Conditional Pricing Practices
DOJ-FTC Workshop
June 23, 2014

Leah Brannon

Background Principles

- **The antitrust laws promote price cutting.** *See, e.g.*, *Matsushita v. Zenith.*, 475 U.S. 574, 594 (1986) ("[C]utting prices in order to increase business often is the very essence of competition."); *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 896 (9th Cir. 2008) ("[P]rice cutting is a practice the antitrust laws aim to promote.").

- **Rules that punish discounting are "especially costly** because they chill the very conduct the antitrust laws are designed to protect." *Brooke Grp. v. Brown & Williamson Tobacco*, 509 U.S. 209, 226 (1993)

- **Bundles, discounts, and loyalty rebates are common in many markets.** *Jefferson Parish v. Hyde*, 466 U.S. 2, 12 (1984) ("Buyers often find package sales attractive; a seller's decision to offer such packages can merely be an attempt to compete effectively-conduct that is entirely consistent with the Sherman Act.")

Efficiency Reasons for Conditional Discounts

- **Commonly used by firms without market power, which suggests efficiencies**. *See, e.g.*, Antitrust Modernization Comm'n, Report at 95 (2007).

- **Reward and promote brand loyalty**. *See, e.g., Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 265 (2d Cir. 2001) ("These kinds of agreements allow firms to reward their most loyal customers. Rewarding customer loyalty promotes competition on the merits.").

- **Prevent free-riding.** *Cf. Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 395 (7th Cir. 1984) (Posner, J.) (even exclusivity may "enable a manufacturer to prevent dealers from taking a free ride on his efforts … to promote his brand").

- **Encourage resellers to promote supplier's product.** *Cf. Ryoko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1234 n.17 (8th Cir. 1987) (exclusivity encourages "investment in marketing activity, and thus encourages interbrand competition").

- **Promote new products**. *See, e.g., Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 896 n.7 (9th Cir. 2008) (bundles can encourage use of a new product or help entry into a new market).

- **Reduce transactions costs.** *See, e.g., United States v. Microsoft Corp.*, 253 F.3d 34, 87 (D.C. Cir. 2001) ("Bundling obviously saves distribution and consumer transaction costs.").

Loyalty Discounts: Courts Converging on Price-Cost Test

"Accordingly, ***we join our sister circuits*** in holding that ***the price–cost test applies to market–share or volume rebates*** offered by suppliers within a single-product market."

ZF Meritor, LLC v. Eaton Corp.,
696 F.3d 254, 274-275 n.11 (3d Cir. 2012)

ZF Meritor, LLC v. Eaton Corp.

"[W]hen price is the ***clearly predominant*** mechanism of exclusion, the price-cost test tells us that, so long as the price is above-cost, ***the procompetitive justifications for, and the benefits of, lowering prices far outweigh any potential anticompetitive effects***."

***ZF Meritor, LLC v. Eaton Corp.*,**
696 F.3d 254, 275 (3d Cir. 2012)

Eaton's Contracts
Long-term agreements ("LTAs") of at least 5 years with all 4 customers in the relevant market
Contracts exclusive in practice. Customers feared being cut off if they used a rival product
Defendant could terminate contracts with 2 out of 4 customers if market share targets not met.
2 of the LTAs required the customers to remove competitors' products from their data books
LTAs required Eaton transmissions as the standard offering in customer data books

Eisai v. Sanofi

- Eisai contracted with Pfizer for the U.S. rights to market Fragmin, an anticoagulant
- Eisai sued for billions of dollars in damages, alleging that Sanofi US's market share and volume discounts on its anticoagulant, Lovenox, limited Eisai's sales
- Eisai argued that there were 6 mechanisms of exclusion that were non-price in nature, thus the price cost test should not apply
- The court granted Sanofi US's motion for summary judgment.
  - All "6 mechanisms" came back to price (e.g. "imposed disloyalty penalties")
  - No threat of non-supply and no requirement to favor one product over others
- Held that, even under alternative test, Sanofi US was still entitled to summary judgment because, among other things, Eisai charged a price "that was 7.8 times its cost, or, in other words, Eisai's profit margins…were approximately 85%."

LOVENOX (enoxaparin sodium injection) Fragmin dalteparin sodium AriXtra Innohep (tinzaparin sodium injection)

Critics of Price-Cost Test for Loyalty Discounts Often Focus on "Incontestable Demand"

- **What does "incontestable" mean?**

Definition	Source
The "part that is always purchased from the dominant firm"	Nicholas Economides, *Loyalty/Requirement Rebates and the Antitrust Modernization Commission: What is the appropriate liability standard?*, 54 Antitrust Bulletin No. 2, Summer 2009, at 261
"[T]he amount that would be purchased by the customer from the dominant undertaking in any event"	European Comm'n, *Communication from the Commission — Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty* ¶¶ 39, 42, 2009 O.J. (C 45) 7 (Dec. 3, 2008)

- **Is the demand "incontestable" if…**
  - **Rival can win by discounting an extra 50%** and still be above all measures of cost?
    - What about **discounting by 10% or 1%?**
    - Does the rival have a **right to price at an equal level** as the dominant firm in a differentiated product market?
  - **Rival can win through other measures**, e.g., advertising and promotion, training, product quality improvement?
  - **Other (non-plaintiff) rivals can and do win these sales?**

Critics of Price-Cost Test Often Focus on "Incontestable Demand"

- **Why is demand "incontestable" in the first place?**
  - **Product differentiation**. Customers don't like the entrant's product as well
  - **Brand/reputation**. Less investment in advertising or promotion
  - **Capacity**. Entrant cannot fulfill all orders
  - **Other**.
- **Effect of a rule turning on "incontestable" demand**
  - Effect on rivals' incentives to invest in quality, innovation, advertising, capacity
  - Effect of offering greater protection to entrants with less attractive products
  - Effect on counseling for incumbent suppliers

> "If taken seriously by a cautious dominant firm, [the concept of contestable shares] ***would seriously discourage price competition, as well as greatly increasing transaction costs*** by involving cost accountants, economists, industry experts (to estimate production capacities) and lawyers."
>
> John Temple Lang, *Article 82 EC – The Problems and the Solution* 16 (Fondazione Eni Enrico Mattei, Working Paper No. 326, 2009).