Conditional Pricing Practices
DOJ-FTC Workshop

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Common Ground?

- Conditional discounts are assessed under the rule of reason (at least in the US).
- They can be a means of competing.
- "At a minimum, [the antitrust injury] requirement means that one competitor may not use the antitrust laws to sue a rival merely for vigorous or intensified competition." *NicSand, Inc. v. 3M Co.*, 547 F.3d 442, 450 (6th Cir. 2007) (en banc).
- So a plaintiff who loses out because it is lazy, incompetent, or inefficient should not be allowed to sue; and a plaintiff who can compete effectively for the business notwithstanding the conditional discounts should equally not be allowed to sue.

How do we get from common ground to actual rules?

- Practices that impair rivals to the extent that they can no longer constrain the defendant's market power – RRC – may warrant prohibition.
- But competition for the contract should be encouraged, and attaching conditions to a discount may make that competition more effective.
- So a rule that allows suit by inefficient rivals to prevent procompetitive discounts can be a use of antitrust to subvert competition.

- And the rules need to provide some basis to distinguish legitimate conditional pricing practices from those that harm consumers.

The Equally Efficient Rival Test

- Conditional discounts that a hypothetical rival, facing the same incremental costs as the defendant, can meet or beat profitably should not be deemed exclusionary; discounts that cannot be met on that basis may be exclusionary and unlawful if the effect of the condition is to increase, protect, or maintain the defendant's market power. Such a test ensures that the defendant will be able to compete for the contract.
  - "Actionable exclusion requires a showing not merely that a particular rival cannot compete effectively, but that no equally efficient rival can." Areeda-Hovenkamp ¶ 749a.
- This hypothetical equally efficient (or "as efficient") rival (EER) analysis appears to be the best way, given current knowledge, to accommodate the competing concerns, and should be an essential element or at least a key factor in determining liability.
  - Determining the right measure of incremental cost is very hard, and is left here for another day; see Cost Based Rules in the New Economy, http://www.wsgr.com/publications/PDFSearch/jacobson032509.pdf

The Equally Efficient Rival Test

- The concerns about bundling and loyalty discounts are a bit different and there will necessarily be some differences in applying the EER test to these practices:
  - The underlying concern about bundling is similar to the concerns about tying;
  - The underlying concern about loyalty discounts is similar to exclusive dealing;
  - Neither is really about predatory pricing; any harm flows from the conditions, not the price level.

The Equally Efficient Rival Test

- Critics on the right say we should apply a "full Brooke Group" approach because discounting is so important. But the concern here isn't price levels as such, it's tying or exclusive dealing – both of which can be profitable even if the total price is above "full Brooke Group" levels.
  - The practical per se legality of a "full Brooke Group" test is unwarranted because the defendant recoups immediately, and because prices can be reduced without the conditions.
- Critics on the left say "but even less efficient rivals can compete in a manner that lowers prices to consumers." That is true. But we need some leeway for granting conditional discounts, and we do not want to discourage competition for the contract. Otherwise, the long run dampening of competition will raise prices to consumers even more.
- The EER approach seems to be the best way to avoid discouraging aggressive competition on the merits while preventing the undue maintenance or expansion of market power.

Application to Bundling

- Application to bundling is relatively straightforward under the discount attribution test adopted or advocated by many, *e.g., Peacehealth, Ortho*, and the Antitrust Modernization Commission.
- Under this approach, all the discounts (from the two or more products) are applied to the competitive (tied) product; there is a safe harbor for the defendant if the pricing, on that basis, remains above incremental cost.
  - If a rival cannot compete profitably, the problem is its higher cost structure.
- Care must be taken to ensure that the defendant has not artificially raised the unbundled prices – i.e., that the discounts are discounts and not disguised penalties – but this is not nearly as hard as critics make out.

Application to Loyalty Discounts

- Loyalty discounts are more challenging.
- Here, there is no good way to attribute all the relevant discounts to a "competitive product." The closest we can get is to try to separate contestable and incontestable volume. But that is tough even in the abstract and, in the real world of litigation, would involve an insoluble battle on what volume is contestable and what volume is not.
- For this reason, loyalty discounts may be more appropriately treated as simple exclusive dealing cases subject to a substantial foreclosure analysis – with appropriate adjustments to account for the fact that not <u>all</u> the volume in issue is covered by the arrangement.
  - "In my view, loyalty discounts elicit the same concerns about raising rivals' costs that 'total' exclusive dealing does and, for that reason, ought to be analyzed under the same legal rubric as exclusive dealing." Joshua D. Wright, *Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts*, at 20 (June 3, 2013).

Application to Loyalty Discounts

- Nevertheless, the touchtone should still be the same. In applying the rule of reason and examining the foreclosure in issue, the key question should still be whether an equally efficient rival can meet or beat the discounts on sufficient volume that it can continue to constrain the defendant's market power.
- So, absent the unusual case where the plaintiff is more efficient than the defendant, if it is clear that the plaintiff can compete effectively for the business in question – but simply has not done so – summary judgment should be granted.

Eisai Inc. v. Sanofi Aventis U.S. LLC

- The recent *Eisai* case provides a useful analysis.
- "These antitrust plaintiffs could have offered greater discounts or improved their products in order to maintain and increase their market shares. The fact that they did not and suffered a loss in profits is of no concern to the antitrust laws. . . . [I]n general, antitrust claims fail if customers are able to walk away from the defendant's discounts and still use the defendant as a supplier." 2014 WL 1343254, at *36 (D.N.J. 2014).
- Performed both price-cost and exclusive dealing analysis to find discounts at issue did not violate the Sherman Act.
  - Key factor was the huge profit margin the plaintiff had, which, according to the court, could have been reduced to compete more effectively while still remaining profitable.

ZF Meritor, LCC v. Eaton Corp.

- Contrast *Meritor*.
- Accepting the majority's analysis of the facts, discounts for 90% loyalty combined with legitimate threat of complete loss of supply from the defendant and other restrictions held to be exclusionary.
- "Although prices are unlikely to exclude equally efficient rivals unless they are below-cost, exclusive dealing arrangements can exclude equally efficient (or potentially equally efficient) rivals, and thereby harm competition, irrespective of below-cost pricing. . . . Where, as here, a dominant supplier enters into *de facto* exclusive dealing arrangements with every customer in the market, other firms may be driven out not because they cannot compete on a price basis, but because they are never given an opportunity to compete, despite their ability to offer products with significant customer demand." 696 F.3d 254, 281 (3d Cir. 2012).

And Europe?

- If you like simple rules, the recent Intel judgment from the E.U. General Court provides one:
  - Discounts by a dominant firm conditioned on getting some portion of the customer's business are per se unlawful, with no market analysis, no foreclosure analysis, or any defense.
- What?
- Yup! And in 283 pages.
- Note that the EC in fact applied the EER test (although evidently it didn't have to). Note also that, after the decision appealed from came down, the EC issued a guidance paper with a far more defensible EER standard. Hopefully, that will be what is applied going forward.
- If the EC finds against you, though, good luck on appeal.