

# Loyalty Discounts and their Effects on Competition

*FTC v. Surescripts*

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\* The views expressed herein are entirely those of the author and do not necessarily reflect those of the Federal Trade Commission or any of its Commissioners.

# Motivation

## *Exclusive contracts in platform markets*

- Loyalty discounts (e.g., all-units discounts) can have similar effects to exclusive contracts.
- Exclusive contracts can be pro-competitive by reducing costs and discouraging free-riding.
- However, they can also exclude rivals by denying them sufficient scale to compete. E.g., the *divide-and-conquer* strategy of Segal and Whinston (2000).
- In platform markets, the effects of (de facto) exclusive contracts can be magnified due the indirect network effects.

# Overview

## *FTC v. Surescripts*

### Question

- What are the competitive effects of (de facto) exclusive contracts in two-sided markets?

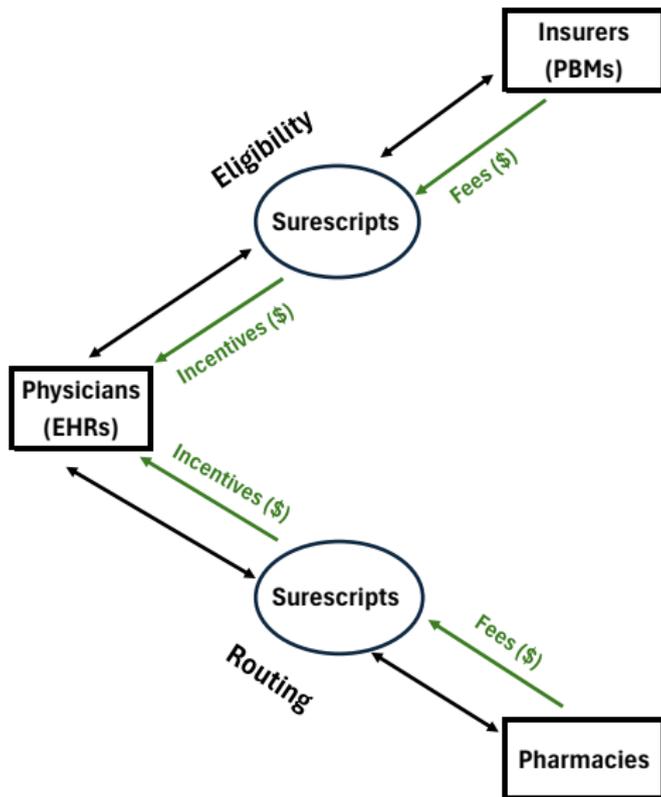
### Roadmap

- Surescripts' business: electronic prescribing and eligibility
- Surescripts' alleged anticompetitive conduct: loyalty pricing
- Why was the conduct so effective?: a simple stylized example
- Case outcome

# Surescripts

# Surescripts

*A healthcare technology company*



Conduct

# Conduct

## *Loyalty pricing*

Contracts for routing and eligibility:

- Pharmacies and PBMs paid a lower price if they used Surescripts for (generally) 100% of their transactions.
- EHR vendors received a higher incentive fee if they used Surescripts for (generally) 100% of their transactions.
- Contracts were not nominally exclusive, but included *all-units* discounts.

# Conduct

## *Loyalty pricing*

FTC's complaint alleges:

- Contracts were *de facto* exclusive due to the price/incentive differential and the *all-units* nature of the discounts.
- Most of Surescripts' customers on both sides of each market had loyalty contracts.
- Due to indirect network effects, this gave Surescripts an advantage over rival platforms and prevented rivals from signing up significant connections (i.e., critical mass) on both sides of the network.
- Surescripts had monopoly power in the electronic routing and eligibility markets by 2009.

Effects

# Effects

*A simple quantitative stylized illustration (routing)*

## Assumptions

- Suppose Surescripts has loyalty contracts covering 90% of transactions with both EHRs and pharmacies.
- A pharmacy routes 100 transactions per day and pays Surescripts 4 cents per transaction if loyal to Surescripts and 6 cents per transaction otherwise.

# Effects

*A simple quantitative stylized illustration (routing)*

Suppose a rival platform can offer connections to the other 10% of transactions with customers not loyal to Surescripts. The rival offers a pharmacy a price,  $p^r$ .

- If the pharmacy decides to be loyal, it pays Surescripts  $100 * 0.04 = \$4$ .
- If it accepts the rival's offer and multi-homes, its total routing cost becomes  $90 * 0.06 + 10 * p^r$ .
- Therefore, the rival would have to offer a price of  $-0.14$  to make the pharmacy equally well-off. I.e, the rival would need to *pay* the pharmacy to make up for the transactions the pharmacy still needs to route through Surescripts (at a higher price).
- A similar analysis holds for EHRs.

Outcome

# Outcome

## *Settlement*

Summary judgement ruling:

- Judge denied Surescripts' motion for full SJ on the FTC's claims.
- Ruled in favor of the FTC's motion for partial SJ on monopoly power (and market definition).
- In his order, the Judge deferred ruling on Surescripts' motion on competitive effects, but said "success on its motion was an uphill battle."

Soon after, the parties agreed to a settlement including a prohibition on exclusive contracts and loyalty contracts requiring 50% or more of a customer's transactions.

Thank you!