Alerts & Publications

DOJ and FTC Weigh Anticompetitive Effects of Conditional Pricing Practices, Probe Usefulness of Price-Cost Test

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In a joint workshop on June 23rd, the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") questioned top economists and practitioners on potential anticompetitive effects of conditional pricing practices and their enforcement options. The agencies specifically asked whether it would be "wrong" for an agency to pursue a case against such practices—which include market-share discounts, volume discounts, and bundled discounts— without using the price-cost measure in its analysis. Workshop participants largely *answered "no," but could not reach consensus on an alternative legal test that would meet the three guiding principles* that FTC Commissioner Maureen Ohlhausen described at the outset of the workshop: predictability, fairness, and transparency. The agencies are continuing to solicit comments on conditional pricing practices until August 22, 2014.

Price-cost test disappoints economists but has support in the law

The price-cost test is supported by two of the "three key cases" identified by Commissioner Ohlhausen in her opening statement: *PeaceHealth* and *ZF Meritor*.[1] This test, which courts adapted from predatory pricing cases, requires the plaintiff to show below-cost pricing. In *PeaceHealth*, the Ninth Circuit ruled for the defendant seller after using a "discount attribution" price-cost test that allocated the full amount of the defendants' discounts to the products for which the defendant was competing with its rival and then assessed whether the resulting price of the competitive product was below the defendants' incremental cost of production.[2] The Third Circuit's ZF Meritor opinion also endorsed the price-cost test but only when price is clearly the predominant method of exclusion; non-price provisions were important, so the court applied the rule of reason framework.[3] Recently, in Eisai Inc. v. Sanofi-Aventis U.S., LLC, the U.S. District Court for the District of New Jersey followed ZF Meritor and evaluated a challenge to loyalty discount contracts using a price-cost test.[4]

Despite the supportive case law, most panelists urged the DOJ and FTC to reject the price-cost test. They described the test as inaccurate and poorly-suited for exclusionary loyalty discounts, which are far easier to execute than a predatory pricing scheme. A number of economists also faulted the price-cost test's lack of predictability and administrability—its supposed main selling point—because there is no consensus on the appropriate measure of cost or the method for allocating discounts among the purchased products. Notably, in the workshop's only session with a single speaker, Professor Steven Salop of Georgetown University Law Center detailed the drawbacks of the price-cost test and advocated for an alternative test that examines whether loyalty discounts raise rivals' costs. And at the final session of the day, American University Washington College of Law Professor Jonathan Baker summarized the workshop's "big takeaway" as "price-cost tests . . . [are] really not helpful."

Stronger support for fact-based rule-of-reason test, but details lacking

Many panelists instead advocated for an adaptable approach that considers whether particular loyalty discounts hinder rivals' ability to gain customers and achieve efficiencies: this can be done by foreclosing rivals' access to buyers to decrease rivals' scale and ability to compete. Professor Salop strongly endorsed a variant of this approach that would focus on whether the loyalty discount raised rivals' costs. These tests found broader support because of the greater accuracy they allow in identifying anticompetitive conduct. Multiple panelists emphasized the fact-specific nature of antitrust generally and the need to analyze conditional pricing programs on a case-by-case basis. But such tests also have significant drawbacks for the agencies, as a flexible approach is cumbersome for the agencies to administer and difficult for sellers to predict, two important goals identified by Commissioner Ohlhausen.

Complicating the discussion, workshop participants also expressed concern that buyers could use loyalty discounts with a common seller as a facilitating device for collusion. Cases brought under this theory would require a separate test, as the collusion would result in prices well-above marginal cost. When questioned by the agencies, others argued that such collusion is unrealistic.

Under any test, certain types of loyalty discounts will draw more scrutiny

Whatever the legal standard adopted for conditional pricing practices, economists stressed that certain types of loyalty discounts are more likely to cause competitive harm—and attract the attention of the enforcement agencies and private litigants:

- High market share is key. A loyalty discount that ties up 90% of the market has a far greater impact than a discount that ties up 50%.
- All-or-nothing discounts (i.e., discounts on all sales if buyer reaches 80% share) are far more exclusionary than discounts that only apply to sales over a particular threshold. These discounts create a "cliff," which can act as a de facto ceiling on a rival's sales.
- Restraints clearly designed to exclude a new entrant or target a rival (based on the timing and/or structure of the restraint) will draw attention.

The agencies have not issued guidance on conditional pricing practices and it is not clear that they will do so. But their sponsorship of this workshop signals their interest in pursuing conditional pricing practices that harm competition. Corporations should carefully assess such practices, giving particular attention to the issues identified above and tempering their reliance on price-cost measures as a safe harbor.

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[1] *See Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008) and *ZF Meritor, LLC v. Eaton Corp*., 696 F.3d 254 (3d Cir. 2012). The third key case, LePage's Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003) (en banc), did not apply the price-cost test to a bundled discount because the principle anticompetitive effect of the bundled rebate was to foreclose part of the market from a potential competitor without an equally diverse product line.
[2] *PeaceHealth*, 515 F.3d at 906, 911.
[3] *ZF Meritor*, 696 F.3d at 269, 277.
[4] *Eisai Inc. v. Sanofi-Aventis U.S., LLC*, No. 08-4168 (MLC), 2014 U.S. Dist. LEXIS 46791, at *73 (D.N.J. Mar. 28, 2014).
[5] FTC Commissioner Joshua Wright previously stated that, in his opinion, the price-cost standard is simple but wrong, and the exclusive dealing framework is complex but more likely to get accurate results when applied to loyalty pricing contracts. Joshua Wright, Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts, Bates White 10th Annual Antitrust Conference (June 3, 2013). Fiona Scott-Morton, while Deputy Assistant Attorney General for the Antitrust Division of the DOJ, noted that contracts that reference rivals can be both pro-competitive and anti-competitive, depending on the situation, so there is no "simple blanket rule" governing their legality. She recognized the difficulty this creates for firm managers and counsel. Fiona Scott-Morton, Contracts that Reference Rivals, Georgetown University Law Center Antitrust Seminar (April 5, 2012).
