AntitrustConnect Blog

FTC/DOJ Workshop on Conditional Pricing Practices – Good as Far as It Goes

Steven J. Cernak (Bona Law PC) · Sunday, June 29th, 2014

On June 23, 2014, the U.S. Federal Trade Commission and Department of Justice Antitrust Division held a workshop on "conditional pricing practices"—loyalty discounts, bundled discounts and similar pricing techniques. Many economists, academic experts and practitioners, some of them even hailing from outside the Beltway, opined on the rationale for and against antitrust legality of such common marketing practices. The agencies are to be congratulated for leading this discussion and advancing the thinking on this important topic; still, real-world businesses continue to look for clearer guidance than what has been provided by the agencies and courts to date, but the conference promised nothing clear any time soon.

Loyalty and bundled discount programs, and all the marketing techniques that go with them, have posed difficult competition law questions for years. On the one hand, customers get an immediate discount; on the other, there appear to be circumstances when such discounts, at least when offered by a monopolist, can starve competitors of necessary sales or inputs and ultimately harm competition. Appellate court cases like *Concord Boat*, *LePage's*, *Cascade Health* and *Eaton* have struggled with the appropriate mode of analysis while the Supreme Court has declined to provide any guidance. Despite many articles and speeches, the proper method of analysis is still unclear. Leave the U.S. and change the terms to "dominant actor" and "abuse of dominance" and the tests still are not clear, although the skepticism of such discounts does increase, as Intel recently discovered in the European Union.

The confusion in the lower U.S. courts is evident from just two of several recent cases considering the proper standards when judging these claims. The majority of a 2011 8th Circuit panel extended its 2000 *Concord Boat* decision on loyalty pricing to bundled discounts in *Southeast Missouri Hospital v. C.R. Bard, Inc.* A grant of summary judgment for the defendant was affirmed because buyers of hospital products were not required to buy 100 percent of their needs to obtain discounts and could choose to buy from competitors at any time. The dissent would have remanded for further consideration of evidence that buyers felt forced to purchase from the defendant because the discounts were substantial. Also, the dissent would have applied the 9th Circuit's discount attribution test from *Cascade Health* to the bundled discount claims. In March 2014, the New Jersey District Court in *Eisai Inc. v. Sanofi-Aventis U.S.* followed the 3rd Circuit's *Eaton* case to determine how to characterize a drugmaker's loyalty discounts to hospitals. Unlike *Eaton*, however, the court found that price was the dominant method of exclusion—and so the defendant-friendly price-cost test applied—despite the plaintiff's arguments that the defendant's requirements for display of the drugs in a hospital's formulary could not be distinguished from Eaton's

requirements regarding truck builders' databooks.

So, the workshop helpfully brought together experts and deep thinkers to debate the topic. The morning and early afternoon were consumed by "economists being economists." Assumptions were made and models displayed that showed such pricing programs were either procompetitive or anticompetitive. The most helpful information came from three professors who discussed the limited empirical work in the area. Professor Julie Holland Mortimer explained why research like her work on loyalty pricing in candy bar vending machines is rare: While numerous, these programs are private contracts and, even when shared, their results are hard to untangle from other economic factors. She and professors Kusum Ailawadi and Francine Lafontaine described how businesses use these programs to influence channel effort and price. As to effort, manufacturers use these and many other programs to increase distributor focus through methods like shelf space and salespeople training. These programs can also help keep the product's resale price near the level desired by the manufacturer, which might be higher or lower than the price originally chosen by the distributor. Finally, Ailawadi described the difficulties in negotiating these contracts. In addition to the discount level, the forecasting, monitoring and other elements of the agreements can be nettlesome issues that mean these programs "aren't built in a day."

Lawyers, both academics and practitioners, carried the rest of the program. Most of the discussion was a debate between supporters of standards suspicious of such programs (raising rival's costs, full rule of reason) and those favoring standards more hospitable to low prices (price/cost test, *Brooke Group*). The debate was captured nicely by the dueling presentations of professors Einer Elhauge and Dan Crane. Elhauge supported a "raising rival's costs" theory and explained how these programs could be anticompetitive even if easily terminable. Crane pointed to numerous Supreme Court quotes showing support for low prices, "no matter how set." He and other speakers also explained that these programs can be found throughout the economy, especially among "large and sophisticated buyers" who, presumably, "are not poor grandmothers or idiots."

The Elhauge/Crane colloquy also included one of several disagreements during the day about the facts in the real world. Elhauge claimed he had seen many instances when a monopolist manufacturer had raised its price before offering a loyalty discount. Crane's experience was different and he thought such pricing strategies were implausible. While it might have been difficult to find a willing speaker, the program would have benefited greatly from current or former big company pricing managers who actually made such pricing decisions. Having sat through such meetings for years, my experience is that the process often is like sausage-making, with back-of-the-envelope assumptions like perfectly inelastic demand substituting for the careful analysis many would expect. When one conference participant said that sometimes nobody at the company remembers the rationale for a long-running program, some of the academics found that explanation laughable. Those of us who have lived with the inertia of a large conservative bureaucracy smiled in recognition.

The workshop clearly advanced the antitrust community's understanding of these common pricing practices. The discussion of the various experts helped to clarify areas of agreement and where more research and thinking might be helpful, especially the real-world goals and effects of these programs. Still, the workshop can only be judged ultimately successful if eventually it leads to clearer standards that businesses can follow. Real marketers and lay judges and juries need a test or set of factors they can understand and apply without a Ph.D. in economics. As FTC Commissioner Ohlhausen said to open the program, the standard should be predictable, fair and transparent. Until then, companies, especially those with arguably high market shares, might avoid

the risk of years of litigation and treble damages by not discounting as aggressively—and that result is not good for competition and consumers.

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