition for their inputs?
16. A most-favored-nation (MFN) clause in Nielsen's upstream contracts for purchase of inputs guaranteed to Nielsen that if the supplier provided the input to a competitor of Nielsen's at a lower price, Nielsen would be charged the lower price as well. Can these MFN clauses have an exclusionary impact?

17. We described above the simultaneous bidding game between Nielsen and IRI for upstream contracts. But of course the bidding was not simultaneous. In fact, the entrant, IRI, was the first to establish upstream exclusive contracts. Exclusionary contract theory is about the incentives for an incumbent. Should we even worry about the entrant entering exclusivity contracts?
18. Nielsen's principal defense (p.24) in the case was the following:

“ Throughout the course of the proceedings counsel for Nielsen returned again and again to the origin of the present exclusive arrangements and the role of IRI to argue that, because IRI ‘initiated’ the practice of exclusives, Nielsen’s use of exclusives cannot be anti-competitive. Nielsen’s position was that it was forced to adopt exclusives in order to protect its legitimate business interests against the threat of being locked out of the emerging technology and to safeguard its existing tracking services.” (*Nielsen*, p.68)

Do you think that Nielsen’s contracts were a rational business practice, notwithstanding the likelihood of their being struck down as a matter of competition law? Nielsen was arguably in a position where it had to offer upstream exclusives, given that IRI initiated the practice. Does this mean that the contracts should have been allowed by the Tribunal?
19. Consider the alternative defense of Nielsen’s upstream contracts, which was not offered in the proceeding: As owner of the information contained in the raw data, each input supplier had legitimate property rights to the data. No owner of legitimately-obtained information in the economy is under obligation to share the information. Transferring the information to another party does not create a new monopoly. And the simultaneous transfer of the information from multiple suppliers to Nielsen is not a problem of monopolization through a single owner of the informational assets: the assets are complementary and the common ownership of complementary assets is pro-competitive or efficient, not anticompetitive. Assess.
20. IRI in fact successfully signed up 10 of the 11 suppliers of upstream data. But its contracts were conditioned on IRI’s successful attraction of all suppliers. A single supplier, Safeway, was a "hold-out", leading

to the collapse of all 10 of IRI's exclusive contracts. Why did IRI design its contracts this way?

21. What was the advantage to Safeway of being the sole hold-out?
22. How is the problem that IRI faced similar to the problem (called "the assembly problem" in urban economics) of a developer trying to purchase contiguous plots of land?
23. What is the optimal mechanism that IRI should have used? This problem falls within the class of problems known as "mechanism design without commitment". If IRI could have made a simultaneous, credible take-it-or-leave-it offer to all suppliers, its optimal mechanism would have been simple – but an assumption of this type of commitment is unrealistic.
24. The Tribunal recognized possibility of exclusivity being sustained even without explicit exclusivity contracts. The Tribunal called this *de facto* exclusivity. In fact, as of 2013, IRI has not entered the Canadian market. Set up a game to show that implicit exclusivity contracts can be sustained as an equilibrium in an infinite game. Discuss the factors upon which the existence of such an equilibrium depends.
25. The Tribunal struck down the exclusivity clauses in the upstream contracts, but not the entire contracts. Apart from the explicit exclusivity clauses, the entire contracts including prices remained intact. Is the structure of this decision related to the economic outcome of the case, in which Nielsen remains the sole supplier in the market?