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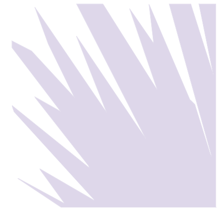

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LOYALTY & FIDELITY DISCOUNTS & REBATES IN THE U.S. & EU: WILL DIVERGENCE OCCUR OVER COST-BASED STANDARDS OF LIABILITY?

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I. INTRODUCTION

The practice by suppliers of products or services of providing discounts or rebates to customers who purchase progressively larger shares of their needs for a particular product or service from that supplier goes by many different names, "loyalty" or "fidelity" rebates and "market-share" discounts being among the more well-known. The practice has drawn occasional judicial rebuke and scrutiny by antitrust commentators in the U.S. and Europe for 30 years, at least when practiced by a dominant firm in the market at issue. Interest in and cases regarding market share discounts have grown in the past decade, though often as an afterthought to a discussion of multi-product bundled discounts. Perhaps as a by-product of increased scrutiny of and rationalizations for multi-product bundled discounts, as well as the Supreme Court's increasing reliance on cost-based standards for evaluating predatory conduct, single product loyalty and fidelity rebates have largely withstood judicial scrutiny in the U.S. in recent years, to the point where it is fair to ask, unless the particular discount at issue constitutes predatory pricing under accepted tests for that practice, are single product loyalty and fidelity rebates now per se legal in the United States? If so, this is another area of increasing antitrust *divergence* between the U.S. and the European Union in the treatment of single-firm conduct, as European competition authorities remain ready to condemn the practice on non-cost-based grounds, and are only recently even considering incorporating any cost-based standards into their analysis.

This article will review United States and European Union law on the subject of loyalty and fidelity rebates, and provide observations on the apparent course of judicial and regulatory treatment of the practice in both jurisdictions. Before embarking on this analysis, a brief definition of the practices at issue is in order.

A 2003 report from the OECD defines fidelity discounts as follows:

> *Fidelity discounts can be defined as pricing structures offering lower prices in return for a buyer's agreed or de facto commitment to source a large and/or increasing share of his requirements with the discounter.*
>
> Fidelity discounts come in a great many forms. Most, however, share the characteristic that the percentage discount increases, usually in discrete jumps, in

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> response to current reference period purchase volumes exceeding purchases in a previous reference period. The reference period is usually considerably longer than would normally elapse between successive purchases in a pertinent market.[1]

Loyalty and fidelity discounts are usually thought of as occurring between a manufacturer and a distributor; however they can also be offered to end-users, airline frequent flier programs being a notable example. In addition to prospective discounts, the practice can encompass end-of-period rebates, which kick in upon the purchaser achieving some pre-set target. Loyalty discounts can apply only to incremental units purchased, but often are "first dollar" discounts or rebates, involving a retroactive grant (or denial) of a discount or rebate on all units purchased during the reference period.

Market-share discounts and loyalty and fidelity rebates and discounts are typically embodied in some sort of contract. However (and complicating legal analysis), it is difficult to make general statements about such contracts. They can be essentially unilateral offers by suppliers to distributors. They may occur at the behest of distributors upon somewhat unwilling suppliers as the price for entry into a market, or for retail shelf space commitments. Length of term can vary. Each of these details and their impact upon the market at issue tend to be worked out only case-by-case.[2]

Courts and commentators assessing market-share discounts have observed that they are Janus-like, having features of both exclusive dealing and predatory pricing. Often which face the commentator sees as most important will turn on whether or not a cost-based test for liability for the practice is being advanced.[3] Based on recent U.S. decisional law dealing with single-firm conduct, the open question appears to be how rigidly courts will apply the requirements of *Brooke Group*,[4] requiring both below-cost pricing and a dangerous probability of post-predation recoupment, to single-product market-share discounts. In Europe, the question appears to be whether a cost-based element will creep into the liability analysis for loyalty and fidelity discounts and rebates, or whether the jurisprudence of exclusive dealing, with no cost-based tests, will continue to hold sway.

II. EUROPEAN UNION TREATMENT OF LOYALTY AND FIDELITY DISCOUNTS AND REBATES

The European Court of Justice has long treated loyalty and fidelity discounts and rebates as a potential abuse of a dominant position, in violation of Article 82 of the European Community Treaty and its predecessors.[5] Two cases from 1979 and 1983 set forth the basic rationale and conditions for this treatment. Those cases are *Hoffman-LaRoche v. Commission*,[6] and *N.V. Nederlandsche Banden-Industrie Michelin v. Commission*.[7]

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1 Organization for Economic Co-operation and Development, *Loyalty and Fidelity Discounts and Rebates* (2003) ("OECD Report"), Executive Summary at 7. The OECD Report notes that in European Commission jurisprudence, "the term 'fidelity discount' is reserved for discounts offered in return for a customer agreeing to give most or all of its business to the discounter," whereas "target discounts" is a term used for achieving lesser quantity targets. *Id.* at 46, n. 27. This paper does not adhere strictly to the Commission's terminology.

2 Further, the line between single-product market-share discounts and loyalty and fidelity rebates and discounts, on the one hand, and multi-product bundled pricing on the other, is often blurred in real life, as suppliers implement programs having elements of both. This article attempts to focus on the former, without wading into the ample cases and commentary on bundled discounts.
The principal analytical difference between single-product loyalty rebates and bundled-product pricing is that the allegedly anticompetitive impact from a single-product loyalty rebate comes from the exclusionary effect of the rebate on another manufacturer who is otherwise able to produce a competing product, while in the bundled-product rebate, the exclusionary impact typically occurs because of the inability of a single competitor to provide all of the products in the bundle.

3 *Compare* Willard K. Tom, David A. Balto and Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 Antitrust L.J. 615 (2000) (arguing that market-share discounts "should be judged according to the same economic principles that govern exclusive dealing," and containing no cost-based test for liability), *with* Herbert Hovenkamp, *Discounts and Exclusion*, 2006 Utah L. Rev. 841, 848 ("above-cost discounts on single products should be regarded as lawful"). *See also* Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?,* 2006 Utah L. Rev. 863 (rebutting Hovenkamp).

4 *Brooke Group Ltd. v. Brown &Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

5 In full, Article 82 reads:
> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.
> Such abuse may, in particular, consist in:
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
> (b) limiting production, markets or technical development to the prejudice of consumers;
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (d) making the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

For a discussion of the similarities and differences between EC Article 82 and Section 2 of the Sherman Act, 15 U.S.C. Section 2, *see generally* Gregory J. Werden, *The Reach of Article 82 of the EC Treaty*, paper presented at The 8th Annual Sedona Conference on Antitrust Law and Litigation, Oct. 2006.

6 *Hoffman-LaRoche v. Commission*, Case 85/76, 1979 E.C.R. 461 (ECJ), 3 CMLR 211 (1979), [1978-1979 Transfer Binder] Common Mkt. Rep. (CCH) Paragraph 8527.

7 *N.V. Nederlandsche Banden-Industrie Michelin v. Commission*, Case 322/81, 1983 E.C.R. 3461 (ECJ), 1 CMLR 282 (1985), [1983-1985 Transfer Binder] Common Mkt. Rep. (CCH) Paragraph 14,031 ("*Michelin I*").

Hoffman-LaRoche was found to have a dominant position in the then-Common Market in a number of vitamins in which it had a market share of between 41% and 51%, and in Vitamin B6, in which its market share exceeded 80%.[8] The company used both traditional exclusive supply and requirements contracts, as well as fidelity rebates, with purchasers. The fidelity rebates were "first dollar" rebates, and generally applied cumulatively to the purchase of more than one kind of vitamin.

The Court of Justice concluded that the exclusive dealing and requirements contracts were an abuse of dominance by Hoffman-LaRoche and — applying a lens of exclusive dealing law to the practice — concluded likewise with regard to the fidelity rebates. The Court identified three reasons for this conclusion: 1) the fidelity rebate is "designed through the grant of a financial advantage to prevent customers from obtaining their supplies from competing producers;" 2) it constituted price discrimination based on exclusivity; and 3) it extended dominance "by means of a form of competition which is not based on the transaction effected and is therefore distorted."[9]

In *Michelin I*, the Court of Justice found that the tire manufacturer had abused a dominant position by price discrimination through discounts. In order to maintain sales, Michelin devised a system of variable discounts based on annual sales tailored to each dealer. The Court found that this discount system put pressure on the dealers to meet their targets, or risk a loss for the entire year. The Court further found that Michelin's large size prevented competitors from offering commensurate levels of discount, sufficient to entice year-end purchases from dealers. The Court also pointed to the vagueness of Michelin's program as being calculated to coerce dealers into compliance.

The Court concluded that Michelin's fidelity discounts,

> limit[ ] the dealers' choice of supplier and makes access to the market more difficult for competitors. Neither the wish to sell more nor the wish to spread production more evenly can justify such a restriction of the customer's freedom of choice and independence. The position of dependence in which dealers find themselves and which is created by the discount system in question, is not therefore based on any countervailing advantage which may be economically justified.[10]

Neither case attempted to identify the relationship of the discounts offered to the costs of production of Hoffman-LaRoche or Michelin. However, in striking down the distribution practices at issue, the Court of Justice may have been intuitively in sync with then-prevailing U.S. antitrust doctrine. In particular, the fidelity rebate scheme struck down in *Hoffman-LaRoche* bears a passing resemblance to Ely Lilly's bundled antibiotic rebates held by the Third Circuit in a 1978 case to violate Section 2 of the Sherman Act.[11]

In 1993, Virgin Atlantic Airways lodged a complaint under Article 82 with the European Commission, and filed suit in United States District Court, against various discounting practices of British Airways. As described later by the United States Court of Appeals for the Second Circuit:

> Part of the way in which British Airways competes in the airline industry is through the use of incentive agreements entered into with travel agencies and corporate customers. . . . As British Airways describes its own agreements, commissions or discounts are awarded when specified thresholds of sales are reached, but the agreements contain no set mandatory minimum. . . . In some agreements, travel anywhere on British Airways will count towards the thresholds, while in other agreements certain routes are specified. "Back-to-dollar-one" provisions allow the discount or rebate to apply retroactively to all sales under the agreement once a performance target is met.[12]

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8 The descriptions of *Hoffman-LaRoche and Michelin I* are drawn heavily from Eleanor M. Fox, *Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity and Fairness*, 61 Notre Dame L. Rev. 981, 1006-1007 (1986).

9 *Hoffman-LaRoche*, 1979 E.C.R. at 540, [1978-1979 Transfer Binder] Common Mkt. Rep. (CCH) Paragraph 8527, at 7,553.

10 *Michelin I*, 1983 E.C.R. at 3518, [1983-1985 Transfer Binder] Common Mkt. Rep. (CCH) Paragraph 14,031 at 14,521.

11 *See SmithKline Corp. v. Eli Lilly and Co.*, 575 F.2d 1056 (3d Cir. 1978).

12 *Virgin Atl. Airways Ltd v. British Airways PLC*, 257 F.3d 256, 261 (2d Cir. 2001) (affirming summary judgment against Virgin Atlantic). *See also* discussion below in Part III.B, at text accompanying nn. 63-70.

The European Commission focused its analysis on the British travel agent services market, concluding that British Airways was a necessary business partner to such agents. The Commission then concluded that British Airways' incentive payments were "loyalty discounts as condemned in the *Michelin [I]* and *Hoffman-LaRoche* cases and abusive [price] discrimination between travel agents."[13] The Commission stated that *Michelin I* and *Hoffman-LaRoche*, "taken together, establish that a dominant company can only give rebates in return for efficiencies realized and not in return for loyalty."[14]

The European Commission had no trouble finding British Airways' incentive payments to be loyalty based, and struck them down, fining British Airways 6.8 million Euros and banning the unlawful behavior. The European Court of Justice upheld the ruling and the fine in the spring of 2007.[15]

In its contribution to the OECD Report, the European Commission noted that, based upon the cases discussed above and others,[16] "under EC competition law, there is a tendency not to permit fidelity discounts in the case of companies with substantial market power."[17] Although the European Union court decisions on the matter do not contain a cost-based element in defining the offense of abuse of dominance through loyalty and fidelity rebates, the European Commission does give a nod to a marginal cost-based test in its contribution to the OECD Report:

> If a fidelity discount is structured in such a way that marginal sales are made at "prices" below marginal costs this can be considered abusive. While "classical" predatory pricing below average costs cannot be a long-term strategy to exclude competitors[,] pricing of marginal sales below marginal costs may be applied as long-term strategy by dominant companies.[18]

More recently, in a 2005 DG Competition discussion paper, the European Commission adheres to a standard for finding abuse of dominance through the use of "first-dollar" loyalty and fidelity rebates which does not explicitly require the discounts to be (in whatever sense) "below-cost."[19] However, the Commission does state that it will consider cost-based tests (and defenses) in its analysis of the exclusionary impact of such discounts and rebates.[20] In particular, the Commission will look to the effective price to a buyer of a quantity necessary to provide a commercially viable share to an equally efficient competitor (not an uncomplicated task in practice). The Commission states,

> In case this effective price is below the average total cost of the dominant company, it will be very difficult and possibly even impossible for as efficient competitors to compete with the dominant company for this part of demand.[21]

Finally, in regard to discounts and rebates that apply only to incremental purchases beyond some target level, the Commission states that it "will conclude that the rebate system constitutes an abuse only if the resulting price for those incremental purchases is a predatory price."[22] Thus, there is reason to believe that European competition law will eventually gravitate to cost-based standards for defining abuse of dominance through loyalty and fidelity discounts and rebates, though the process is very gradual.

13 European Commission decision in *Virgin Atl. Airways Ltd. v. Brtish Airways PLC*, IV/D-2/34.780 (1999) at Paragraph 96, available electronically through EUR-Lex at http://eur-lex.europa.eu/en/index.htm.
14 *Id.* at Paragraph 101. *See also Michelin v. Commission*, Case T-203/01, [2003] ECR II 4071 (CFI) (Sept. 30, 2003) ("*Michelin II*") Paragraphs 2, 56-57, 65 (same).
15 ECJ Judgment of Mar. 15, 2007, Case C-95/04 P, *British Airways v. Commission*, available electronically through EUR-Lex at http://eur-lex.europa.eu/en/index.htm.
16 *See, e.g., Irish Sugar PLC v. Commission*, Case T-228/97, 1999 ECR II 2969 (CFI), 5 CMLR 1300 (1999) Paragraph 213 (holding that a loyalty rebate "by an undertaking in a dominant position . . . constitutes an abuse of that dominant position . . . .").
17 OECD Report, *supra* n.1, at 198.
18 *Id.*
19 *See* European Comm'n, *DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* Paragraph 162 at 49-50 (2005), available at http://ec.europa.eu/comm/competition/antitrust/others/discpaper2005.pdf.
20 *Id.* at Paragraphs 153-154, pp. 44-45, and Paragraph 165, pp. 50-51.
21 *Id.* at Paragraph 154, p. 45.
22 *Id.* at Paragraph 168, p. 51.

III. MARKET-SHARE DISCOUNTS AND LOYALTY REBATES UNDER THE SHERMAN ACT AND CLAYTON ACT

A. Overview

U.S. courts have analyzed market-share discounts and loyalty and fidelity rebates under the law of exclusive dealing and predatory pricing. An exclusive dealing arrangement is defined as "one in which a buyer agrees to purchase all or a significant portion of its requirements of a product or service solely from a particular seller or sellers."[23] Although exclusive dealing is generally litigated as a rule-of-reason claim under Section 1 of the Sherman Act, 15 U.S.C. Section 1, "the logic of treating exclusive dealing claims under the Sherman Act's Section 2, [15 U.S.C. Section 2,] which is concerned with monopolization, is clear: . . . [E]xclusive dealing may enable a firm to move into a position of dominance that allows it to restrict market output and raise prices."[24] Under Section 3 of the Clayton Act, 15 U.S.C. Section 14, which deals specifically with exclusive dealing, such an arrangement must have the practical effect of foreclosing the business of competitors in a "substantial share" of the line of commerce affected.[25] This standard has crept explicitly into courts' analysis of exclusive dealing claims under Section 1, and to influence consideration of Section 2 claims.[26]

Section 2 claims targeting market-share discounts commonly contain some accusation of pricing irregularities, and often encounter the difficulties found in pursuing predatory pricing claims generally. The Supreme Court has warned that "the success of such schemes is inherently uncertain … it is not enough simply to achieve monopoly power … the success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain."[27] As such, "predatory pricing schemes are rarely tried, and even more rarely successful."[28]

In order to successfully prove a predatory pricing claim, a plaintiff must demonstrate: "(1) that the prices complained of are below an appropriate measure of its rival's costs, and (2) that the predatory rival has a 'dangerous probability' of recouping its investment through a below cost pricing scheme."[29] An "appropriate measure of costs" is an amorphous and undefined term with substantial ambiguity, though courts tend to accept average variable cost as a fair measure.[30] Given the pro-competitive effects of price cutting, the general rule is that "above cost discounting is not anticompetitive."[31]

In order to fulfill the second requirement for a predatory pricing claim, recoupment, "below-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm's rivals, whether driving them from the market, or … causing them to raise their prices to supracompetitive levels within a disciplined oligopoly."[32] Further, "determining whether recoupment of predatory losses is likely requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market."[33] Some courts take the recoupment analysis a logical step further, holding that "neither monopoly power nor a dangerous probability of achieving monopoly power can exist absent barriers to new entry or expansion."[34]

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23 *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of Rhode Island*, 239 F. Supp. 2d 180, 185 (D.R.I. 2003).
24 *NicSand, Inc. v. 3M Co.*, 457 F.3d 534, 543 (6th Cir. 2006), *rev'd en banc on other grounds*, 507 F.3d 442 (6th Cir. 2007), citing Richard A. Posner, *Antitrust Law* 229 (2d ed. 2001).
25 *See Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).
26 *See, e.g., Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1059-1060 (8th Cir. 2000) (focusing on lack of foreclosure in dismissing claims that boat engine manufacturer's market-share discount programs constituted exclusive dealing in violation of Sherman Act Section 1 or 2).
27 *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) (emphasis in original).
28 *Id.*
29 *Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 266 (2d Cir. 2001) (citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. at 222).
30 *See United States v. AMR Corp.*, 335 F.3d 1109, 1116 (10th Cir. 2003) ("A commonly accepted proxy for marginal cost in predatory pricing cases is Average Variable Cost ('AVC'), the average of those costs that vary with the level of output."); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 466 (S.D.N.Y. 1996) ("It is clear also in this Circuit that the 'appropriate measure' of a rival's costs generally is average variable cost, although the Supreme Court has yet to make such a determination and other circuits are not in uniform agreement.").
31 *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d at 1061, citing *Brooke Group* and *Matsushita*.
32 *Brooke Group*, 509 U.S. at 225.
33 *Id.* at 226.
34 *See, e.g., McKenzie-Willamette Hosp. v. PeaceHealth*, 2003 WL 23537980, *10 (D. Ore. Aug. 15, 2003). The Ninth Circuit later vacated a plaintiff's jury verdict in the *PeaceHealth* case. *See Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir. 2007), *as amended at* 515 F.3d 883 (9th Cir. 2008).

When considering market-share discounts and loyalty rebates, courts often look toward the Supreme Court's predatory pricing decisions in *Brooke Group* and *Matsushita*. The view expressed in *Matsushita* that "predatory pricing schemes are rarely tried, and even more rarely successful,"[35] when combined with the two-pronged test of below-cost pricing and recoupment developed in *Brooke Group*, usually terminates plaintiffs' claims.[36]

Only one decision — *Masimo v. Tyco* — appears to affirm any sort of final ruling in favor of a plaintiff in a Sherman Act Sections 1 and 2 and Clayton Act Section 3 challenge to a market-share discount or loyalty rebate program.[37] Even the *Masimo* court expressed doubt about the facts of the plaintiff's case, but nonetheless upheld a plaintiff's jury verdict. After noting the high burden a movant must meet in order to overturn a jury's verdict on a motion for judgment as a matter of law and request for a new trial, the *Masimo* court engaged in what can be characterized as a "yes, but . . ." form of analysis.[38] The prospect for plaintiffs is unlikely to improve in the near future given the Supreme Court's recent endorsement of the restrictive *Brooke Group* rule in the *Weyerhaeuser* case, in which it extended *Brooke Group* to predatory buying strategies.[39]

B. Significant Market-Share Discount/Loyalty Rebate Cases Analyzed Under The Sherman Act And Clayton Act

Market-share discounts and loyalty rebates have generally withstood claims under the Sherman Act and Clayton Act.[40] Courts have constructed a gauntlet of sometimes overlapping screens to filter out plaintiffs' claims, generally before trial. First, defendants have found sympathy in the courts for the fact-based argument that the defendant does not have sufficient monopoly power to fall within the reach of Section 2.[41] Second, defendants have successfully challenged the causation component of the plaintiff's injury claim.[42] Third, defendants have successfully contested the existence of antitrust injury.[43] Fourth, defendants have successfully challenged the existence of a below-cost pricing arrangement.[44] Of the market-share discount and loyalty rebate cases, the following decisions are of particular interest.

1. *NicSand, Inc. v. 3M Co.*, 457 F.3d 534 (6th Cir. 2006), *rev'd en banc*, 507 F.3d 442 (6th Cir. 2007)

In *NicSand, Inc. v. 3M Co.*, a panel of the Sixth Circuit reversed the lower court's order of dismissal pursuant to Rule 12(b)(6), Fed. R. Civ. P.[45] The plaintiff, a marketer of do-it-yourself retail automotive coated abrasives, brought suit against 3M alleging that certain exclusive dealing contracts 3M executed with large distributors constituted monopolization or attempted monopolization in violation of Section 2 of the Sherman Act. Rather than manufacturing products itself, plaintiff engaged in a business of purchasing do-it-yourself automotive coated abrasives which it cut and then

35 *Matsushita*, 475 U.S. at 589.
36 *See, e.g., Virgin Atl.*, 257 F.3d at 269; *Concord Boat*, 207 F.3d at 1061.
37 *Masimo Corp. v. Tyco Health Care Group, L.P.*, 2006 WL 1236666 (C.D. Cal. 2006). This decision is presently on appeal, but the plaintiff is pressing for a retrial on a bundling theory, rather than the market-share discounts offered by Tyco.
38 *See id.* at *5 ("the court might have reached a somewhat different conclusion [than the jury]"); *id.* at *6 ("Although the Market Share Discount agreements appear to have been terminable on short notice on their face, the jury could reasonably have concluded that in practice they were not."); *id.* at *6 ("Ample evidence was introduced at trial showing that Masimo was not foreclosed from all hospitals.... Nevertheless, the jury could reasonably conclude from the evidence presented at trial that competitors were foreclosed....").
39 *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007). *See also* Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law Paragraph 768 (Supp. 2007) ("Just as *Brooke Group* had a significant impact on the number of predatory selling cases, *Weyerhaeuser* is likely to make most . . . predatory buying claims unpromising for plaintiffs.").
40 The cases discussed here will often contain claims under both Sherman Act Sections 1 and 2, 15 U.S.C. Sections 1 and 2, and Section 3 of the Clayton Act, 15 U.S.C. Section 14, reflecting the various ways in which an exclusive dealing claim can be asserted.
41 *See Smith Wholesale Co. v. Philip Morris USA, Inc.*, 219 Fed. Appx. 398, 410 (6th Cir. 2007) ("*Smith Wholesale I*") (excess production capacity of defendant's competitors foreclosed finding of monopoly); *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d 101, 108 (2d Cir. 2002) (rejecting the plaintiff's proferred definition of a market for fountain-distributed soft drinks); *R. J. Reynolds Tobacco Co. v. Philip Morris, Inc.*, 199 F. Supp. 2d 362, 394 (M.D.N.C. 2002) (court found defendant did not possess monopoly power in the relevant market).
42 *See J.B.D.L. Corp. v.Wyeth-Ayerst Labs., Inc.*, 485 F.3d 880, 887 (6th Cir. 2007) (no genuine issue of material fact as to causal relationship between discount plan and increased price of challenged product); *Concord Boat*, 207 F.3d at 1062-63 ("Boat builders and dealers were free to walk away from Brunswick's discounts at any time, and the evidence showed that they did so when Brunswick's competitors offered better discounts.") (internal citation omitted); *Ortho Biotech Prods., L.P. v. Amgen, Inc.*, 2006 WL 3392939 (D.N.J. Nov. 21, 2006) (no irreparable harm found); *R. J. Reynolds*, 199 F. Supp. 2d at 394 (plaintiffs did not demonstrate exclusionary conduct or an anticompetitive act by defendant).
43 *See R. J. Reynolds*, 199 F. Supp. 2d at 395 ("no evidence indicates Plaintiffs' losses, if any, are a result of anticompetitive activity associated with [the discount program]"); *Allied Orthopedic Appliances, Inc. v. Tyco Healthcare Group, L.P.*, 247 F.R.D. 156, 169, 175 (C.D. Cal. 2007) (denying class certification on market share discount claims, in part, because many members of the putative class received benefits in the form of lower prices as a result of the allegedly exclusionary conduct).
44 *See Virgin Atl.*, 257 F.3d at 267-68 ("a factfinder would necessarily conclude that the decision to offer incentives was nothing more than an attempt to generate increased business on the whole by limiting profitability on selected sales").
45 *NicSand, Inc. v. 3M Co.*, 457 F.3d 534 (6th Cir. 2006), *vacated pending hearing en banc*, 2006 U.S. App. LEXIS 32342 (6th Cir. Nov. 22, 2006), *and rev'd en banc,* 507 F.3d 442 (6th Cir. 2007).

packaged for the retail consumer. Plaintiff alleged that it was 3M's sole competitor in the retail automotive coated abrasives market before it went out of business. According to NicSand, 3M provided "big box" retailers with large discounts in return for multi-year exclusive dealing agreements. During the relevant period, the six largest retailers accounted for 80% of the market for the products in question. Between 1997 and 2001, 3M secured long-term exclusive contracts to supply do-it-yourself retail automotive coated abrasives to four of these retailers. Rather than attempt to compete in such an environment, NicSand exited the market in 2001 and sought bankruptcy protection.

The Sixth Circuit panel found that NicSand alleged conduct that was sufficient to state a Section 2 claim. Significantly, the panel noted, "[t]he Amended complaint alleges that such discounts served no business purpose other than to exclude NicSand's products from the market, and that the effect of such exclusion was to raise NicSand's costs, to prevent it from competing effectively in the market, and eventually to bring about its bankruptcy."[46] NicSand did not allege, and the Sixth Circuit panel did not require, that the discounts 3M gave to obtain the big box retailers' business resulted in any sales below 3M's cost. The dissenter on the panel pointed out that NicSand admitted that prior to 3M's discounting, NicSand was earning margins in the vicinity of 40% to 50% over cost, suggesting that plenty of room for above-cost discounting existed.[47]

The Sixth Circuit *en banc* reversed the panel opinion in *NicSand* by a 10-4 vote.[48] While decided in terms of the lack of antitrust injury, the *en banc* opinion addressed at length the subject of loyalty discounts and exclusive dealing. The court held that a complaint alleging discounts which are non-predatory (defined as "not . . . below cost with the goal of recouping . . . losses . . . later")[49] fails to state an antitrust claim. The court showed little concern that a loyalty discount was used as part of a package to induce "multi-year" (duration greater than one year, but less than five years) exclusive supply agreements.[50] The Sixth Circuit concluded that, where a market was already characterized by functional annual exclusive dealing, the offering of multi-year, formal exclusive deals to a substantial majority of the available distribution channel's members was procompetitive, entry-inducing conduct.[51]

The Sixth Circuit *en banc* majority stated that its opinion "does not mean that a potential competitor may never bring an antitrust claim for exclusive dealing."[52] However, *NicSand* does look to stand for the proposition that an antitrust claim cannot be premised on an above-cost discount, period. Even the dissent in *NicSand* only argued that the plaintiff should be allowed discovery to see if it could fit its claim into the *Brooke Group* framework.[53]

2. *Masimo Corp. v. Tyco Health Care Group, L.P.*, 2006 WL 1236666 (C.D. Cal. 2006)

Masimo Corp. v. Tyco Health Care Group, L.P.,[54] involved claims against Tyco, a manufacturer of pulse oximetry systems and other medical products, that progressed to a jury trial. The plaintiff alleged, *inter alia*, that Tyco provided "loyalty discounts" to hospitals in exchange for promises not to purchase more than a specified percentage of the hospital's requirements for oximetry products from Masimo or other Tyco competitors.[55] Masimo also charged that Tyco entered into certain exclusive dealing and equipment financing arrangements with various hospitals which effectively foreclosed Masimo's ability to compete.[56] Finally, the plaintiff alleged that Tyco offered "bundled rebates" which linked oximetry sales to completely unrelated Tyco products.[57]

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46 *Id.* at 545.
47 *Id.* at 556.
48 *NicSand, Inc. v. 3M Co.*, 507 F.3d 442 (6th Cir. 2007).
49 *Id.* at 452.
50 *Id.* at 453.
51 *Id.* at 453-454.
52 *Id.* at 457.
53 *Id.* at 463. The *NicSand en banc* opinion is also noteworthy for its repeated citations to *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955 (2007), as setting the appropriate standard of review of a Sherman Act Section 2 claim in the context of a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). This explicit extension of *Twombly* into the Section 2 jurisprudence is of particular interest because the court did so on its own — neither party relied on *Twombly* affirmatively or negatively in their *en banc* briefing, and 3M's *en banc* brief explicitly noted that "*Twombly* deals with pleading of conspiracy in a Section 1 context, an issue not presented here." Supp. Br. of 3M Co. in *NicSand v. 3M Co.*, Appeal No. 05-3431 (Jan. 6, 2007).
54 *Masimo Corp. v. Tyco Health Care Group, L.P.*, 2006 WL 1236666 (C.D. Cal. 2006).
55 *Id.* at *1.
56 *Id.*
57 *Id.*

The jury found Tyco liable for violations of Sections 1 and 2 of the Sherman Act, and Section 3 of the Clayton Act, though it only awarded damages for the Section 1 and Section 3 violations.[58] Tyco moved for judgment as a matter of law or, alternatively, a new trial. The United States District Court for the Central District of California rejected Tyco's motions as to liability, though it found the jury's award of $140 million in damages (before trebling) to be unsustainable and ordered a new trial on damages.

As to market share discounts the district court concluded:

> The jury had to decide whether Masimo's difficulties were the result of anticompetitive Market Share Discounts, or instead, whether Masimo's difficulties stemmed from the fact that it was trying to win business from customers with pre-existing investments in a competitor's product (*i.e.*, Tyco monitors). Irrespective of the Market Share Discounts, in most cases, hospitals already had strong incentives to buy a certain percentage of their sensor requirements from Tyco in order to support their Tyco compatible monitors. Although the court might have reached a somewhat different conclusion, the jury concluded the Market Share Discounts were anticompetitive. The jury could reasonably have reached that conclusion.[59]

The court also concluded that the jury could reasonably have found Tyco's Market Share Discounts to "in practical effect" have required hospitals to deal exclusively with Tyco.[60]

As to accusations that Tyco engaged in anticompetitive product bundling, the court noted that it could not find a single case holding that such conduct violated Section 1 of the Sherman Act or Section 3 of the Clayton Act. Rather, the court said, the only cases which had found impermissible bundling fell under Section 2. The court went on to note, "[i]nsufficient evidence was presented for a jury to reasonably conclude that the bundling programs were compulsory, predatory in nature or tying arrangements."[61] Finally, with regard to Masimo's monopolization claim, the court sustained the jury's verdict stating that "[a] jury could reasonably have determined that the Market Share Discounts and Sole Source contracts discussed in the previous sections were designed to and did maintain monopoly power."[62] The case is currently on appeal, but due to the plaintiff's repositioning of its claims on appeal to focus on a bundled-service claim, the market-share discount claims may play no further role in the case.

3. *Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256 (2d Cir. 2001)

In *Virgin Atlantic Airways Ltd. v. British Airways PLC,*[63] Virgin Atlantic alleged that British Airways employed incentive agreements with travel agents and corporate purchasers to monopolize or restrain trade in the air travel market for flights from the United States to London in violation of Sections 1 and 2 of the Sherman Act. Under the British Airways incentive system, discounts or commissions were awarded when certain levels of sales were reached, as specified in applicable contracts. Virgin alleged that these incentive agreements substantially delayed its entry into the market for air services between five particular cities in the United States and London's Heathrow airport. The United States Court of Appeals for the Second Circuit upheld the district court's grant of summary judgment in favor of British Airways, holding that "Virgin submitted insufficient proof to permit a factfinder to render a verdict in its favor" and, critically, that "Virgin failed to show how British Airways' competition harmed consumers."[64]

58 *Id.* at *2.
59 *Id.* at *5.
60 *Id.*
61 *Id.* at *9. *See also id.* at *12 (dismissing claims of impermissible bundling under a Section 2 analysis, and distinguishing *LePage's, Inc. v. 3M Co.*, 324 F.3d 141 (3d Cir. 2003), and *SmithKline Corp. v. Eli Lilly and Co.*, 575 F.2d 1056 (3d Cir. 1978)).
62 *Id.* at *11.
63 *Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256 (2d Cir. 2001).
64 *Id.* at 259.

With respect to Virgin's Section 1 claims, the Second Circuit found that Virgin could prove neither concerted action nor unreasonable restraint of trade in violation of the Sherman Act.[65] British Airways' conduct was essentially unilateral in nature and there was "no allegation that British Airways' incentive arrangement partners agreed to do anything in exchange for the benefits British Airways awarded to high-volume ticket buyers."[66] Furthermore, under the rule of reason, Virgin failed to demonstrate harm to consumers from British Airways' incentive agreements, thereby necessitating dismissal as a matter of law.[67]

With respect to Virgin's Section 2 claims, the court was not persuaded by Virgin's argument that the incentive agreements resulted in below-cost pricing on certain air travel routes, holding that "a factfinder would necessarily conclude that the decision to offer incentives was nothing more than an attempt to generate increased business on the whole by limiting profitability on selected sales."[68] The court went on to question Virgin's theory of recoupment, finding that British Airways' incentives were neither coercive nor that British Airways compensated for lower prices on the routes Virgin was contesting by charging higher prices on other routes or the same routes before Virgin's entry into the market.[69]

As discussed above in the text accompanying notes 13-15, the European competition authorities did find British Airways' loyalty and fidelity rebates to travel agents in the United Kingdom to be an unlawful abuse of a dominant position. The two Virgin/British Airways cases thus represent the most explicit example of antitrust divergence between the U.S. and the EU on loyalty and fidelity rebates.[70]

4. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000)

Concord Boat Corp. v. Brunswick Corp.,[71] involved a boat builder who brought an antitrust suit against the manufacturer of stern drive engines alleging violations of Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act. Brunswick was the leading manufacturer of stern drive engines, having captured some 75% of the market by 1983. In line with several of its competitors, Brunswick began to offer market-share discounts to boat builders sometime in 1984. These discount arrangements provided a boat builder with a markdown on the list price of Brunswick's stern drive engines in exchange for an agreement to purchase a certain percentage of its engine requirements from Brunswick. None of the incentive programs offered by Brunswick prohibited boat builders from purchasing stern drive engines from other manufacturers. "Builders and dealers were able to buy up to 40% of their engines from other manufacturers and still obtain a discount from Brunswick."[72]

At trial, the jury found that Brunswick had violated Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act and awarded plaintiff over $44 million in damages, before trebling.[73] Brunswick appealed the district court's denial of its motion for judgment as a matter of law on both the Clayton Act and Sherman Act claims.

In a lengthy opinion, the United States Court of Appeals for the Eighth Circuit vacated the district court judgment in all respects. The Eighth Circuit started by dismissing the plaintiff's Clayton Act Section 7 claim as being barred by the applicable statute of limitations.[74]

In its analysis of the Section 1 claims the court noted, "[i]t is undisputed that the market share discounts were not exclusive contracts. At most the programs were de facto exclusive dealing

65 *Id.* at 263-65.
66 *Id.* at 263.
67 *Id.* at 265.
68 *Id.* at 269.
69 *Id.* at 271-72.
70 Ironically, British Airways has recently been the source of EU/U.S. antitrust convergence in the area of enforcement against cartel behavior. In 2007, British Airways pled guilty in the U.S. to criminal price fixing in the markets for passenger and air cargo shipments and was sentenced to pay a $300 million fine, following a joint investigation by U.S. and European regulatory authorities.
71 *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000).
72 *Id.* at 1045.
73 *Id.* at 1047.
74 *Id.* at 1050-1053, citing the four-year statute of limitations contained in Section 4B of the Clayton Act, 15 U.S.C. Section 15b.

arrangements."[75] The court recognized that although Section 1 claims alleging only de facto exclusive dealing may be viable, the plaintiff failed to demonstrate that a substantial share of the relevant market was foreclosed by the market-share discount programs, that the duration of the putatively exclusive arrangements was prohibitively long, or that significant barriers to entry existed.[76] Rather, the discounts were structured in such a way that the boat builders "were free to walk away from the discounts at any time" and the discounts "because they were significantly above cost, left ample room for new competitors."[77]

The Eighth Circuit was similarly skeptical of the plaintiff's Section 2 claims. The court cited *Brooke Group* and *Matsushita* for the proposition that "above cost discounting is not anticompetitive."[78] The court noted that "[n]o one argues in this case that Brunswick's discounts drove the engine price below cost."[79] Therefore, the court held that Brunswick's act of cutting prices to attract additional business was a legitimate business decision.[80] Further, "Brunswick's discount programs were not exclusive dealing contracts and its customers were not required either to purchase 100% from Brunswick or to refrain from purchasing from competitors in order to receive the discount."[81] Therefore, the court granted Brunswick judgment as a matter of law on the Sherman Act claims, concluding that the plaintiff "did not offer sufficient evidence to enable a jury to determine that Brunswick's market share discount programs . . . were anticompetitive."[82]

5. *J.B.D.L Corp. v. Wyeth-Ayerst Laboratories, Inc.*, 485 F.3d 880 (6th Cir. 2007)

In *J.B.D.L Corp. v. Wyeth-Ayerst Laboratories, Inc.*,[83] retail and wholesale pharmaceutical purchasers brought Section 2 claims against defendant Wyeth. Wyeth had produced estrogen replacement therapy ("ERT") pharmaceuticals for over 60 years, including the popular drug Premarin. In 1999 a competing manufacturer, Duramed, won FDA approval for a drug, Cenestin, that the plaintiffs alleged caused Wyeth competitive concern.

The plaintiffs alleged that Wyeth attempted to limit the sale of Cenestin by entering into restrictive contractual agreements with third-party payers such as Pharmacy Benefit Managers ("PBMs") and Managed Care Organizations ("MCOs"). In exchange for priority placements on the formularies of such PBMs and MCOs, Wyeth agreed to provide rebates on a variety of ERT drugs. Furthermore, Wyeth "consistently" tied the size of its rebates to the market share of Premarin, with the goal of maintaining Premarin's market position.[84] Plaintiffs also argued that at the same time Wyeth was limiting the market access of Cenestin, it increased the price of Premarin, resulting in allegedly unlawful overcharges.[85]

The Sixth Circuit affirmed the lower court's holding that the plaintiff failed to establish a causal link between Wyeth's programs promoting the purchase of Premarin and increases in the price of the drug.[86] The court noted, "[n]either of the experts account for the numerous alternative explanations for Cenestin's failure to secure market share, including poor marketing by Duramed, the unavailability of certain dosages of Cenestin, low physician demand, or the clinical and therapeutic differences between Cenestin and Premarin."[87] Accordingly, the Sixth Circuit affirmed the trial court's grant of summary judgment.

75 *Id.* at 1058.
76 *Id.* at 1059.
77 *Id.*
78 *Id.* at 1061.
79 *Id.* at 1062.
80 *Id.*
81 *Id.* at 1062-63.
82 *Id.* at 1063.
83 *J.B.D.L Corp. v. Wyeth-Ayerst Laboratories, Inc.*, 485 F.3d 880 (6th Cir. 2007).
84 *Id.* at 884-885.
85 *Id.* at 886.
86 *Id.* at 887.
87 *Id.* at 890.

IV. MARKET-SHARE DISCOUNTS AND LOYALTY REBATES UNDER THE ROBINSON-PATMAN ACT

Though the Sherman Act has been the most frequent mechanism used to challenge market-share discounts and loyalty rebates in U.S. courts, plaintiffs have occasionally looked to the Robinson-Patman Act, 15 U.S.C. Section 13 ("RPA"), for relief. While the RPA deals with price discrimination, it does not necessarily ban all price differences charged to different purchasers of commodities of like grade and quality.[88]

As the Sixth Circuit succinctly noted in a leading recent case addressing the issue, *Smith Wholesale Co. v. R.J. Reynolds Tobacco Co.* ("*Smith Wholesale II*"), "there is a dearth of precedent addressing the legality of market-share discount programs under the [Robinson-Patman] Act."[89] However, this limited body of case law indicates that Robinson-Patman challenges to market-share discounts have generally been unsuccessful. The plaintiff-friendly rulings have been quite narrow.[90] Though plaintiffs challenging *quantity* discounts have found some success, this success generally has not carried over into cases challenging market-share discounts and loyalty rebates.[91]

Some courts have disposed of RPA challenges to market-share discounts and loyalty rebates on the ground that they were "functionally available" to the plaintiff.[92] Some defendants have also successfully challenged the causal link between the alleged impermissible discount program and any injury to competition.[93]

In *Smith Wholesale II*, wholesalers of R.J. Reynolds' tobacco products alleged secondary line price discrimination in violation of the Robinson-Patman Act. The details of the challenged discount program offered by R.J. Reynolds were complex. In 2000, R.J. Reynolds introduced a new discount program entitled the Wholesale Partners Program ("WPP") in order to bolster sales of its so-called "savings" or lower-cost brands of cigarettes. A wholesaler could achieve three different levels of discounts from R.J. Reynolds based on its percentage of sales of R.J. Reynolds' savings-brand cigarettes as compared to sales of all other savings-brand cigarettes. The target percentage for each distributor was individually calculated based on a formula which took into account not only that wholesaler's percentage sales of R.J. Reynolds' savings-brand cigarettes, but also similar sales figures throughout the state in which the wholesaler was located.

Plaintiffs charged that the WPP violated the RPA as it was functionally impossible for them to reach the more lucrative discount levels. The plaintiffs claimed that because they sold primarily to retailers in rural or lower income areas where demand for even cheaper cigarettes was high, it was impossible for them to reach the target percentages the WPP required.

The district court granted summary judgment for R.J. Reynolds, finding that the WPP program was functionally available to the plaintiffs and therefore precluded a finding of liability under the RPA. The Sixth Circuit agreed with the district court, and affirmed its summary judgment ruling. The court of appeals began by noting the unique nature of this suit, "heretofore, legal challenges to

88 *Brooke Group*, 509 U.S. at 220.

89 *Smith Wholesale Co. v. R. J. Reynolds Tobacco Co.*, 477 F.3d 854, 865 (6th Cir. 2007) ("*Smith Wholesale II*").

90 *See George Haug Co. v. Rolls Royce Motor Cars, Inc.*, 148 F.3d 136 (2d Cir. 1998) (denying defendant's motion for summary judgment on grounds that fact questions remained as to whether discount was a subterfuge to avoid RPA liability); *Drug Mart Pharmacy Corp. v. American Home Prods. Corp.*, 472 F. Supp. 2d 385 (E.D.N.Y. 2007) (denying defendant's motion for summary judgment on grounds that fact issues remained regarding whether rebates offered by defendant amounted to control over price offered to retailers by wholesalers and whether competition existed among relevant parties), *amended by* 2007 WL 4526618 (E.D.N.Y Dec. 20, 2007); *American Booksellers Ass'n, Inc. v. Barnes & Noble, Inc.*, 135 F. Supp. 2d 1031 (N.D. Cal. 2001) (denying defendant's summary judgment motion on grounds that fact issues remained regarding whether discounts offered by defendant were lawful functional discounts or were cost-justified).

91 *See Smith Wholesale II*, 477 F.3d at 871-72 (citing a string of cases where plaintiffs were successful in challenging quantity discounts under the RPA).

92 *See, e.g. Smith Wholesale I,* 219 Fed. Appx. at 405 (affirming grant of summary judgment on Robinson-Patman challenge to market-share discount program because the best discount was functionally available to plaintiffs); *Metro Ford Truck Sales, Inc. v. Ford Motor Co.*, 145 F.3d 320, 326 (5th Cir. 1998) ("the record further establishes that the [discount] program functioned to ensure that all Ford dealers issuing bids to the same customer received equal [discounts]…."); *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 120 (3d Cir. 1980) ("a uniform pricing formula applicable to all customers is not a price discrimination under the [Robinson-Patman] act…. [P]laintiff has failed to establish that the hauling allowance formula discriminates in violation of the Robinson-Patman Act"); *Amer. Tara Corp. v. Int'l Paper Co.*, 1981 WL 375752, at *3 (N.D. Ill. 1981) ("the factors which plaintiff claims made the program disadvantageous to plaintiff are not unique to plaintiff…. As long as defendant offered the same bad bargain to plaintiff as to its competitors, however, defendant did not violate the Robinson-Patman Act.").

93 *See Water Craft Mgmt., LLC v. Mercury Marine,* 361 F. Supp. 2d 518, 538 (M.D. La. 2004) (finding that plaintiffs failed to establish a prima facie case under the RPA because they did not show "actual injury to a disfavored purchaser because of a violation of the federal antitrust laws"); *Intimate Bookshop v. Barnes & Noble, Inc.*, 2003 WL 22251312, at *5 (S.D.N.Y. 2003) (plaintiff failed to show a causal link between its alleged injuries and the discounts offered by the defendant).

secondary-line pricing practices under Section 13(a) have arisen in the original context contemplated by the Act — discriminatory pricing arising from standard quantity discounts. We nonetheless would be remiss if we were to suggest that market-share discounts are immune from Robinson-Patman scrutiny."[94] The court reasoned that the RPA does not guarantee equal outcomes for all purchasers, "[i]ndeed, by definition, an incentive-based program will lead to different outcomes for different purchasers . . . . Commitment to a particular product is the sine qua non of an incentive program."[95]

After outlining the legal standard of functional availability, the Sixth Circuit upheld R.J. Reynolds' market share discounts as functionally available to all the wholesalers:

> We initially noted that the WPP does not bear any of the obvious hallmarks of a discriminatory pricing program. [R.J. Reynolds] developed a share-based program, not a quantity-based program of the sort condemned by the Supreme Court in *Morton Salt* . . . . [R.J. Reynolds] has evenhandedly applied the WPP, treating all of its wholesalers equally and offering all of them the same qualification terms.[96]

Ultimately, the court held, "Defendant's program is designed to promote its financial welfare at the expense of that of the wholesalers. Perhaps it is unfair, but it is not illegal."[97]

V. CONCLUSIONS

While single-product loyalty rebate programs can occasionally trigger liability under various antitrust theories, the reality is that such claims rarely succeed, though more often in Europe than the U.S. There is currently no uniform framework for analyzing such claims, and often liability rules designed for multi-product bundling situations are stretched to cover single-product rebate schemes as an afterthought. Since antitrust law particularly in the U.S. is focused on protecting interbrand competition, and loyalty rebates can have significant procompetitive effects in lowering price and providing dealers incentives to increase sales efforts for a particular supplier, we should anticipate great judicial tolerance for loyalty rebate programs, given the now rote manner in which courts reiterate their abhorrence of falsely condemning potentially procompetitive conduct.

In the United States, given the lack of judicial success in attacking market share rebates as either predatory pricing or exclusive dealing (the *Masimo* case, currently on appeal to the Ninth Circuit, appears to be the only case in which plaintiffs have prevailed post-trial), the quest for a definitive legal standard by which to judge the practice largely comes down to trying to identify a rule that will permit all but the most exclusionary forms of loyalty rebates. A cost-based standard which permits all loyalty rebate programs which do not result in the marginal units which are affected by the rebate being functionally discounted below marginal cost — with some consideration of post-predation recoupment — appears to be the standard toward which commentators and courts will soon gravitate.[98] This standard is not free of difficulty in implementation, in particular when products such as computer software are involved for which marginal cost is often close to zero. But even here, thought has been given to including in the calculation of marginal cost a portion of the development costs attributable to the product.[99]

Such a cost-based standard also has a surface similarity to the *Brooke Group* predatory pricing test and the test for bundled product discounts adopted by the Antitrust Modernization Committee (and in part by the Ninth Circuit in *PeaceHealth*).[100] However, moving solely to such a cost-based test does have problematic consequences in the extreme case where a loyalty rebate

94 *Smith Wholesale II*, 477 F.3d at 865.
95 *Id.* at 866.
96 *Id.* at 877. *See FTC v. Morton Salt Co.*, 334 U.S. 37 (1948).
97 *Smith Wholesale II,* 477 F.3d at 880.
98 *See, e.g.*, Herbert Hovenkamp, *supra* n.3.
99 *See, e.g.*, Robert H. Lande, *supra* n.3.
100 See Antitrust Modernization Committee, *Report and Recommendations* at p. 83, Recommendation No. 17 (2007), available electronically at www.amc.gov; *Cascade Health Solutions v. PeaceHealth*, 502 F.3d at 921, n.21, *superseded and amended on other grounds by* 515 F.3d 883 (9th Cir. 2008); *see also* M. Laurence Popofsky and Adam J. Gromfrin, *Bundled Discounting: From LePage's to PeaceHealth and Beyond*, paper presented at The 9th Annual Sedona Conference on Antitrust Law and Litigation, Oct. 2007, *reprinted in* Sedona Conf. J. vol. 9 (2008).

program is structured to create true exclusive dealing on the part of a monopolist or a party with significant market power. Under existing exclusive dealing law, depending upon the significance of the distribution opportunities foreclosed by such conduct, such a rebate program could run afoul of the Sherman Act regardless of the price-to-marginal-cost ratio involved.

Perhaps the European competition authorities' reluctance fully to embrace a cost-based standard for judging loyalty and fidelity discounts and rebates reflects a reluctance to give dominant firms a functional pass on programs that essentially mirror formal exclusive dealing regimes. However, the past European judicial decisions have probably tended toward over-deterrence, if the economic policy goal in regulating such conduct is to ensure that equally efficient competitors of dominant firms are not excluded from the market by loyalty and fidelity rebate programs. The European competition authorities appear now to be moving to introduce cost-based calculations into their assessment of such programs, as a check on their prior practice of condemning such arrangements without resort to cost-based analysis, to avoid striking down rebate programs that have a procompetitive justification.

The remaining open question is whether there is a judicially-administrable formulation which will retain the ease of application of a strict cost-based rule while preserving the flexibility to strike down a loyalty rebate program which functionally results in exclusive dealing that forecloses an equally efficient competitor. Before embracing a cost-based test to measure loyalty rebate programs, there needs to be a discussion of what is being given up in terms of combating anticompetitive forms of above-cost loyalty rebate programs and whether the administrative convenience of a cost-based rule is worth the inevitable narrowing of the scope of anticompetitive loyalty rebate programs that such a filter will catch.