

## ANTITRUST BY ANALOGY: DEVELOPING RULES FOR LOYALTY REBATES AND BUNDLED DISCOUNTS

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*Though analogy is often misleading, it is the least misleading thing we have.*  
—Samuel Butler

Economics has come to dominate antitrust jurisprudence. Preserving and enhancing economic welfare (in one form or another) is now the conceded goal of antitrust. Accordingly, economic analysis permeates antitrust scholarship, drives agency decisions, and is the basis of modern judicial decisions. The thought of developing an antitrust liability rule without a well-considered underlying economic theory is anathema. The mention of such a possibility brings pursed lips, condescending looks, and hushed ridicule. But what should a court do when there is no consensus on the underlying economic theory? That is the situation for the antitrust treatment of loyalty rebates and bundled discounts.

The antitrust case law offers little guidance. Many of the critical debates in antitrust law have centered on whether the prevailing framework of analysis for particular competitive conduct should be changed in light of economic analyses. In *Continental T.V., Inc. v. GTE Sylvania Inc.*,<sup>1</sup> for instance, the Supreme Court was asked to revisit its prior holding that vertical nonprice restraints were “so obviously destructive of competition” as to merit per se condemnation.<sup>2</sup> This holding had become “the subject of continuing controversy and confusion, both in the scholarly journals and in the federal courts.”<sup>3</sup> As the Court acknowledged, the “great weight of scholarly opinion [was] . . . critical of the decision” and lower courts had sought to limit the holding.<sup>4</sup> Concluding that its prior holding rested on “formalistic line drawing” rather than economic effects, the Court overruled its prior decision, rejected the use

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<sup>1</sup> 433 U.S. 36 (1977).

<sup>2</sup> *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1967).

<sup>3</sup> *Continental T.V.*, 433 U.S. at 47.

<sup>4</sup> *Id.* at 48 nn.13 & 14.

of per se analysis for vertical non-price restrictions, and held that the rule of reason should apply instead.<sup>5</sup>

Similarly, the Court has used developments in economic theory to reject established antitrust precedents. For example, in *State Oil Co. v. Khan*,<sup>6</sup> the Court overruled its nearly 30-year-old holding in *Albrecht v. Herald Co.*<sup>7</sup> that vertical maximum price fixing is per se illegal. After chronicling the development of the antitrust treatment of vertical restraints, the Court concluded “that there is insufficient economic justification for *per se* invalidation of vertical maximum price fixing.”<sup>8</sup>

In *Illinois Tool Works Inc. v. Independent Ink, Inc.*,<sup>9</sup> the Court rejected the decades-old rule in tying cases that “when a seller conditions its sale of a patented product (the ‘tying’ product) on the purchase of a second product (the ‘tied’ product),” the seller should be presumed to possess market power in the market for the patented product.<sup>10</sup> Noting that the “vast majority of academic literature recognizes that a patent does not necessarily confer market power,”<sup>11</sup> the Court abrogated its prior cases by holding that “in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product.”<sup>12</sup>

Finally, in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,<sup>13</sup> the Court overruled the nearly century-old rule that minimum resale price maintenance is per se unlawful. The Court found that the bases for the rule, first announced in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*<sup>14</sup>—the common-law rule against restraints on alienation and treating vertical restraints as analogous to horizontal restraints—had been rejected in the Court’s more recent antitrust cases.<sup>15</sup> Noting that “respected authorities in the economics literature suggest the *per se* rule is inappropriate, and there is now widespread agree-

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<sup>5</sup> *Id.* at 58–59.

<sup>6</sup> 522 U.S. 3 (1997).

<sup>7</sup> 390 U.S. 145 (1968).

<sup>8</sup> *State Oil*, 522 U.S. at 18; *see also* 522 U.S. at 14–15 (citing *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 343 n.13 (1990) (“The procompetitive potential of a vertical maximum price restraint is more evident now than it was when *Albrecht* was decided . . . . Many commentators have identified procompetitive effects of vertical, maximum price fixing.” (citations omitted)); *see also* *Khan v. State Oil Co.*, 93 F.3d 1358, 1363 (7th Cir. 1996) (following *Albrecht* “despite all its infirmities, its increasingly wobbly, moth-eaten foundations”).

<sup>9</sup> 547 U.S. 28 (2006).

<sup>10</sup> *Id.* at 31.

<sup>11</sup> *Id.* at 44.

<sup>12</sup> *Id.* at 46.

<sup>13</sup> 551 U.S. 877 (2007).

<sup>14</sup> 220 U.S. 373 (1911).

<sup>15</sup> *Leegin*, 551 U.S. at 887–88.

ment that resale price maintenance can have procompetitive effects,”<sup>16</sup> the Court overruled *Dr. Miles* and held that “[v]ertical price restraints are to be judged according to the rule of reason.”<sup>17</sup>

But what if there is no established framework of analysis, no long line of cases, no “great weight of scholarly opinion” presenting a consensus view? What if there is no standard underlying economic analysis of the particular conduct?

That is precisely the situation with the antitrust treatment of rebates (loyalty and bundled).<sup>18</sup> The scholarship is divided.<sup>19</sup> The economics is murky.<sup>20</sup> The courts are just starting to address such conduct. The critical question then is what tool can the courts use to develop antitrust liability rules for rebates?

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<sup>16</sup> *Id.* at 900.

<sup>17</sup> *Id.* at 907.

<sup>18</sup> Recognizing the differences, I use the term “rebates” to refer to both loyalty rebates (rebates given when the customer meets certain purchasing thresholds, typically a percentage of its requirements) and bundled discounts (discounts or rebates given when the customer purchases two products together or more typically meets certain purchasing thresholds based on its requirements for a bundle of products, e.g., 90% of the customer’s requirements for a certain class of pharmaceuticals).

<sup>19</sup> Compare Thomas A. Lambert, *Appropriate Liability Rules for Tying and Bundled Discounting*, 72 OHIO ST. L.J. 909, 980–81 (2011) (arguing for cost-based test similar to predatory pricing), and Herbert Hovenkamp & Erik Hovenkamp, *Complex Bundled Discounts and Antitrust Policy*, 57 BUFF. L. REV. 1227, 1234–37 (2009) (advocating version of cost-based test), with Kevin W. Caves & Hal J. Singer, *Bundles in the Pharmaceutical Industry: A Case Study of Pediatric Vaccines* 48 (Aug. 11, 2011), available at <http://ssrn.com/abstract=1908306> (arguing that “[r]ecent scholarship demonstrates that cost-based tests . . . may fail to properly classify a given bundled pricing scheme as anticompetitive”), Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397, 461–69 (2009) (arguing against use of price-cost tests for bundled discounts) [hereinafter Elhauge, *Bundled Discounts*], Einer Elhauge, *How Loyalty Discounts Can Perversely Discourage Discounting*, 5 J. COMPETITION L. & ECON. 189, 216–17 (2009) (arguing against price-cost tests for loyalty discounts) [hereinafter Elhauge, *Loyalty Discounts*], and Timothy J. Brennan, *Bundled Rebates as Exclusion Rather than Predation*, 4 J. COMPETITION L. & ECON. 335, 337–38 (2008) (arguing that cost-based test is flawed).

<sup>20</sup> See, e.g., Brief for the United States as Amicus Curiae at 12 n.9, *3M Co. v. LePage’s Inc.*, No. 02-1865 (U.S. May 28, 2004), available at <http://www.justice.gov/atr/cases/f203900/203900.pdf> (“the theoretical and empirical analysis of [bundled rebates] as a potentially exclusionary mechanism is relatively recent and sparse”); Nicholas Economides, *Loyalty/Requirement Rebates and the Antitrust Modernization Commission: What Is the Appropriate Liability Standard?*, 54 ANTITRUST BULL. 259, 259 (2009) (noting a “number of alternative economic standards have been proposed for establishing antitrust liability” in rebate cases); Einer Elhauge & Abraham L. Wickelgren, *Anti-competitive Market Division Through Loyalty Discounts Without Buyer Commitment*, Harvard John M. Olin Discussion Paper No. 723 (Aug. 2012) (noting division among scholarship); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the Economic Literature*, 1 J. COMPETITION L. & ECON. 707 (2005) (concluding that the economic literature does not support whether the exclusionary effects of bundled discounts outweigh procompetitive benefits); Timothy J. Muris & Vernon L. Smith, *Antitrust and Bundled Discounts: An Experimental Analysis*, 75 ANTITRUST L.J. 399, 400 (2008) (noting lack of consensus regarding antitrust standard for bundled discounts).

The answer is simple—analogy.<sup>21</sup> The courts have sought to craft antitrust rules for rebates through analogy to existing case law regarding exclusive dealing, tying, and predatory pricing.

While analogical reasoning is a uniquely powerful tool, superficial analogies lead to incorrect conclusions. Unfortunately, courts in rebate cases have examined only whether rebates share certain characteristics with the chosen analog (exclusive dealing, tying, or predatory pricing). Based on these facial commonalities, the courts adopt the legal rules applied to the analog. But antitrust legal rules reflect an amalgam of economic, policy, and prudential concerns. And the courts have not done a good job of determining whether the amalgam of concerns that resulted in the legal rule for the chosen analog carry over in the case of rebates. Nor have the courts considered whether the legal rules of the chosen target are sufficiently sound to extend them into other areas. In other words, the courts' sloppy use of a wholly appropriate tool has brought significant and inappropriate baggage into the analysis of rebates. More thorough analysis of the analogies leads to the conclusion that a multifaceted rule of reason is the better approach.

### I. ANALYZING REBATES THROUGH ANALOGY

Legal rules are most often developed through analogy to existing rules.<sup>22</sup> In fact, the “importance of legal reasoning by analogy cannot be overstated. It is the heart of the study of law . . . the method of analogy goes to the fundamentals of the common-law tradition.”<sup>23</sup> As the Sherman Act is a “common-law” statute, which “adapts to modern understanding and greater experience” and must thus “evolve to meet the dynamics of present economic conditions,”<sup>24</sup> courts have used the method of reasoning by analogy to address antitrust challenges to rebate systems.

But given antitrust law's dependence on economics, it is important to note that reasoning by analogy is not unique to the common law. It is not limited to lawyers. Its utility is not limited to nonempirical studies. To the contrary,

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<sup>21</sup> For a discussion of how the use of different analogies in the antitrust analysis of bundling practices in the United States and the European Union helps to explain the cross-Atlantic divergence in this area, see generally Nicholas Economides & Ioannis Lianos, *The Elusive Antitrust Standard on Bundling in Europe and in the United States in the Aftermath of the Microsoft Cases*, 76 ANTITRUST L.J. 483 (2009).

<sup>22</sup> “In reasoning by analogy, a court normally begins with a rule, announced in a prior case, that is *not* in terms applicable to the case at hand, and then determines that there is no good reason to treat the case at hand differently. The court therefore reformulates the announced rule (or, what is the same thing, formulates a new rule) in a way that requires the two cases to be treated alike.” MELVIN ARON EISENBERG, *THE NATURE OF THE COMMON LAW* 87 (1988).

<sup>23</sup> RUGGERO J. ALDISERT, *LOGIC FOR LAWYERS* 96 (3d ed. 1997).

<sup>24</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 899 (2007) (citing *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978)).

“Analogical reasoning has been regarded as a key component of intelligence, inductive reasoning, and everyday discourse, as well as learning, understanding our environment, and generating novel ideas.”<sup>25</sup> Reasoning by analogy is used in every intellectual endeavor; it is a basic human reasoning process.<sup>26</sup> Importantly, reasoning by analogy is key to developing an understanding of new phenomena; “analogical reasoning is about solving problems, describing something, learning or explaining things by extending our thought from things we do understand to things we do not, at the time, comprehend.”<sup>27</sup>

Analogical reasoning often offers advantages over other types of reasoning. Arguments by analogy are irreducible and can therefore go from particular to particular, without any dependence on any universal premise.<sup>28</sup> This feature often gives analogical reasoning significant advantages in certain situations.<sup>29</sup>

This feature also makes analogical reasoning especially apt for the antitrust analysis of rebates. Simply put, the antitrust analysis of rebates has accentuated the lack of a comprehensive categorical theory for monopolization.<sup>30</sup> The courts cannot, therefore, simply deduce the proper outcome in a given case. Yet, in evaluating rebates, the courts have used three solid analogs to guide their analysis: exclusive dealing, tying, and predatory pricing.

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<sup>25</sup> Adam E. Green, Jonathan A. Fugelsang & Kevin N. Dunbar, *Automatic Activation of Categorical and Abstract Analogical Relations in Analogical Reasoning*, 37 *MEMORY & COGNITION* 1414, 1414 (2006) (citations omitted).

<sup>26</sup> See, e.g., Scott Brewer, *Exemplary Reasoning: Semantics, Pragmatics, and the Rational Force of Legal Argument by Analogy*, 109 *HARV. L. REV.* 925, 926 (1996) (stating that “theorists and practitioners in all intellectual disciplines, scientific and nonscientific alike, routinely rely on analogical reasoning”).

<sup>27</sup> A. Juthe, *Argument by Analogy*, 19 *ARGUMENTATION* 1, 3 (2005).

<sup>28</sup> *Id.* at 5 (“Two objects are analogous if and only if there is a one-to-one correspondence between the elements of the objects. This is what makes analogical inference go from particular to particular without going via any universal premise.”); see also Steven Gamboa, *In Defense of Analogical Reasoning*, 28 *INFORMAL LOGIC* 229, 234–40 (2008) (discussing successful use of analogical reasoning in scientific realm); Emily Sherwin, *A Defense of Analogical Reasoning in Law*, 66 *U. CHI. L. REV.* 1179, 1193 (1999) (stating that “the practice of analogical reasoning by judges may produce fewer errors than a straightforward analysis of what is best”).

<sup>29</sup> For instance, where the implementation of a rule depends on consideration of benefits and effects that cannot be quantified or compared, analogical reasoning may be more useful than other forms of analysis. See, e.g., Cass R. Sunstein, *On Analogical Reasoning*, 106 *HARV. L. REV.* 741, 788 (1993) (“A special advantage of analogical reasoning over economic analysis is that the former, unlike the latter, need not insist that plural and diverse social goods should be assessed according to the same metric. To make diverse goods commensurable in this way may do violence to our considered judgments about how each good should be characterized.”).

<sup>30</sup> See Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 *EMORY L.J.* 423, 485–86 (2006) (“Antitrust analysis of mixed bundling schemes is complicated by the fact that we still have not resolved how to think categorically about the monopolization of-fense.”). Cf. John Kallaughner & Brian Sher, *Rebates Revisited: Anti-Competitive Effects and Exclusionary Abuse Under Article 82*, 2004 *E.C.L.R.* 263 (discussing influence of ordoliberalism on EC cases involving rebates).

## A. THE ANALOGY TO EXCLUSIVE DEALING

A fundamental premise of antitrust challenges to rebate systems is that they exclude rivals from sufficient access to downstream distributors. Rebate schemes may thus be analogous to exclusive dealing contracts.

Courts have long recognized both the exclusionary and the procompetitive potential of exclusive dealing. The courts have acknowledged that a firm may be able to use exclusive dealing to establish or maintain market power “by raising its rivals’ distribution costs by eliminating their access to downstream markets.”<sup>31</sup> But the courts also long ago recognized the potential procompetitive benefits of the practice. For the upstream party, exclusive dealing may reduce “selling expenses, give protection against price fluctuations . . . offer the possibility of a predictable market,”<sup>32</sup> and prevent free riding on promotional efforts.<sup>33</sup> For the downstream distributor, exclusive dealing “may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand.”<sup>34</sup>

These benefits create a dilemma for downstream distributors. While creating or maintaining an upstream monopolist is not in their collective interest, each individual distributor has strong incentives to enter into exclusive dealing contracts. Thus, distributors “by their individual acts might thus enable the formation of an upstream monopoly . . . despite their having a collective incentive not to do so.”<sup>35</sup>

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<sup>31</sup> *NicSand, Inc. v. 3M Co.*, 457 F.3d 534, 543 (6th Cir. 2006), *vacated on rehearing en banc*, 507 F.3d 442 (6th Cir. 2007); *see also* *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O’Conner, J., concurring) (“Exclusive dealing arrangements may, in some circumstances, create or extend market power of a supplier or the purchaser party to the exclusive dealing arrangement, and may thus restrain horizontal competition. Exclusive dealing can have adverse economic consequences by allowing one supplier of goods or services unreasonably to deprive other suppliers of a market for their goods, or by allowing one buyer of goods unreasonably to deprive other buyers of a needed source of supply.”).

<sup>32</sup> *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 306–07 (1949) (citations omitted); *see also* *Jefferson Parish*, 466 U.S. at 45 (O’Conner, J., concurring) (exclusive dealing contracts “may be substantially procompetitive by ensuring stable markets and encouraging long-term, mutually advantageous business relationships”).

<sup>33</sup> *See, e.g., Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1234 n.17 (8th Cir. 1987) (“Indeed, the overall effect on interbrand competition in such cases may be beneficial by focusing the distributor’s efforts on one product line and, in turn, removing the ‘free rider’ threat to the manufacturer’s own selling efforts. . . . [A]n exclusive dealing clause guarantees that the manufacturer’s marketing investment will not be lost to other firms when the distributor makes his sales presentation to potential buyers. This assurance encourages the manufacturer’s investment in marketing activity, and thus encourages interbrand competition.”).

<sup>34</sup> *Standard Oil*, 337 U.S. at 306–07.

<sup>35</sup> *NicSand*, 457 F.3d at 544; *see also* Joseph Farrell, *Deconstructing Chicago on Exclusive Dealing*, 50 ANTITRUST BULL. 465, 473–78 (2005) (explaining theories for why buyers accept exclusive dealing arrangements).

Antitrust law therefore seeks to prevent exclusive dealing only when its use threatens to create or maintain market power. In an exclusive-dealing case, a plaintiff must “make a sufficient showing of power to warrant the inference that the challenged agreement threatens reduced output and higher prices in a properly defined market . . . [and] show foreclosure coverage sufficient to warrant an inference of injury to competition.”<sup>36</sup>

Significantly, even where a manufacturer pays a distributor in some way to enter into an exclusive dealing contract, the courts do not apply a predatory pricing analysis: “[p]redatory pricing and exclusive dealing are distinct offenses under antitrust law.”<sup>37</sup>

The correspondence between rebate schemes and exclusive dealing has not been lost on the courts. For example, *Concord Boat Corp. v. Brunswick Corp.*<sup>38</sup> involved loyalty discounts for boat sterndrive engines in which the defendant offered all-purchase discounts that increased with increasing purchaser market share.<sup>39</sup> Reviewing a jury verdict in favor of the plaintiffs, the court of appeals analyzed the loyalty rebates as “*de facto*” exclusive dealing.<sup>40</sup> The court thus examined “the extent to which competition has been foreclosed in a substantial share of the relevant market, the duration of [the] exclusive arrangement, and the height of entry barriers.”<sup>41</sup>

The analogy to exclusive dealing helped the court to identify which evidence was important. For instance, the evidence showed that distributors “were free to walk away from the [defendant’s] discounts at any time” and that several customers had in fact switched from purchasing most of their engines from Brunswick engines to purchasing a majority of their engines

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<sup>36</sup> *NicSand*, 457 F.3d at 545 n.7 (quoting 11 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1821 (2d ed. 2002)).

<sup>37</sup> *Id.* at 546.

<sup>38</sup> 207 F.3d 1039 (8th Cir. 2000); *see also* Se. Mo. Hosp. v. C.R. Bard, Inc., 642 F.3d 608, 613 (8th Cir. 2011).

<sup>39</sup> Defendant (Brunswick) offered a 3% discount to boat builders that purchased 80% of their engines from Brunswick, a 2% discount at 70% market share, and a 1% discount at 60% market share. *Concord Boat*, 207 F.3d at 1044. Brunswick later lowered the market share requirements to 70%, 65%, and 60%, respectively. *Id.* Brunswick also offered discounts of an additional 1% or 2% in return for a two- or three-year market share agreement. *Id.*

<sup>40</sup> *Id.* at 1058–59; *see also* Brennan, *supra* note 19, at 336–40 (proposing test for bundled rebates based on exclusive dealing analogy); Benjamin Klein & Andres V. Lerner, *The Law and Economics of Bundled Pricing: LePage’s, PeaceHealth, and the Evolving Antitrust Standard*, 53 ANTITRUST BULL. 555, 561 (2008) (arguing that bundled discounts should be viewed as the “purchase of preferred distribution” and that “[p]laintiffs should be required to show substantial foreclosure, analogous to the minimum foreclosure requirement in exclusive dealing case law”); Can Erutku, *Rebates as Incentives to Exclusivity*, 39 CANADIAN J. ECON. 477, 490 (2006) (“We find that, by offering rebates in the form of lump-sum payments, an incumbent manufacturer can induce retailers to exclusivity and deter efficient entry whatever the cost advantage of the entrant and the degree of differentiation between retailers.”).

<sup>41</sup> *Concord Boat*, 207 F.3d at 1059.

from competitors of Brunswick within a short time frame.<sup>42</sup> Further, there was scant evidence of entry barriers. Even the discounts themselves, “because they were significantly above cost,” did not foreclose entry.<sup>43</sup> Given this record, the court held that there was not sufficient evidence to support the jury verdict.

Similarly, in *Broadcom Corp. v. Qualcomm Inc.*,<sup>44</sup> the court used the analogy to exclusive dealing to examine the use of loyalty discounts conditioned on the customer’s purchasing all of its requirements from the defendant. In doing so, the court focused on the issue of whether purchasers were “coerced” into dealing exclusively with the defendant:

[T]he alleged exclusive deal does not require that patent licensees only purchase Qualcomm chipsets. The “deal” provides incentives for those patent licensees choosing to purchase Qualcomm chipsets. The practical effect may be to make the purchase of Qualcomm chipsets more financially viable; however, it does not foreclose the purchase of another company’s chipset. That the discounts offered by Qualcomm “substantially raise competitors’ costs of selling and marketing UMTS chipsets” does not give rise to antitrust liability. The antitrust laws are not intended to place competitors on equal footing in the market; they are intended to address conduct that forecloses competition and unreasonably restrains trade.<sup>45</sup>

The court thus declined the “invitation” to “extend claims for . . . exclusive dealing to include coercion in the form of rebates, discounts, and other incentives.”<sup>46</sup>

In contrast, the court in *Masimo Corp. v. Tyco Health Care Group, L.P.*<sup>47</sup> found that a loyalty discount program did create de facto exclusive dealing. Plaintiff (Masimo) was a new entrant into the market for oximetry systems, which consist of expensive monitors (with a five- to seven-year useful life) and compatible sensors (with a short useful life). The defendant (Tyco) offered substantial all-unit discounts on sensors for those customers that purchased 90 percent of their oximetry needs from Tyco. The need for compatibility between monitors and sensors was critical to the court’s conclusion that the loyalty discounts were de facto exclusive.<sup>48</sup> The evidence showed

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<sup>42</sup> In contrast, the court in *ZF Meritor LLC v. Eaton Corp.*, 769 F. Supp. 2d 684 (D. Del. 2011), *aff’d*, 696 F.3d 254 (3d Cir. 2012), found that defendant’s customer-market-share-based rebates were a “big hammer,” indicating compliance with the “market penetration targets was mandatory.” *Id.* at 692.

<sup>43</sup> *Concord Boat*, 207 F.3d at 1059.

<sup>44</sup> No. 05-3350 (MLC), 2006 WL 2528545 (D.N.J. Aug. 31, 2006), *aff’d in part, rev’d in part and remanded*, 501 F.3d 297 (3d Cir. 2007).

<sup>45</sup> *Id.* at \*16.

<sup>46</sup> *Id.*

<sup>47</sup> No. CV 02-4770 (MRP), 2006 WL 1236666 (C.D. Cal. Mar. 22, 2006), *aff’d*, 350 F. App’x 95 (9th Cir. 2009).

<sup>48</sup> In a later case involving a time period after the expiration of a key Tyco patent and the consequent entry of generic sensors, the Ninth Circuit upheld a finding that Tyco’s discounts



that customers were locked in to purchasing a fixed amount of Tyco sensors to support the installed base of Tyco monitors. Thus, this “fixed demand for Tyco sensors for an extended period of time, when combined with the Market Share Discounts, effectively prevented the hospitals from purchasing sensors outside of the Market Share Discount agreements on short notice.”<sup>49</sup>

Similarly, the Third Circuit in *LePage’s Inc. v. 3M*<sup>50</sup> also found a rebate program combined with other factors analogous to exclusive dealing. *LePage’s* involved a monopolization claim challenging a combination of a “multi-tiered ‘bundled rebate’ structure, which offered higher rebates when customers purchased products in a number of 3M’s different product lines,” with offers to some customers of “large lump-sum cash payments, promotional allowances and other cash incentives to encourage them to enter into exclusive dealing arrangements with 3M.”<sup>51</sup> The court concluded that “‘unilaterally imposed quantity discounts can foreclose the opportunities of rivals when a dealer can obtain its best discount only by dealing exclusively with the dominant firm. For example, discounts might be cumulated over lengthy periods of time, such as a calendar year, when no obvious economies result.’”<sup>52</sup> Thus, according to the court, “Discounts conditioned on exclusivity are ‘problematic’ ‘when the defendant is a dominant firm in a position to force manufacturers to make an all-or-nothing choice.’”<sup>53</sup> The court then held that the combination of the rebate program and the exclusive dealing incentives was sufficient to support the jury’s verdict of monopolization based on the analogy to exclusive dealing.<sup>54</sup>

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were not sufficient in themselves to create de facto exclusivity. *See Allied Orthopedic Appliances Inc. v. Tyco Health Care Group LP*, 592 F.3d 991, 997 n.2 (9th Cir. 2010).

<sup>49</sup> *Masimo*, 2006 WL 1236666, at \*6; *see also Behrend v. Comcast Corp.*, No. 03-6604, 2012 WL 1231794, at \*31 (E.D. Pa. Apr. 12, 2012) (finding discount combined with free premium cable channels “was an exclusivity arrangement”); *Church & Dwight Co. v. Mayer Labs, Inc.*, No. C-10-4429 EMC, 2011 WL 1225912, at \*10 (N.D. Cal. Apr. 1, 2011) (use of rebates to obtain shelf space “asserts the same kind of harm that occurs in exclusive dealing cases”); *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int’l, Ltd.*, No. 05-12024 PBS, 2009 WL 2914313, at \*6 (D. Mass. Aug. 29, 2009) (treating similar loyalty discount program as exclusive dealing); *Se. Mo. Hosp. v. C.R. Bard, Inc.*, No. 1:07cv0031 TCM, 2008 WL 199567, at \*6–7 (E.D. Mo. Jan. 22, 2008) (analogizing loyalty discounts and rebates as exclusive dealing and denying motion to dismiss); Jonathan M. Lave, *The Law and Economics of De Facto Exclusive Dealing*, 50 ANTI-TRUST BULL. 143, 164–74 (2005) (discussing case law regarding loyalty discounts as de facto exclusive dealing).

<sup>50</sup> 324 F.3d 141 (3d Cir. 2003) (en banc).

<sup>51</sup> *Id.* at 145.

<sup>52</sup> *Id.* at 158 (quoting 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 768b2, at 148 (2d ed. 2002)).

<sup>53</sup> *Id.* (quoting 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1807a, at 117 n.7 (1998)).

<sup>54</sup> *Id.* at 159 (“LePage’s produced evidence that the foreclosure caused by exclusive dealing practices was magnified by 3M’s discount practices, as some of 3M’s rebates were ‘all-or-nothing’ discounts, leading customers to maximize their discounts by dealing exclusively with the dominant market player, 3M, to avoid being severely penalized financially for failing to meet their quota in a single product line. Only by dealing exclusively with 3M in as many product

## B. THE ANALOGY TO TYING

Courts have also turned to the analogy to tying when analyzing rebate systems. Though the analogy is obvious for bundled rebates, it may also be apt for single-product cases in which some portion of a customer's purchases must be made (for whatever reason) from the discounting seller.<sup>55</sup>

According to the Supreme Court, the "essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms."<sup>56</sup> Tying law therefore seeks to prevent "the use of power over one product to attain power over another."<sup>57</sup> As the Court has explained, the mechanism for this attainment is forcing the rival to compete not only with the tied product, but the tying product as well:

[T]he practice of tying forecloses other sellers of the tied product and makes it more difficult for new firms to enter that market. They must be prepared not only to match existing sellers of the tied product in price and quality, but to offset the attraction of the tying product itself.<sup>58</sup>

Under antitrust law, therefore, there are four elements to a tying violation: "(1) the tying and tied goods are two separate products; (2) the defendant has market power in the tying product market; (3) the defendant affords consumers no choice but to purchase the tied product from it; and (4) the tying arrangement forecloses a substantial volume of commerce."<sup>59</sup>

The characteristics of bundled rebates make an apt comparison to tying. For instance, the *LePage's* court stated that bundled rebates "are best compared

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lines as possible could customers enjoy the substantial discounts. Accordingly, the jury could reasonably find that 3M's exclusionary conduct violated § 2." *But see* St. Francis Med. Ctr. v. C.R. Bard, Inc., 657 F. Supp. 2d 1069, 1099 (E.D. Mo. 2009) (granting summary judgment because there was no evidence from "any hospital purchasing employee that he or she elected not to purchase a superior product in quality or price because of Bard's rebate or discount program.").

<sup>55</sup> See, e.g., European Comm'n, DG Competition, *Communication from the Commission, Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings*, 2009 O.J. (C 45) 7, 13 (Dec. 3, 2008) [hereinafter *Article 82 Guidance*] ("A conditional rebate granted by a dominant undertaking may enable it to use the 'non contestable' portion of the demand of each customer (that is to say, the amount that would be purchased by the customer from the dominant undertaking in any event) as leverage to decrease the price to be paid for the 'contestable' portion of demand (that is to say, the amount for which the customer may prefer and be able to find substitutes).").

<sup>56</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984).

<sup>57</sup> *Id.* at 13 n.19 (quoting *Fortner Enters. v. United States Steel Corp.*, 394 U.S. 495, 512–14 (1969) (White, J., dissenting)).

<sup>58</sup> *Id.*

<sup>59</sup> *United States v. Microsoft Corp.*, 253 F.3d 34, 85 (D.C. Cir. 2001). If these elements are met, harm to competition is presumed.

with tying, whose foreclosure effects are similar. Indeed, the “package discount” is often a close analogy.’”<sup>60</sup> The court thus summarized the effects of bundled rebates in tying-like terms: “The principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.”<sup>61</sup>

Despite this resemblance, courts have for the most part refused to find rebate systems to be tying arrangements. Illustrative is *SmithKline Corp. v. Eli Lilly & Co.*,<sup>62</sup> in which the court found “overwhelming evidence” that the defendant possessed “sufficient economic power over the tying products . . . to appreciably restrain free competition in the [relevant] market” and “that a very substantial amount of commerce is affected by the” rebates.<sup>63</sup> The court nevertheless held that the rebate system was not tying because the purchase of the tied products was not strictly conditioned on the purchase of the tying product:

From an abstract perspective, if one disregards the economics of the market place, hospital pharmacists had the “freedom to choose” any of Lilly’s products without having to buy a tied product; thus they were “free to take either product by itself.” The economics of the marketplace precluded that freedom of choice for most hospitals; such a freedom of choice, more prevalent in theory than in operational reality, is enough to circumvent the tie-in prohibitions of the relevant antitrust laws.<sup>64</sup>

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<sup>60</sup> *LePage’s Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc) (quoting PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 794, at 83 (Supp. 2002)).

<sup>61</sup> *Id.*; see also *id.* at 155 (“The anticompetitive feature of package discounting is the strong incentive it gives buyers to take increasing amounts or even all of a product in order to take advantage of a discount aggregated across multiple products. In the anticompetitive case, which we presume is in the minority, the defendant rewards the customer for buying its product B rather than the plaintiff’s B, not because defendant’s B is better or even cheaper. Rather, the customer buys the defendant’s B in order to receive a greater discount on A, which the plaintiff does not produce. In that case the rival can compete in B only by giving the customer a price that compensates it for the foregone A discount.” (quoting PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 94, at 83 (Supp. 2002)); *St. Francis Med. Ctr. v. C.R. Bard, Inc.*, 657 F. Supp. 2d 1069, 1102 (E.D. Mo. 2009) (“The Third Circuit has analogized bundles rebates to tying because the foreclosure effects are similar.”); *Se. Mo. Hosp. v. C.R. Bard, Inc.*, No. 1:07cv0031 TCM, 2008 WL 199567, at \*8 (E.D. Mo. Jan. 22, 2008) (following *LePage’s*).

<sup>62</sup> 427 F. Supp. 1089 (E.D. Pa. 1976), *aff’d*, 575 F.2d 1056 (3d Cir. 1978).

<sup>63</sup> *Id.* at 1113.

<sup>64</sup> *Id.* at 1114 (citation omitted); see also *Broadcom Corp. v. Qualcomm Inc.*, No. 05-3350 (MLC), 2006 WL 2528545, at \*14–15 (D.N.J. Aug. 31, 2006) (“The requisite coercion here is lacking. . . . Qualcomm, however, has not conditioned the availability of licenses to its patents on the purchase of UMTS chipsets. It has conditioned the availability of discounts and incentives on the purchase of UMTS chipsets. . . . Qualcomm’s decision to offer discounts to licensees who purchase Qualcomm chipsets may make the purchase of Qualcomm chipsets a more economically viable option for those licensees. Such an incentive, however, does not amount to a forced sale.”), *aff’d in part, rev’d in part and remanded*, 501 F.3d 297 (3d Cir. 2007); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 471 (S.D.N.Y. 1996) (“Ortho may prevail only

But the courts have used the analogy to tying to identify necessary elements of an antitrust analysis of rebate systems. Reviewing the district court opinion in *SmithKline*, the Third Circuit agreed that the necessary element of coercion was absent for a tying claim.<sup>65</sup> The court nonetheless used the analogy to tying to affirm the district court's judgment that the rebate system amounted to monopolization:

[T]he act of willful acquisition and maintenance of monopoly power was brought about by linking products on which Lilly faced no competition . . . with a competitive product . . . . The result was to sell all three products on a non-competitive basis in what would have otherwise been a competitive market . . . . The effect of the [bundled rebates] was to force SmithKline to pay rebates on one product . . . equal to rebates paid by Lilly based on volume sales of three products. On the basis of expert testimony, the court found SmithKline's prospects for continuing in the cephalosporin market under these conditions to be poor.<sup>66</sup>

Similarly, in *Virgin Atlantic Airways Ltd. v. British Airways PLC*,<sup>67</sup> the Second Circuit stressed that tying and bundled rebates are distinct:

An invalid tying arrangement conditions the purchase of one product to the purchase of a second product that the buyer either does not want or would have preferred to purchase elsewhere. In contrast, a bundling arrangement offers discounted prices or rebates for the purchase of multiple products, although the buyer is under no obligation to purchase more than one item.<sup>68</sup>

Yet the court was also quick to note that, unlike other cases, there was no evidence before it that "specific customers felt *compelled* to purchase products under the defendant's bundling program because the plaintiff could not match the discounts, [and] no evidence . . . that [the] incentive agreements were *coercive*."<sup>69</sup>

Courts have thus reserved the tying analogy to instances in which the bundled discount makes economically irrational the purchase of the defendant's products separately. For instance, in *Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal & Professional Publications, Inc.*,<sup>70</sup> the court held that there was sufficient evidence of conditioning to let the case go to a jury where the allegedly tied product was "free" if purchased with the tying prod-

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if it establishes, in addition to the other elements of a tying violation, that Abbott's pricing structure makes purchase of the tying and tied products together the only viable economic option.").

<sup>65</sup> *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1061–62 (3d Cir. 1978).

<sup>66</sup> *Id.* at 1065; *see also In re Hypodermic Prods. Antitrust Litig.*, No. 05-CV-1602 (JLL/CCC), 2007 WL 1959224, at \*10 n.21 (D.N.J. June 29, 2007) (relying on *SmithKline* to deny motion to dismiss claim based on market-share-based rebates and bundled discounts).

<sup>67</sup> 257 F.3d 256 (2d Cir. 2001).

<sup>68</sup> *Id.* at 270 (citation omitted).

<sup>69</sup> *Id.* (emphasis added).

<sup>70</sup> 63 F.3d 1540 (10th Cir. 1995).

uct, making the price for the bundle the same as for the tied product purchased separately.<sup>71</sup>

The analogy to tying is therefore powerful but leaves open the question of what circumstances would make bundled rebates sufficiently coercive to merit condemnation. As the United States observed in its amicus brief to the Supreme Court in *LePage's*, “[T]he applicability of tying concepts depends on whether the structure of the discounts results in coercion of the buyer, and that in turn requires consideration of price and cost factors.”<sup>72</sup>

### C. THE ANALOGY TO PREDATORY PRICING

Not surprisingly therefore, perhaps the analogy most often used for the analysis of rebates is predatory pricing. Rebates, after all, are a form of discounting.<sup>73</sup>

The courts’ approach to predatory pricing reflects a deep-seated concern that the antitrust laws should not interfere with procompetitive price competition. Antitrust law “rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.”<sup>74</sup> As the Supreme Court has recognized, “[C]utting prices in order to increase busi-

<sup>71</sup> *Id.* at 1548; see also *Virtual Maint., Inc. v. Prime Computer, Inc.*, 11 F.3d 660, 666 (6th Cir. 1993) (finding sufficient conditioning where defendant offered software support for sale separately, but “repurchase of software to obtain updates would cost as much as 900% more than if purchased in the software support/hardware maintenance package”).

<sup>72</sup> Brief for the United States as Amicus Curiae at 17, *3M Co. v. LePage's Inc.*, No. 02-1865 (U.S. May 28, 2004); see also Dennis W. Carlton, Patrick Greenlee & Michael Waldman, *Assessing the Anticompetitive Effects of Multiproduct Pricing*, 53 ANTITRUST BULL. 587, 610–15 (2008) (presenting approach to bundled discounts that “adopts the terminology associated with tying”); Elhaug, *Bundled Discounts*, *supra* note 19, at 468–69 (proposing that when “linking product’s unbundled price exceeds its but-for price, bundled discounts have the same power effects as ties and thus should be treated like ties”); Barry Nalebuff, *Exclusionary Bundling*, 50 ANTITRUST BULL. 321, 328, 364 (2005) (proposing test that “the incremental price for an *A-B* bundle over *A* alone is less than the long-run average variable costs of *B*” because “the bundle discount is so large that the à la carte prices are economically irrelevant”); John Simpson & Abraham L. Wickelgren, *Bundled Discounts, Leverage Theory, and Downstream Competition*, 9 AM. L. & ECON. REV. 370, 370 (2007) (showing that monopolist of tying good “can place each downstream buyer in a prisoner’s dilemma by offering them more favorable pricing on the tying good if they sign a requirements-tying contract covering the tied good”).

<sup>73</sup> Thus, the *Concord Boat* court could state that the defendant’s business justification “was trying to sell its product” since “[c]utting prices is the ‘very essence of competition.’” *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1062 (8th Cir. 2000). Similarly, the *Virgin Airways* court noted that loyalty rebates “allow firms to reward their most loyal customers. Rewarding customer loyalty promotes competition on the merits.” 257 F.3d at 265. *But see* Elhaug, *Loyalty Discounts*, *supra* note 19, at 216–21 (arguing that loyalty discounts can result in higher prices and discussing implications of that position).

<sup>74</sup> *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1958).

ness often is the very essence of competition.”<sup>75</sup> Injudicious condemnation of discounting—even aggressive discounting—may therefore “chill the very conduct the antitrust laws are designed to protect.”<sup>76</sup> Thus, predatory pricing is defined as pricing “below an appropriate measure” of cost.<sup>77</sup> This rule adopts the position that a “firm which drives out or excludes rivals by selling at unremunerative prices is not competing on the merits, but engaging in behavior that may properly be called predatory.”<sup>78</sup> But it also holds that,

[a]s a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting.<sup>79</sup>

In evaluating rebate cases, courts have relied heavily on the analogy to predatory pricing. Through this analogy, the courts have developed the equally efficient competitor test for rebates. For instance, in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*,<sup>80</sup> the defendant (Abbott) enjoyed market shares from 70 percent to 90 percent for four of five blood screening tests and the plaintiff (Ortho) produced only three of the five. Abbott offered discounts to customers that purchased four of the tests from Abbott and greater discounts to those that purchased all five. To determine how to evaluate the discounts, the court turned to the analogy of predatory pricing.

Examining that analogy, the court focused on the rationale for the predatory pricing price-cost test. This focus led the court to conclude that the test distin-

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<sup>75</sup> *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

<sup>76</sup> *Id.*

<sup>77</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222–23 (1993). Although the Supreme Court has not defined the appropriate measure of cost, courts often use average variable cost. *See, e.g.*, *United States v. AMR Corp.*, 335 F.3d 1109, 1115–16 (10th Cir. 2003) (“For predatory pricing cases, especially those involving allegedly predatory production increases, the ideal measure of cost would be marginal cost because ‘[a]s long as a firm’s prices exceed its marginal cost, each additional sale decreases losses or increases profits.’ However, marginal cost, an economic abstraction, is notoriously difficult to measure and ‘cannot be determined from conventional accounting methods.’ Economists, therefore, must resort to proxies for marginal cost. 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.”) (citations omitted).

<sup>78</sup> Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 697 (1975).

<sup>79</sup> *Brooke Group*, 509 U.S. at 223; *see also* *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990) (“Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition”); *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 116 (1986) (“To hold that the antitrust laws protect competitors from the loss of profits due to such price competition [(prices at or slightly above costs)] would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result.”).

<sup>80</sup> 920 F. Supp. 455 (S.D.N.Y. 1996).

guishes behavior that affects equally efficient competitors from conduct that does not:

There is general consensus that the sacrifice of current profits in the expectation that the losses will be recouped by higher prices after the competition is driven from the marketplace is a necessary, albeit not a sufficient, condition of predation. What separates the competitive sheep from the anticompetitive goats, however, is the sacrifice of current profits in consequence of pricing below an appropriate measure of the defendant's cost. The reason is plain: below-cost pricing, unlike pricing at or above that level, carries with it the threat that the party so engaged will drive equally efficient competitors out of business, thus setting the stage for recoupment at the expense of consumers.<sup>81</sup>

Using the predatory pricing analogy, the court held that bundled rebates are an antitrust issue only when “(a) the monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant’s pricing makes it unprofitable for the plaintiff to continue to produce.”<sup>82</sup>

The district court in *SmithKline Corp. v. Eli Lilly & Co.*<sup>83</sup> also relied on the analogy of predatory pricing to develop an equally efficient competitor test. In that case, the incumbent (Lilly) offered a 3 percent rebate applied to the combined purchases of three of its five cephalosporins (which are antibiotics). SmithKline produced one cephalosporin (Ancef), which was a substitute for one of the five Lilly products. The district court had found that even if SmithKline’s costs matched Lilly’s, to meet the rebates, SmithKline’s profits would be -2.7 percent on large accounts and 4.0 percent on average hospital accounts. There was evidence that these profits were not sufficient to make

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<sup>81</sup> *Id.* at 466–67 (citations omitted); *see also id.* at 467 (“Adopting marginal cost as the proper test of predatory pricing is consistent with the pro-competitive thrust of the Sherman Act. When the price of a dominant firm’s product equals the product’s marginal costs, only less efficient firms will suffer larger losses per unit of output; more efficient firms will be losing less or even operating profitably. Marginal cost pricing thus fosters competition on the basis of relative efficiency.”) (quoting *Ne. Tel. Co. v. Am. Tel. & Tel. Co.*, 651 F.2d 76, 87 (2d Cir. 1981) (citations omitted)).

<sup>82</sup> *Id.* at 469. Implicit in the equally efficient competitor test is a rejection of the notion that bundled rebates are procompetitive so long as the price of the bundle remains above the cost of the entire bundle. *Id.* at 467; *see also* *J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, Nos. 1:01-CV-704, 1:03-CV-781, 2005 WL 1396940, at \*11 (S.D. Ohio June 13, 2005); Dennis W. Carlton & Michael Waldman, *Safe Harbors for Quantity Discounts and Bundling*, 15 *Geo. Mason L. Rev.* 1231, 1238–39 (2008) (advocating safe harbors for loyalty and bundled discounts “based on standard tests for predatory pricing”). *But see* *N.W.S. Mich., Inc. v. Gen. Wine & Liquor Co.*, 58 F. App’x 127, 129–30 (6th Cir. 2003) (rejecting claim against bundled rebates because defendant’s bundled prices were not below cost).

<sup>83</sup> 427 F. Supp. 1089 (E.D. Pa. 1976).

the product viable and that SmithKline would be forced to exit.<sup>84</sup> The court thus found that Lilly monopolized the market for cephalosporins.<sup>85</sup>

While the analogy to predatory pricing (and the attendant equally efficient competitor test) is commonly used in courts,<sup>86</sup> it is also the center of the current debate.<sup>87</sup> For instance, the dissent in *LePage's* complained that “in this case Section 2 of the Sherman Act is being used to protect an inefficient producer from a competitor not using predatory pricing but rather selling above cost.”<sup>88</sup> Thus, courts have been confronted with the question of whether rebates resulting in above-cost pricing may violate the antitrust laws.

This question was squarely before the court in *J.B.D.L. Corp. v. Wyeth-Ayerst Laboratories, Inc.*,<sup>89</sup> which involved a combination of bundled rebates and rebates expressly conditioned on exclusivity. Reviewing the *LePage's* decision, the court noted that the “en banc majority essentially concluded that exclusionary conduct that used above-cost price discounting was actionable under Section 2.”<sup>90</sup> After rehearsing the *LePage's* dissent’s criticism, the court concluded that the Third Circuit decision did not provide a clear test:

The Third Circuit decision also leaves unclear (at least to this Court) the precise nature of 3M’s violation of Section 2. The verdict imposed a heavy penalty on 3M without producing consistent guidance for what is permissi-

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<sup>84</sup> See *id.* at 1123–24.

<sup>85</sup> The Third Circuit affirmed but seemed to focus more on the analogy to tying than on the equally efficient competitor test. See *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1065 (3d Cir. 1978).

<sup>86</sup> See also, e.g., *Invacare Corp. v. Respironics, Inc.*, No. 1:04 CV 1580, 2006 WL 3022968, at \*12 (N.D. Ohio Oct. 23, 2006) (granting summary judgment against bundling claim based on findings that (1) plaintiff sold both of the bundled products and “can match the product bundles offered by Defendant”; (2) defendant did not price its bundles or single product below cost); *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770 (MRP), 2006 WL 1236666, at \*13 (C.D. Cal. Mar. 22, 2006) (disagreeing with *LePage's* and the Third Circuit opinion in *SmithKline*, and holding that a monopolization claim against bundled rebates requires predatory pricing or tying), *aff'd*, 350 F. App’x 95 (9th Cir. 2009).

<sup>87</sup> Compare ANTITRUST MODERNIZATION COMM’N, REPORT AND RECOMMENDATIONS 94–100 (2007) (advocating predatory-pricing test for bundled discounts); Hovenkamp & Hovenkamp, *supra* note 19, at 1234–37 (advocating modified version of Antitrust Modernization Commission test), and Lambert, *supra* note 19, at 980–81 (arguing that predatory-pricing-based test rather than tying analogy should be used for bundled discounts), with Brennan, *supra* note 19, at 337–38 (price-cost tests are flawed), Caves & Singer, *supra* note 19, at 48 (cost-based tests may result in false negatives), Elhauge, *Bundled Discounts*, *supra* note 19, at 461–69 (price-cost tests should not be used for bundled discounts), and Elhauge, *Loyalty Discounts*, *supra* note 19, at 216–17 (price-cost tests should not be used for loyalty discounts). See also Giulio Federico, *The Antitrust Treatment of Loyalty Discounts in Europe: Towards a More Economic Approach* (IESE Occasional Paper, OP-186, Feb. 2011) (discussing rebates in terms of competing theories of consumer harm—predation and anticompetitive leverage).

<sup>88</sup> *LePage's Inc. v. 3M*, 324 F.3d 141, 177 (3d Cir. 2003) (en banc) (Greenberg, J., dissenting).

<sup>89</sup> Nos. 1:01-CV-704, 1:03-CV-781, 2005 WL 1396940 (S.D. Ohio June 13, 2005).

<sup>90</sup> *Id.* at \*13.



ble price competition in the retail market for a simple item like transparent tape.<sup>91</sup>

After reviewing the Eighth Circuit's decision in *Concord Boat*, the court found itself confronted with inconsistent guidance:

Thus, this Court finds itself faced with somewhat imprecise and certainly conflicting standards by which to judge Plaintiffs' allegations of Wyeth's monopolistic behavior. *LePage's* obviously favors letting a jury sort it out, using the same imprecise, conflicting Section 2 standards transformed into jury instructions. *Concord Boat*, on the other hand, illustrates the dangerous possibility of a tremendous waste of time and resources of all involved here in permitting a jury to "sort it out" when the appellate court may well find that there is no jury issue here.<sup>92</sup>

Finding guidance in the Supreme Court's admonition that in applying Section 2, "[m]istaken inferences and the resulting false condemnations are especially costly, because they chill the very conduct the antitrust laws are designed to protect,"<sup>93</sup> the court entered summary judgment against the plaintiffs' claims.

Other courts, however, have rejected the necessity of pricing below cost.<sup>94</sup> For example, *Applied Medical Resources Corp. v. Ethicon Inc.*<sup>95</sup> involved bundled discounts "linked to the percentage of requirements purchased from [the defendant], with a higher percentage of purchases yielding a higher discount."<sup>96</sup> In addition, the defendant offered "sole source" contracts "for some

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<sup>91</sup> *Id.* at \*14.

<sup>92</sup> *Id.* at \*16.

<sup>93</sup> *Id.* at \*17 (quoting *Verizon Commc'ns v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004)).

<sup>94</sup> *See, e.g., Behrend v. Comcast Corp.*, No. 03-6604, 2012 WL 1231794, at \*31 (E.D. Pa. Apr. 12, 2012) (denying summary judgment, rejecting below-cost pricing test for discount combined with free premium channels used to prevent customer switching); *ZF Meritor LLC v. Eaton Corp.*, 769 F. Supp. 2d 684, 691 (D. Del. 2011) (denying motion for judgment as a matter of law, rejecting argument that market-share-based rebates should be judged using price-based test), *aff'd*, 696 F.3d 254 (3d Cir. 2012); *Church & Dwight Co. v. Mayer Labs, Inc.*, No. C-10-4429 EMC, 2011 WL 1225912, at \*10 (N.D. Cal. Apr. 1, 2011) (denying motion to dismiss, explicitly rejecting price-based test for rebates used to obtain shelf space); *McKenzie-Willamette Hosp. v. PeaceHealth*, No. Civ. 02-6032-HA, 2004 WL 3168282, at \*5 (D. Or. Oct. 13, 2004) (refusing to overturn jury verdict of monopolization based, in part, on bundled discounts, relying on *LePage's*, and finding substantial evidence "that defendant was a monopolist, discounts were bundled to enhance defendant's preferred provider status, and substantial market foreclosure resulted after or contemporaneously with the offer of bundled discounts."); *Avery Dennison Corp. v. Acco Brands, Inc.*, No. CV 99-1877 DT (MCx), 2000 WL 986995, at \*19 (C.D. Cal. Feb. 22, 2000) (denying summary judgment against monopolization claim based, in part, on bundled rebates where evidence showed that purpose was to drive out competitor and defendant had ability to recoup losses).

<sup>95</sup> No. SA-CV-031329 (JVS) (MLGx), 2006 WL 1381697 (C.D. Cal. Feb. 3, 2006).

<sup>96</sup> *Id.* at \*2.

or all of the products in the bundle, in exchange for even deeper discounts.”<sup>97</sup> The court rejected the argument that plaintiffs must show predatory pricing:

The Court disagrees that a claim under Section 2 can only be established by the specific predatory or exclusionary acts which J & J then proceeds to catalogue. Unlawful maintenance of monopoly power may be shown where a firm’s conduct “impaired competition in an unnecessarily restrictive way.” As noted above, otherwise lawful conduct may violate Section 2 where there are anticompetitive effects.<sup>98</sup>

The court also rejected the argument that the possibility of false positives was so great as to drive the legal rule because “the conduct is [not] so obviously pro-competitive—straight, single-product price cutting—that the Court should be concerned about the chilling effect of antitrust liability.”<sup>99</sup> Finally, the court explained that it “is not creating liability for a monopolist who offers a bundle . . . but rather simply finds that the monopolist is subject to conventional monopolization analysis on a disputed factual record.”<sup>100</sup> The court therefore allowed the case to go to trial, at which the jury found for the defendants.<sup>101</sup>

Significantly, the antitrust agencies have not taken a position on the appropriateness of the analogy to predatory pricing. As the agencies explained in their amicus brief in *LePage’s*, the analogy may prove to be apt, but further analysis must bear this out. An examination of the development of the below-cost pricing rule reveals the issue.

The Court made pricing below the defendant’s costs the touchstone, not because above-cost pricing would necessarily guarantee the absence of anti-competitive price-cutting, but because, in the specific context of aggressive price-cutting, that standard provided a sensible dividing line that preserves the important role of price-cutting as a primary means of competition on the merits.<sup>102</sup>

According to the agencies, the reasons the Court gave for the below-cost rule were: (1) allowing above-cost price cuts provides clear benefit in exchange for a speculative future benefit; (2) above-cost pricing may exclude competitors merely because the price-cutter has a lower cost structure, which

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<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at \*5 (citations omitted).

<sup>99</sup> *Id.* at \*6 (citations omitted).

<sup>100</sup> *Id.*; see also *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int’l, Ltd.*, No.1:05-CV-12024-PBS, 2009 WL 4061631, at \*5–6 (D. Mass. Nov. 20, 2009) (recognizing that “[u]nder the emerging caselaw, Defendants have the better argument that, without more, above-cost market share discounts cannot constitute improper exclusionary dealing” but denying summary judgment based on evidence of other “coercive factors”).

<sup>101</sup> See Judgment, *Applied Med. Res. Corp. v. Ethicon Inc.*, No. SACV-03-1329 (JVS) (MLGx) (C.D. Cal. Sept. 26, 2006).

<sup>102</sup> Brief for the United States as Amicus Curiae at 10–11, *3M Co. v. LePage’s Inc.*, No. 02-1865 (U.S. May 28, 2004).

represents a result of competition on the merits; (3) it may be impossible for a judicial tribunal to police anticompetitive above-cost discounting without intolerably chilling legitimate discounting; and (4) false negatives would not be frequent because, in the Court's view at the time, "predatory pricing schemes are rarely tried, and even more rarely successful."<sup>103</sup> The agencies then noted, "Relative to the practice of predatory pricing . . . there is less knowledge on which to assess whether, or to what extent, the legal approach to a monopolist's allegedly exclusionary bundled discounts should be driven by a strong concern for false positives and low risk of false negatives."<sup>104</sup> The agencies therefore submitted that the Court defer plenary review of the issue to allow judicial experience and scholarly analysis to develop.

In contrast, one of the circuit courts to examine bundled discounts squarely adopted the predatory pricing analogy. In *Cascade Health Solutions v. PeaceHealth*,<sup>105</sup> the Ninth Circuit developed a "discount attribution" standard for bundled discounts, which is derived from predatory pricing analysis. Noting that bundled discounts are "pervasive" and that the "varied and pervasive nature of bundled discounts illustrates that such discounts transcend market boundaries," the Ninth Circuit reasoned that bundled discounts "generally benefit buyers because the discounts allow the buyer to get more for less."<sup>106</sup> Thus, the court cautioned that "we should not be too quick to condemn price-reducing bundled discounts as anticompetitive, lest we end up with a rule that discourages legitimate price competition."<sup>107</sup>

The court went on to explain its concern that false positives may inhibit price competition through bundled discounts and "chill the very conduct the antitrust laws are designed to protect."<sup>108</sup> Based on this concern, the Ninth Circuit parted ways with the Third Circuit and adopted a predatory pricing model for bundled discounts:

We think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct within the meaning of § 2 of the Sherman Act unless the discounts resemble the behavior that the Supreme Court in *Brooke Group* identified as predatory. Accordingly, we hold that the exclusionary conduct element of a claim arising under § 2 of the Sherman Act cannot be satisfied by reference to bundled discounts unless the discounts result in prices that are below an appropriate measure of the defendant's costs.<sup>109</sup>

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<sup>103</sup> *Id.* at 11 n.8 (citation omitted).

<sup>104</sup> *Id.* at 14.

<sup>105</sup> 515 F.3d 883 (9th Cir. 2008).

<sup>106</sup> *Id.* at 895.

<sup>107</sup> *Id.* at 896.

<sup>108</sup> *Id.* 902–03 (citation omitted).

<sup>109</sup> *Id.* at 903.

The Ninth Circuit thus developed a predatory pricing test under which “the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product.”<sup>110</sup> The court reasoned that this price-cost test “makes the defendant’s bundled discounts legal unless the discounts have the potential to exclude a *hypothetical* equally efficient producer of the competitive product.”<sup>111</sup>

In adopting this standard, however, the court emphasized the need for further experience with bundled discounts. Because “there is limited judicial experience with bundled discounts, and academic inquiry into the competitive effects of bundled discounts is only beginning,” the court reasoned that its cost-based standard “will allow courts the experience they need to divine the prevalence and competitive effects of bundled discounts and will allow these difficult issues to further percolate in the lower courts.”<sup>112</sup>

Further percolation occurred in the Ninth Circuit’s own backyard. In *Meijer, Inc. v. Abbott Laboratories*,<sup>113</sup> a California district court held that the *Cascade Health* price-cost test should not apply to a bundled discount involving pharmaceutical products. The court determined that applying the “discount allocation” standard to the facts before it would stifle competition because “even a competitor who could produce an equally effective drug for only \$0.01 per pill would be excluded from the market.”<sup>114</sup> According to the court, this “failure is attributable to the unique structural characteristics of the pharmaceutical industry, where fixed costs in the form of investment in research and development dwarf variable costs.”<sup>115</sup>

In other words, the *Meijer* court determined that the predatory pricing analogy fails in industries involving high up-front fixed costs and low variable costs. The pharmaceutical industry, of course, is not the only industry that exhibits these characteristics. The issue of bundled discounts continues to percolate.

#### D. THE “IT DEPENDS” ANALOGY

In reality, rebates are seldom the sole means by which an incumbent monopolist may seek to exclude rivals. In addition to offering loyalty rebates, for

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<sup>110</sup> *Id.* at 906.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 908.

<sup>113</sup> 544 F. Supp. 2d 995 (N.D. Cal. 2008).

<sup>114</sup> *Id.* at 1004.

<sup>115</sup> *Id.*; see also *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int’l, Ltd.*, No.1:05-CV-12024-PBS, 2009 WL 4061631, at \*5–6 (D. Mass. Nov. 20, 2009) (denying summary judgment despite evidence that discounts were above cost under discount attribution test where there was evidence of other coercive factors).

instance, a monopolist may seek to impose other restraints on distributors. In such cases, which analogy works best?

The answer is: it depends. At least, that is how the Third Circuit resolved the question. In *ZF Meritor, LLC v. Eaton Corp.*,<sup>116</sup> the incumbent monopolist, Eaton, entered into long-term agreements with each of the only four direct purchasers of heavy-duty truck transmissions. These five-year agreements each included a conditional rebate provision, under which the purchaser would receive rebates only if it purchased a specified percentage of its requirements (e.g., 92 percent) from Eaton. Although nothing required the purchaser to meet the requirement goals, in two of the four agreements, Eaton had the right to terminate the agreement if the purchaser failed to hit the targets. Additionally, if a purchaser did not meet the market-share requirement for one year, Eaton could require repayment of all contractual savings.<sup>117</sup> Eaton also obtained other favorable terms.<sup>118</sup>

After an extended examination of predatory pricing case law, the court agreed that “predatory pricing principles, including the price-cost test, would control if this case presented solely a challenge to Eaton’s pricing practices.”<sup>119</sup> But the court rejected the predatory pricing analogy, instead holding that the conduct should be evaluated as exclusive dealing, because “price itself was not the clearly predominant mechanism of exclusion.”<sup>120</sup> Put another way, the defendant’s pricing was not “the clear driving force” behind customer adherence to the market share targets.<sup>121</sup>

In other words, the appropriate analogy depends on what is the “dominant mechanism” of the exclusion.<sup>122</sup> Unfortunately, the court gave little guidance as to how one determines what mechanism is dominant.

## II. EVALUATING THE ANALOGIES

Missing from the courts’ various analyses of rebates is an in-depth assessment of the efficacy of each analogy. One court says that bundled rebates are like tying, another says that they are a type of price discounting. One court says that loyalty rebates are like exclusive dealing, another says they are like

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<sup>116</sup> 696 F.3d 254 (3d Cir. 2012).

<sup>117</sup> *Id.* at 265–66.

<sup>118</sup> Each of the purchasers was an original equipment manufacturer (OEM), incorporating the transmissions into the purchaser’s heavy-duty trucks, which were sold to the ultimate consumers. *Id.*

<sup>119</sup> *Id.* at 273–74.

<sup>120</sup> *Id.* at 277.

<sup>121</sup> *Id.* at 278.

<sup>122</sup> The dissent would apply the predatory pricing analogy “even if the plaintiff claims that the non-price aspects of the defendant’s practices were the actual exclusionary tactics.” *Id.* at 320.

predatory pricing. Who is right? How do we tell whether an analogy is good? And what does it matter which analogy a court chooses?

Simply put, the choice of analogy is likely outcome-determinative. The choice dictates the threshold elements of the claim. If the court chooses the exclusive dealing analogy, the focus of the litigation will be on whether the rebate scheme amounts to de facto exclusive dealing. In contrast to the predatory pricing analogy, this issue does not necessarily require any analysis of the relationship between the defendant's pricing and its costs. The rebates or discounts are viewed merely as a means of purchasing exclusivity. If, on the other hand, the court chooses the tying analogy, the key issue will be whether the purchase of the tied good (whether it be another product or a greater number of the same product) is effectively coerced. This may, but does not necessarily need to, include a price-cost test. Choosing the predatory pricing analysis, however, focuses almost all of the analysis on the relationship between the defendant's prices and costs.

But more important, by choosing an analogy, the courts choose a set of antitrust liability rules that reflect judgments (right or wrong) regarding the conduct. These judgments are reflected not only in the threshold elements but also in the standard of liability. Predatory pricing, for instance, is only condemned if it accompanies monopoly power. Tying is analyzed under a modified per se rule, while exclusive dealing is analyzed under the rule of reason. The burden on the plaintiff thus varies dramatically under the three analogies. Getting the analogy right is therefore crucial to rational antitrust policy.

#### A. WHAT MAKES A GOOD ANALOGY?

Reasoning by analogy involves identifying a "common relational system between two situations and generating further inferences driven by these commonalities."<sup>123</sup> The commonalities may include concrete property matches, but that is not necessary; what is necessary for analogy is an overlap in relational structure. For example, when we use the analogy "trying to bring consensus among antitrust lawyers is like herding cats," we don't picture furry lawyers, but we recognize that relational structure among antitrust lawyers and cats is similar—they don't tend to follow one another.

The core process of analogy is thus mapping similarities in the relational structures from a base domain (the analog) to a target domain to project inferences from the base to the target.<sup>124</sup> In the example, "An electric circuit is like

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<sup>123</sup> D. Gentner & L. Smith, *Analogical Reasoning*, in *ENCYCLOPEDIA OF HUMAN BEHAVIOR* 130, 130 (V.S. Ramachandran ed., 2012).

<sup>124</sup> *Id.* at 131; see also Dedre Gentner, *Structure-Mapping: A Theoretical Framework for Analogy*, 7 *COGNITIVE SCI.* 155, 156 (1983).

a plumbing system,” the base is the plumbing system and the target is the electric circuit. There is a relational similarity because each has a common causal structure. A plumbing system has a water source that creates a pressure differential across the system; an electrical system has a power source that creates a voltage differential across the system. Water flows through a plumbing system from the higher pressure source to a lower pressure outlet. Electricity flows through an electric system from the higher voltage source to lower voltage parts of the system. By aligning the relational similarities, we are able to make inferences through a process of relational pattern completion. For example, we know that an increase in water pressure results in a higher water flow. From this, we may infer that a higher voltage will result in a greater electric current. A good analogy therefore is one in which the elements of the base domain map to a target such that all of the relations are preserved.<sup>125</sup>

On examination, the analogies for rebates do not stack up well. The reason is that the courts have focused almost solely on examining commonalities in the conduct. Rebates are like price discounts; predatory pricing involves price discounting. Bundled rebates are conditioned on the purchase of two separate products; tying involves the purchase of two separate products. Based on these commonalities, the courts infer a similar competitive effect and thus adopt the same legal rule.

But antitrust rules are based on more than potential anticompetitive effects. Antitrust rules blend policy, economic, and prudential concerns.<sup>126</sup> Determining whether an analogy is appropriate must include an examination of whether the target has concerns analogous to those animating the base. Antitrust rules are also shaped by the existence of plausible procompetitive justifications for the conduct. Any use of analogy to extend an antitrust rule to different conduct must consider whether the target offers analogous justifications. Moreover, only sound legal rules should be extended to analogous situations. Where the legal rule applied to the base is the subject of extensive criticism, the courts should be wary of making a bad situation worse.

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<sup>125</sup> Julian S. Weitzenfeld, *Valid Reasoning by Analogy*, 51 *PHILOSOPHY SCI.* 137, 140 (1984).

<sup>126</sup> See, e.g., *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 914–15 (2007) (“Economic discussion, such as the studies the Court relies upon, can *help* provide answers to these questions, and in doing so, economics can, and should, inform antitrust law. But antitrust law cannot, and should not, precisely replicate economists’ (sometimes conflicting) views. That is because law, unlike economics, is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients.”); A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct—Are There Unifying Principles?*, 73 *ANTITRUST L.J.* 375, 404 (2006) (antitrust rules must be shaped by legal policy of seeking to “minimize the sum of the costs of enforcement errors and transaction costs overall”).

In determining the legal rules for rebates, the courts have by and large either ignored or done a superficial job of examining these issues.

#### B. THE PREDATORY PRICING ANALOGY: UNMERITED CAUTION

Predatory pricing has become the analogy of choice for bundled discounts. The Ninth Circuit, for instance, recognized that “in some respects, bundled discounts are similar to both predatory pricing and tying” but reasoned that tying requires “coercion”<sup>127</sup> and that predatory pricing analysis would be “safer for consumers and our competitive economy” because it requires pricing below incremental costs.<sup>128</sup> In other words, the Ninth Circuit reasoned that bundled discounts are a type of price discounting, that above-cost price discounting reflects competition on the merits, and the stringent requirements of predatory pricing law should apply.<sup>129</sup>

But is the analogy valid? Does the relationship between single product pricing and competition on the merits really give us a valid inference to be used with bundled pricing? To answer these questions, one must examine not only whether bundled discounts are a type of price discounting, but also whether the rationale underlying the predatory pricing rule applies to bundled pricing.

The genesis of predatory pricing law is the normative statement that a “firm which drives out or excludes rivals by selling at unremunerative prices is not competing on the merits.”<sup>130</sup> The choice to set the standard for predatory pricing as “unremunerative” is not driven by economics; it is well recognized in economics that above-cost pricing may reduce economic welfare (and thus be characterized as anticompetitive).<sup>131</sup> Rather, the standard for predatory pricing law is driven by prudential concerns.

First, the courts adopted the extreme skepticism toward predatory pricing associated with one school of economic thought.<sup>132</sup> While recognizing that predatory pricing is theoretically possible, the Supreme Court adopted the view that predatory pricing is “rarely tried, and even more rarely successful” because it requires a short-run sacrifice while recoupment may be thwarted by competitive entry.<sup>133</sup>

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<sup>127</sup> *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 900 (9th Cir. 2008).

<sup>128</sup> *Id.* at 903.

<sup>129</sup> *Id.* at 906.

<sup>130</sup> *Areeda & Turner*, *supra* note 78, at 697.

<sup>131</sup> *Id.* at 705 (discussing “limit pricing,” which may be used to exclude less efficient rivals and thereby limit competition).

<sup>132</sup> *See United States v. AMR Corp.*, 335 F.3d 1109, 1114 (10th Cir. 2003) (noting that the Supreme Court “adopted the skepticism of Chicago scholars” toward predatory pricing).

<sup>133</sup> *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).



Second, the courts have cautioned that a predatory pricing rule may deter procompetitive pricing. Given that “cutting prices in order to increase business often is the very essence of competition,” the Supreme Court cautioned against legal rules that might “chill the very conduct the antitrust laws are designed to protect.”<sup>134</sup> These prudential concerns led the Court to adopt a below-cost requirement for predatory pricing:

As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting.<sup>135</sup>

A fair question then is whether the relationship between single product, unconditional, below-cost pricing and competitive harm as governed by these prudential concerns allows for an inference of a similar relationship between competitive harm and multiproduct, conditional rebates. Should courts view the probability of successful exclusion through multiproduct, conditional rebates with the same skepticism? The answer is plainly no. Multiproduct, conditional rebates do not require unremunerative pricing, the lost profits for which must be recouped in a later period through increased prices. There is no basis at all to state that bundled discount schemes are “rarely tried, and even more rarely successful.”<sup>136</sup>

Would an antitrust liability rule not based on a below-cost standard unnecessarily chill legitimate price cutting? The answer depends on what we define as “legitimate.” The underlying normative premise of the gerrymandered discount attribution rule is that any above-cost pricing is legitimate because it presumably does not exclude an equally efficient rival. But that is not the basis of the predatory pricing rule. Uncontroversial, consensus economics demonstrates that above-cost pricing may be anticompetitive.<sup>137</sup> The Court,

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<sup>134</sup> *Id.* at 594; see also Areeda & Turner, *supra* note 78, at 699 (the threat of litigation may deter legitimate, competitive pricing).

<sup>135</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993).

<sup>136</sup> There is also reason to moderate the skepticism toward single-product predatory pricing schemes. See, e.g., *AMR Corp.*, 335 F.3d at 1114–15 (citing Patrick Bolton, Joseph F. Brodley & Michael Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 *GEO. L.J.* 2239 (2000), as an example of recent scholarship challenging the notion that predatory pricing schemes are implausible and irrational); Jonathan B. Baker, *Predatory Pricing After Brooke Group: An Economic Perspective*, 62 *ANTITRUST L.J.* 585, 589–91 (1994) (explaining post-Chicago theories of multimarket recoupment, which make predatory pricing more plausible).

<sup>137</sup> See, e.g., HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE* 173 (2005) (noting that use of predatory pricing analogy based on argument that “above-cost” bundled discounts cannot exclude an “equally efficient firm . . . could exonerate an anticompetitive practice for no good reason”); Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 *YALE L.J.* 941, 955–60 (2002).

however, thought that a bright-line, cost-based rule was needed for predatory pricing because single-product pricing is at the heart of competition.<sup>138</sup>

This fear is not legitimate in the case of multiproduct, conditional discounts. An antitrust liability rule for bundled discounts will not prevent a firm from separately pricing its products at cost. It is thus hard to say, for instance, that the use of bundled rebates conditioned on a customer purchasing 90 percent of its requirements from a monopolist is the very conduct the antitrust laws were intended to protect. Whereas the absence of a bright-line rule for single-product predatory pricing could leave firms without procompetitive pricing options, the absence of such a bright line for multiproduct, conditioned discounts does not.

What then is left of the predatory pricing analogy? Only the superficial similarity that bundled discounts are a form of price cutting. But the mere observation that bundled discounts involve a form of price cutting should be insufficient to justify an inference that the relationship between predatory pricing conduct and the legal rule should be the same for bundled discounts. Using the predatory pricing analogy surely captures the most virulent and anticompetitive forms of bundled discounts, but the prudential concerns that moderate the predatory pricing rule do not clearly map onto bundled discounting. The predatory pricing analogy may therefore improperly diminish economic welfare by justifying anticompetitive conduct.

### C. THE TYING ANALOGY: IRRATIONAL SKEPTICISM

Tying offers an attractive analogy. The mapping is very strong. Both tying and rebates involve two products.<sup>139</sup> Both involve conditioning. And, as with tying, the seller “makes it more difficult for new firms to enter [the competitive] market. They must be prepared not only to match existing sellers of the [competitive] product in price and quality, but to offset the attraction of the [bundled] product.”<sup>140</sup>

The courts, however, have found that the tying analogy is not complete unless the specific rebates “coerce” the purchase of the bundle,<sup>141</sup> and they

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<sup>138</sup> *Brooke Group*, 509 U.S. at 223.

<sup>139</sup> Bundled discounts obviously involve two products. Loyalty rebates condition the rebate on the purchase of additional product over a base, which arguably may be characterized as a separate product. See, e.g., *Article 82 Guidance*, *supra* note 55, at 13. But identifying the “uncontestable” and “contestable” shares of the defendant’s sales could prove very difficult.

<sup>140</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13 n.19 (1984); see also *supra* text accompanying notes 60–61.

<sup>141</sup> See *supra* text accompanying notes 62–69.

have thus limited the analogy to a situation in which forgoing the bundled discount would be economically irrational.<sup>142</sup>

The concern that the analogy is inapt without “forcing” is not without foundation. The Supreme Court stated that “the seller’s exploitation of its control over the tying product to force the buyer into the purchase of a tied product” is an essential characteristic of unlawful tying.<sup>143</sup> By this “forcing,” according to the Court, “a seller coerces the abdication of buyers’ independent judgment as to the ‘tied’ product’s merits and insulates it from the competitive stresses of the open market. But any intrinsic superiority of the ‘tied’ product would convince freely choosing buyers to select it over others, anyway.”<sup>144</sup>

This raises the questions of whether “forcing” is truly the *sine qua non* of tying. Indeed, proponents of the predatory pricing analogy insist that forcing is a prerequisite to anticompetitive tying and that the only appropriate measure of such forcing is below-cost pricing.<sup>145</sup> There are three answers to this logic.

First, “forcing” is not necessary to bring about anticompetitive effects through tying.<sup>146</sup> Indeed, the crux of tying is the use of market power “in the market for the tying product” to “restrain competition in the market for the tied product.”<sup>147</sup> Firms with market power can accomplish this result by inducing buyers into tying contracts with a share of the rents obtained through raising rivals’ costs by means of the tie.<sup>148</sup> Although buyers as a group may be

<sup>142</sup> See *supra* text accompanying notes 70–71.

<sup>143</sup> *Jefferson Parish*, 466 U.S. at 12–13; Justice White explained the vice of tying in *Fortner Enterprises, Inc. v. U.S. Steel Corp.*, 394 U.S. 495 (1969), as follows:

There is general agreement in the cases and among commentators that the fundamental restraint against which the tying proscription is meant to guard is the use of power over one product to attain power over another, or otherwise to distort freedom of trade and competition in the second product.

*Id.* at 512–13 (White, J., dissenting).

<sup>144</sup> *Times-Picayune Publ’g Co. v. United States*, 345 U.S. 594, 605 (1953); see also *Rick-Mik Enters., Inc. v. Equilon Enters. LLC*, 532 F.3d 963, 971 (9th Cir. 2008).

<sup>145</sup> See, e.g., Crane, *supra* note 30, at 482–83 (Tying “analysis generally assumes the plaintiff’s inability to match the defendant’s offer and focuses solely on the competitive effects on the market—whether customers are ‘forced’ to purchase the defendant’s product and the amount of the market ‘foreclosed.’ In mixed bundling cases, . . . [i]f the plaintiff could respond to the defendant’s bundled discount by dropping its own price profitably, then there would be neither ‘forcing’ nor ‘foreclosure.’”).

<sup>146</sup> See, e.g., Alan J. Meese, *Tying Meets the New Institutional Economics: Farewell to the Chimera of Forcing*, 146 U. PA. L. REV. 1, 95–96 (1997) (explaining that tying may be anticompetitive in the absence of forcing); Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L. REV. 111, 145 (1996) [hereinafter Meese, *Coasean World*] (“the mere fact that a contract has not been forced on a franchisee through market power does not, ipso facto, require the conclusion that the agreement is procompetitive or competitively neutral”).

<sup>147</sup> *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 34 (2006).

<sup>148</sup> See, e.g., Meese, *Coasean World*, *supra* note 146, at 146.

better off if each rejected the tie, buyers face a collective action problem, which allows for the use of rebates to effect the equivalent of tying without forcing.<sup>149</sup>

Second, embedded in the argument that predatory pricing is necessary to show forcing is the prior belief that antitrust law should only protect equally efficient entrants.<sup>150</sup> It is well established, however, that exclusion of less efficient competitors may reduce economic welfare.<sup>151</sup>

Third, sufficient forcing may be found without below-cost pricing. For example, forcing may be shown where the defendant raises the unbundled price of the tying product.<sup>152</sup> Moreover, rebates are often one of several means that incumbents use to protect their market power. Viewing rebates in isolation and dismissing challenges to all but below-cost rebates may entirely miss the true coercive effect of a defendant's conduct.<sup>153</sup>

But even if one can get over the forcing hurdle, there is a fundamental reason for caution in using the tying analogy: the legal rule for tying reflects severe skepticism toward tying arrangements that does not map onto the rebate target.

### 1. *A Good Analogy Does Not Justify Extending Bad Law*

Tying is subject to a “modified” per se rule. A tie is condemned without proof of anticompetitive effects or proof the defendant has or can obtain market power in the tied market if four elements are met: (1) the tie involves “separate products,” (2) the defendant has market power in the tying product

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<sup>149</sup> See, e.g., Elhauge, *Bundled Discounts*, *supra* note 19, at 456.

<sup>150</sup> See, e.g., Crane, *supra* note 30, at 483 (“It is putting the cart before the horse to reach the ‘forcing’ and ‘foreclosure’ questions without first requiring a rigorous showing that the effective price was below cost and therefore capable of excluding a competitor.”).

<sup>151</sup> See, e.g., Melamed, *supra* note 126, at 388–89 (rejecting equally efficient rival test; “a rival that is less efficient today might become equally or more efficient” tomorrow); Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 328 (2006) (“The fundamental problem with applying the equally efficient entrant standard to [raising rivals’ cost] conduct is that the unencumbered (potential) entry of less-efficient competitors often raises consumer welfare.”).

<sup>152</sup> See, e.g., Elhauge, *Bundled Discounts*, *supra* note 19, at 450 (arguing that “if the unbundled price for the linking product exceeds its but-for price, then bundled discounts can produce all the same power effects as tying”).

<sup>153</sup> See, e.g., *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 277–78 (3d Cir. 2012) (evidence of implicit threat that monopolist supplier would cancel contract if buyers failed to purchase sufficient products to qualify for rebates); *Cont’l Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699 (1962) (“[P]laintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each . . .”).

market, (3) consumers are coerced into purchasing the tied product, and (4) the arrangement forecloses a “substantial volume of commerce.”<sup>154</sup>

This rule reflects a deep historical skepticism toward tying.<sup>155</sup> In *Standard Stations*, the Supreme Court announced that “tying agreements serve hardly any purpose beyond the suppression of competition.”<sup>156</sup> Although the Court claims that it later rejected this view,<sup>157</sup> the majority in *Jefferson Parish* nonetheless stated, “It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable ‘per se.’”<sup>158</sup>

This rule has come under withering criticism. First, the modified per se rule stems from the presumption that firms use tying to “extend” power in one market “into a second distinct market.”<sup>159</sup> Economists have demonstrated, however, that this sort of leveraging is possible only in limited circumstances.<sup>160</sup> Nonetheless, while “the orthodox version of the leverage theory lacks economic traction, it continues to have legal vitality.”<sup>161</sup>

Second, the assumption that tying can only be an anticompetitive device is unfounded. There are now several well-recognized procompetitive justifica-

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<sup>154</sup> See, e.g., *Reifert v. S. Cent. Wis. MLS Corp.*, 450 F.3d 312, 321-23 (7th Cir. 2006) (Wood, J., concurring); *Wells Real Estate, Inc. v. Greater Lowell Bd. of Realtors*, 850 F.2d 803, 815 n.11 (1st Cir. 1988) (plaintiff need only prove “some minimal showing of real or potential foreclosed commerce caused by the tie”).

<sup>155</sup> See Keith N. Hylton & Michael Salinger, *Tying Law and Policy: A Decision-Theoretic Approach*, 69 ANTITRUST L.J. 469, 475 (2001); Victor H. Kramer, *The Supreme Court and Tying Arrangements: Antitrust as History*, 69 MINN. L. REV. 1013, 1067 (1985).

<sup>156</sup> *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 305 (1949).

<sup>157</sup> *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 36 (2006).

<sup>158</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 9 (1984). The concurring justices in *Jefferson Parish* would have abandoned the “‘per se’ label” and refocused “the inquiry on the adverse economic effects, and the potential economic benefits, that the tie may have.” *Id.* at 35.

<sup>159</sup> *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 487 (1992).

<sup>160</sup> Chicago School scholars argued that such leveraging would not be possible at all because a monopolist can reap only a “single monopoly profit.” See ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 373 (2d ed. 1993) (tying does not allow “two monopoly profits from a single monopoly”); RICHARD A. POSNER, *ANTITRUST LAW* 173 (1976); Ward S. Bowman, Jr., *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19, 23-24 (1957). Several economic models, however, demonstrate that the single monopoly profit theory does not apply in certain limited situations. See, e.g., Jay Pil Choi & Christodoulos Stefanadis, *Tying, Investment, and the Dynamic Leverage Theory*, 32 RAND J. ECON. 52, 60-62 (2001); David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73, 78 (2005); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837, 839 (1990). In addition, tying may be used to preserve market power in the tying market. See, e.g., Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 194, 215-16 (2002).

<sup>161</sup> HOVENKAMP, *supra* note 137, at 201.

tions for tying.<sup>162</sup> The existence of these justifications counsels against the use of the modified per se rule.<sup>163</sup>

Given these “infirmities” and “increasingly wobbly, moth-eaten foundations,”<sup>164</sup> there is no justification for extending the legal rule for tying to rebates. The skepticism toward tying reflected in the legal rule does not have an analog in rebates.

## 2. An Unencumbered Analogy Is Apt

But there may still be an avenue for the use of the tying analogy. In *United States v. Microsoft Corp.*,<sup>165</sup> the D.C. Circuit eschewed per se analysis of a tie involving “technological integration of added functionality into software that serves as a platform for third-party applications.”<sup>166</sup> Given the lack of judicial experience with and the plausible efficiencies of such integration, the court could not “comfortably say that bundling in platform software markets has so little ‘redeeming virtue,’ and that there would be so ‘very little loss to society’ from its ban, that ‘an inquiry into its costs in the individual case [can be] considered [ ] unnecessary.’”<sup>167</sup> Applying per se analysis would create “undue risks of error and of deterring welfare-enhancing innovation”<sup>168</sup> and the court thus held that the rule of reason governs the legality of such ties.<sup>169</sup>

The same should be true of rebates. As a general matter, the courts are appropriately cautious in applying the per se rule to conduct with which the courts have little experience.<sup>170</sup> In addition, bundled rebates arguably present

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<sup>162</sup> See, e.g., *Jefferson Parish*, 466 U.S. at 41 (listing “economic benefits” of tying) (O’Connor, J., concurring); Erik Hovenkamp & Herbert Hovenkamp, *Tying Arrangements and Antitrust Harm*, 52 ARIZ. L. REV. 925, 964 (2010).

<sup>163</sup> See, e.g., Christian Ahlborn, David S. Evans & A. Jorge Padilla, *The Antitrust Economics of Tying: A Farewell to Per Se Illegality*, 49 ANTITRUST BULL. 287, 319–24, 329–30 (2004); Evans & Padilla, *supra* note 160, at 84–86.

<sup>164</sup> *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997) (quoting Judge Posner’s opinion in the Seventh Circuit case (*Khan v. State Oil Co.*, 93 F.3d 1358, 1363 (7th Cir. 1996))).

<sup>165</sup> 253 F.3d 34 (D.C. Cir. 2001).

<sup>166</sup> *Id.* at 84.

<sup>167</sup> *Id.* at 94 (citations omitted).

<sup>168</sup> *Id.* at 89–90.

<sup>169</sup> *Id.* at 84.

<sup>170</sup> As the Supreme Court has made clear, “there is a presumption in favor of a rule-of-reason standard.” *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988). The per se rule is thus appropriate only for business conduct that prior judicial experience demonstrates is a “naked restraint[ ] of trade with no purpose except stifling of competition,” *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963), and conduct that has “manifestly anticompetitive effects and lack[s] . . . any redeeming virtue.” *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007). Thus, the Supreme Court has “expressed reluctance to adopt per se rules . . . ‘where the economic impact of certain practices is not immediately obvious.’” *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (quoting *FTC v. Ind. Fed’n of Dentists*, 476 U.S. 447, 458–459 (1986)).

efficiency justifications similar to those of tying.<sup>171</sup> While the efficiency justifications for rebates may be less clear than for tying (which would weigh in favor of the modified per se rule),<sup>172</sup> there is not sufficient judicial experience to justify the application of a per se rule, modified or otherwise. Accordingly, plaintiffs challenging rebates would be required to prove anticompetitive effects in the market for the competitive product.<sup>173</sup>

The tying analogy unencumbered by the “modified” per se rule is quite appealing for bundled rebates. For single-product loyalty rebates, however, the exclusive dealing analogy may be more apt.

#### D. THE EXCLUSIVE DEALING ANALOGY: AN UNBIASED APPROACH

Like tying, exclusive dealing provides an inviting analogy. At its core, exclusive dealing involves practices that induce buyers to purchase most or all of their requirements from a single supplier.<sup>174</sup> The competitive concern is that a firm with substantial market power may use these practices to exclude or hinder competitors by locking up sufficient means of distribution or supply.<sup>175</sup> Exclusive dealing is thus a classic means to raise rivals’ costs.<sup>176</sup> These are precisely the means and competitive concerns associated with rebates. In effect, rebates can be seen as a means to purchase exclusivity by sharing with the buyer a portion of the monopoly profits.<sup>177</sup>

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<sup>171</sup> See Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1723–24 (2005) (arguing the bundled discounts may create economies of scope, help sellers achieve economies of scale, reduce uncertainty about aggregate demand, and facilitate efficiency-enhancing differential pricing).

<sup>172</sup> See, e.g., Crane, *supra* note 30, at 471 (noting “the efficiency effects of these practices are ambiguous but not clearly negative”).

<sup>173</sup> See *Microsoft*, 253 F.3d at 96.

<sup>174</sup> *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F.3d 1379, 1384 (5th Cir. 1994).

<sup>175</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O’Connor, J., concurring) (“Exclusive dealing can have adverse economic consequences by allowing one supplier of goods or services unreasonably to deprive other suppliers of a market for their goods, or by allowing one buyer of goods unreasonably to deprive other buyers of a needed source of supply.”); *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162 (9th Cir. 1997) (“The main antitrust objection to exclusive dealing is its tendency to ‘foreclose’ existing competitors or new entrants from competition in the covered portion of the relevant market during the term of the agreement.”).

<sup>176</sup> *United States v. Dentsply Int’l, Inc.*, 399 F.3d 181, 191 (3d Cir. 2005) (“‘A set of strategically planned exclusive dealing contracts may slow the rival’s expansion by requiring it to develop alternative outlets for its products or rely at least temporarily on inferior or more expensive outlets. Consumer injury results from the delay that the dominant firm imposes on the smaller rival’s growth.’” (quoting HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1802c, at 64 (2d ed. 2002))); *Microsoft*, 253 F.3d at 71 (use of exclusive dealing to keep rival below critical usage level necessary to threaten defendant’s monopoly); Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1166–67 (2012).

<sup>177</sup> Melamed, *supra* note 126, at 404 (“If the manufacturer expects to gain or preserve market power by excluding its rivals, it could induce the distributors to go along with the exclusionary scheme by sharing with them a portion of the anticipated supracompetitive profits.”).

Exclusive dealing is also an apt analogy because, in contrast to tying, it does not carry the baggage of historical skepticism. From early on, the Supreme Court recognized that exclusive dealing offers potential procompetitive benefits:

In the case of the buyer, they may assure supply, afford protection against rises in price, enable long-term planning on the basis of known costs, and obviate the expense and risk of storage in the quantity necessary for a commodity having a fluctuating demand. From the seller's point of view, requirements contracts may make possible the substantial reduction of selling expenses, give protection against price fluctuations, and—of particular advantage to a newcomer to the field to whom it is important to know what capital expenditures are justified—offer the possibility of a predictable market. They may be useful, moreover, to a seller trying to establish a foothold against the counterattacks of entrenched competitors. Since these advantages of requirements contracts may be sufficient to account for their use, the coverage by such contracts of a substantial amount of business affords a weaker basis for the inference that competition may be lessened than would similar coverage by tying clauses, especially where use of the latter is combined with market control of the tying device.<sup>178</sup>

The recognition of these potential competitive benefits has led courts to apply rule of reason analysis to exclusive dealing.<sup>179</sup> Although early cases indicated that a simplistic showing of a percentage of market foreclosed was sufficient to condemn exclusive dealing, the courts now consider a number of factors beyond simple foreclosure percentages.<sup>180</sup> Factors such as the degree of foreclosure,<sup>181</sup> the duration of the contracts,<sup>182</sup> alternative means of distribu-

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<sup>178</sup> *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 306–07 (1949).

<sup>179</sup> *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 393 (7th Cir. 1984).

<sup>180</sup> *See, e.g., id.* (“Although the Supreme Court has not decided an exclusive-dealing case in many years, it now appears most unlikely that such agreements, whether challenged under section 3 of the Clayton Act or section 1 of the Sherman Act, will be judged by the simple and strict test of *Standard Stations*. They will be judged under the Rule of Reason, and thus condemned only if found to restrain trade unreasonably.”); Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L.J. 311, 349, 361–62 (2002) (“Although the cases still generally speak of this inquiry as one of ‘foreclosure,’ the percentage of the market ‘foreclosed’ by an exclusive arrangement is rarely determinative and, often, not even interesting.”).

<sup>181</sup> *See, e.g., Sterling Merch., Inc. v. Nestle, S.A.*, 656 F.3d 112, 123–24 (1st Cir. 2011) (stating that foreclosure levels of less than 30% or 40% are unlikely to be of concern).

<sup>182</sup> *See, e.g., United States v. Dentsply Int’l, Inc.*, 399 F.3d 181, 193 (3d Cir. 2005) (although arrangements were “at-will,” “the economic elements involved—the large share of the market held by Dentsply and its conduct excluding competing manufacturers—realistically make the arrangements here as effective as those in written contracts”); *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d 101, 111 (2d Cir. 2002) (exclusive contracts did not restrain competition because, among other things, exclusive dealing provisions were “short in duration” and “terminable at will”); *W. Parcel Exp. v. United Parcel Serv. of Am., Inc.*, 190 F.3d 974, 976 (9th Cir. 1999) (provisions were not de facto exclusive dealing because customers could terminate the contracts on minimal notice).



tion or supply,<sup>183</sup> the level of the distribution chain foreclosed,<sup>184</sup> and the existence of entry barriers,<sup>185</sup> help the trier of fact to determine whether competitors are able to circumvent the exclusive dealing arrangements.<sup>186</sup> Ultimately, courts consider evidence of anticompetitive effects and the defendant's procompetitive justifications.<sup>187</sup>

This flexible, rule of reason approach is well-suited for rebates.<sup>188</sup> Although some courts have expressed skepticism that exclusive dealing is likely to be used for anticompetitive ends,<sup>189</sup> the formal rule itself is not biased toward condemning or condoning the practice. Given the uncertainty regarding the economic effects of rebates—and the various types of rebates—a case-by-case, unbiased approach would allow the courts to develop, in common law fashion, legal rules for rebates based on actual facts, rather than stylized models.

The key mapping issue for the exclusive dealing analogy is: under what circumstances do rebates become *de facto* exclusive dealing? Must a plaintiff show that buyers were “coerced” by the rebates to purchase from the defen-

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<sup>183</sup> See, e.g., *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1163 (9th Cir. 1997) (“If competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution, it is unclear whether such restrictions foreclose from competition any part of the relevant market.”)

<sup>184</sup> See, e.g., *id.* at 1162–63 (“exclusive dealing arrangements imposed on distributors rather than end-users are generally less cause for anticompetitive concern”).

<sup>185</sup> See, e.g., *Geneva Pharms. Tech. Corp. v. Barr Labs, Inc.*, 386 F.3d 485, 509 (2d Cir. 2004) (“There is also evidence of high barriers to entry, meaning that potential suppliers could not easily enter the market. To the extent plaintiffs’ theory is accurate, the exclusive dealing agreement had the potential to freeze competitors out of the generic warfarin sodium market.”)

<sup>186</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (O’Connor, J., concurring) (“In determining whether an exclusive-dealing contract is unreasonable, the proper focus is on the structure of the market for the products or services in question—the number of sellers and buyers in the market, the volume of their business, and the ease with which buyers and sellers can redirect their purchases or sales to others. Exclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal.”)

<sup>187</sup> See, e.g., *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 595 (1st Cir. 1993) (courts must engage in a “detailed depiction of circumstances and the most careful weighing of alleged dangers and potential benefits”); *Oltz v. St. Peter’s Cmty. Hosp.*, 861 F.2d 1440, 1448 (9th Cir. 1988) (observing “the price of anesthesia services . . . rose dramatically because of the challenged restraint”); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 237 (1st Cir. 1983) (considering “the existence of legitimate business justifications for the agreements from the perspectives of both buyer and seller”).

<sup>188</sup> This is not to say that the underlying analysis for exclusive dealing cannot be improved upon. See, e.g., *Wright, supra* note 176, at 1181–87 (arguing for a more economically informed measure of foreclosure).

<sup>189</sup> See *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 66 (1st Cir. 2004) (“Indeed, courts tend to be skeptical of such claims because it is not in the long-term interest of the company that grants the ‘exclusive deal’ to drive out of business competitors of the grantee.”).

dant?<sup>190</sup> And because rebates relate to prices, must such “coercion” be evidenced by below-cost pricing?

To start with, it is well established that no coercion is necessary to effect an anticompetitive exclusive dealing scheme. Where, for instance, competitive entry will only occur if there are a sufficient number of buyers unencumbered by an exclusive dealing arrangement, each buyer that accepts the exclusive deal imposes a negative externality on all other buyers (i.e., reducing the likelihood of entry).<sup>191</sup> The incumbent can take advantage of the buyers’ collective action problem and induce a sufficient number of buyers to exclude or hinder entry.<sup>192</sup> Alternatively, if the incumbent can discriminate among buyers, “the incumbent need not rely on a lack of buyer coordination to exclude profitably: discrimination allows the incumbent to successfully exploit the externalities that exist across buyers.”<sup>193</sup>

The real question, therefore, is not whether buyers are “coerced” by the rebate scheme. The question is whether the “practical effect” of the scheme is to sufficiently exclude or hinder entry so as to protect or enhance the incumbent’s market power.<sup>194</sup> In other words, rather than examining whether buyers are “coerced” by the rebates, the issue is whether competitors can circumvent the rebate scheme considering the dynamics of the particular market and the specifics of the rebate scheme. Exclusive dealing case law, with its multifactor approach, provides a good foundation for this evaluation.

This same multifactor, rule of reason approach is also appropriate for applying the tying analogy to bundled rebates. A case-by-case assessment is especially important because bundled rebates are diverse; they can involve multiple products, be triggered only when the buyer reaches certain thresholds in a given time frame, and may be differently calibrated for different buyers.<sup>195</sup>

This approach best avoids pigeonholing rebates into a set of “special substantive rules” that would undermine the purposes of antitrust policy. Such

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<sup>190</sup> See *Race Tires Am., Inc. v. Hoosier Racing Tire Corp.*, 614 F.3d 57, 77 (3d Cir. 2010) (noting that the concept of coercion “has played a key, if sometimes unexplored, role in the relevant case law,” but holding that coercion is only a factor to consider, not an element of an exclusive dealing claim).

<sup>191</sup> MICHAEL D. WHINSTON, *LECTURES ON ANTITRUST ECONOMICS* 144–51 (2006).

<sup>192</sup> *Id.*

<sup>193</sup> Ilya R. Segal & Michael D. Whinston, *Naked Exclusion: Comment*, 90 AM. ECON. REV. 296, 296–97 (2000); see also Claudia M. Landeo & Kathryn Spier, *Naked Exclusion: An Experimental Study of Contracts with Externalities*, 99 AM. ECON. REV. 1850, 1871–72 (2009).

<sup>194</sup> *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).

<sup>195</sup> See, e.g., Kevin Caves & Hal Singer, *Assessing Bundled and Share-Based Loyalty Rebates: Application to the Pharmaceutical Industry*, 8 J. COMPETITION L. & ECON. 889, 901–12 (2012) (describing multiproduct bundled rebates in pharmaceutical industry).

“special rules” regarding what is and is not “properly characterized as an exclusive dealing agreement” or tying arrangement would only “encourage parties to tinker with the details of their arrangements.”<sup>196</sup> And the resulting formalistic inquiries “disserve the purposes of sound competition law.”<sup>197</sup>

### III. APPLYING THE ANALOGIES

The flexibility of the rule of reason analysis, however, may come with costs. Some argue that the rule results in a lack of clear guidelines by which courts can determine cases and firms may govern their conduct.<sup>198</sup> The argument is that the rule of reason requires litigation parties to “engage in an elaborate four-part minuet” of burden shifting that ends in an impossible balancing test and excessive litigation costs all around.<sup>199</sup> Others argue that the rule of reason “is far less amorphous than commonly believed” and point out that the courts rarely get to the balancing stage of the analysis.<sup>200</sup>

Whichever is the reality, the rule of reason analysis of rebates need not start with a blank slate, devoid of any guidance. The same type of reasoning that leads to the conclusion that exclusive dealing and tying are apt analogies may also aid in the recognition of factors important in identifying potentially anti-competitive loyalty rebates and bundled discounts.

#### A. THE ANALYSIS OF LOYALTY REBATES

As in any rule of reason case, the initial burden is on the plaintiff to show likely anticompetitive effects, which for exclusive dealing (and, by analogy, loyalty rebates) is effected by foreclosure. Drawing on the relatively robust case law and literature regarding exclusive dealing, the analysis of loyalty rebates should focus on whether the rebates sufficiently foreclose distribution so as to likely cause anticompetitive effects.

First, aside from the requisite market power, the degree of foreclosure is the obvious starting point. A showing that a rebate scheme prevents the plaintiff from reaching minimum viable scale would clearly be sufficient.<sup>201</sup> But exclusive dealing (and thus loyalty rebates) can bring about anticompetitive effects even if it does not deter entry. What is required is a showing that the rebates

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<sup>196</sup> Melamed, *supra* note 126, at 376.

<sup>197</sup> *Id.*

<sup>198</sup> See, e.g., Maurice Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375, 1382 & n.24 (2009).

<sup>199</sup> *Id.* at 1385–86.

<sup>200</sup> See, e.g., Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827, 827–31 (2009).

<sup>201</sup> See Daniel A. Crane & Graciela Miralles, *Toward a Unified Theory of Exclusionary Vertical Restraints*, 84 S. CAL. L. REV. 605, 639–40 (2011) (explaining how foreclosure limiting entrant’s share to below minimum viable scale harms competition).

impair the ability of rivals to compete (e.g., by raising rivals' costs of distribution) sufficiently to likely harm competition.<sup>202</sup>

Key to the foreclosure analysis is the design of the rebates. What is the effective percentage of the customer's requirements that must be purchased from the defendant to trigger the rebates? What is the time period over which purchases must be accumulated for the rebates to apply? What is the amount of the rebate? The exclusive dealing analogy tells us that higher percentage requirements, longer time periods, and larger rebate amounts increase the likelihood that the rebates will cause anticompetitive effects.

Second, often overlooked but critical, is proof that the defendant's conduct was the *cause* of the foreclosure. Customers may prefer the defendant's products for all sorts of reasons other than the rebates, such as superior quality, service, or reliability.<sup>203</sup> The plaintiff must show that the defendant's rebate scheme, and not other factors, caused the foreclosure.<sup>204</sup>

Third, a plaintiff would be required to prove that the rebate-induced foreclosure will likely lead to anticompetitive effects. While plaintiffs may often satisfy this requirement by a showing of market power,<sup>205</sup> where rebates do not keep rivals below minimum viable scale, the fact that rivals' costs are raised does not necessarily lead to higher market prices or reduced output. A plaintiff proceeding under a raising rivals' cost theory would be required to show either actual effects or sufficient proof of likely effects through convincing market evidence.<sup>206</sup>

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<sup>202</sup> See, e.g., Jacobson, *supra* note 180, at 366. Part of the foreclosure analysis is thus an examination of whether rivals can circumvent the rebate-induced exclusive dealing by, for instance, going past distributors directly to consumers. See *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162–63 (9th Cir. 1997). Notably, incumbents are more likely to succeed in inducing distributors into exclusive dealing contracts than consumers. See Jose Miguel Abito & Julian Wright, *Exclusive Dealing with Imperfect Downstream Competition*, 26 INT'L J. INDUS. ORG. 227, 228 (2008).

<sup>203</sup> In some cases, customers may have instigated the rebates scheme. See Richard M. Steuer, *Customer-Instigated Exclusive Dealing*, 68 ANTITRUST L.J. 239, 251 (2000) (“Courts should hesitate to substitute their own judgment for that of a customer where the customer is trying to sharpen competition among potential suppliers and strike the best deal it can.”).

<sup>204</sup> See Wright, *supra* note 176, at 1181–82 (urging courts to measure foreclosure relative to “what would be obtained but for” the challenged restraint).

<sup>205</sup> See, e.g., *Brookins v. Int'l Motor Contest Ass'n*, 219 F.3d 849, 852 (8th Cir. 2000) (“Injury to competition requires proof either of market power in a relevant market, or of an actual adverse effect on competition.”); *Tops Mkts., Inc. v. Quality Mkts., Inc.* 142 F.3d 90, 96 (2d Cir. 1998) (antitrust plaintiff has “two independent means by which to satisfy the adverse-effect requirement”—proof of an “actual adverse effect on competition” or proof of “sufficient market power to cause an adverse effect on competition”).

<sup>206</sup> See, e.g., Roman Inderst & Greg Shaffer, *Market-Share Contracts as Facilitating Practices*, 41 RAND J. ECON. 709, 723 (2010) (showing how loyalty rebates may reduce consumer surplus even though rivals are not kept below minimum viable scale).

Proof regarding effects should include evidence regarding the *purpose* of the loyalty rebates. *Purpose*, here, is not synonymous with *intent*, although evidence of intent often bears on whether anticompetitive effects are likely.<sup>207</sup> The question is whether the *design* of the loyalty rebates (as opposed to business persons' email banter regarding their intent) shows a purpose to bring about some efficiency. Exclusive dealing and other vertical restraints, for instance, are most often justified as means to purchase or ensure distributor promotional performance by aligning the supplier's and distributor's incentives.<sup>208</sup> Obviously, if the design of the loyalty rebates cannot be explained as an effort to achieve efficiencies, but limits rivals' competitiveness, anticompetitive effects are more likely.

#### B. THE ANALYSIS OF BUNDLED DISCOUNTS

Using analogical reasoning to formulate factors for the analysis of bundled discounts is more difficult. Because of the Supreme Court's unfortunate foray into the world of the modified per se rule, the rule of reason analysis for tying remains anemic. The literature is full of pleas to abandon the per se rule but offers little more than a "structured" rule of reason with few details in its place.<sup>209</sup>

In addition to market power in the tying market, the three factors discussed for loyalty rebates—(i) foreclosure sufficient to impair rivals that is (ii) caused by the rebates, (iii) resulting in actual or likely anticompetitive effects—nonetheless offer a solid starting point for the analysis of bundled discounts.<sup>210</sup> The design of the bundled discounts is of special influence on those factors.

Bundled discounts come in a variety of forms. Much of the literature stylizes bundled discounts as a percentage savings when the customer purchases two products from the supplier (e.g., save 10 percent when you buy A and B together). But bundled discounts are often more complicated, requiring customers to purchase a large percentage of their requirements in a given time period for multiple products.<sup>211</sup> The particular design of a bundled discount

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<sup>207</sup> See *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19–20 (1979) (purpose for a restraint "tends to show [its] effect"); Marina Lao, *Reclaiming a Role for Intent Evidence in Monopolization Analysis*, 54 AM. U. L. REV. 151, 197 (2004).

<sup>208</sup> See, e.g., Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433, 435 (2008); Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 YALE J. ON REG. 169, 172–75 (2006).

<sup>209</sup> See, e.g., Evans & Padilla, *supra* note 160, at 94–96.

<sup>210</sup> See Hylton & Salinger, *supra* note 155, at 506 (stating that market power, substantial foreclosure, entry barriers in the tied market, and large scale economies are necessary for anticompetitive effects in tying cases).

<sup>211</sup> See, e.g., Caves & Singer, *supra* note 195, at 907–11 (describing bundled discounts related to vaccines).

thus bears on the degree of foreclosure and the likelihood of anticompetitive effects.

This is especially the case when considering the purpose of the particular bundled discounts as evidenced by the design. The economic literature has identified a number of potential efficiencies for tying—“benefits of integration, economies of scope in distributing products, packaging cost savings, reduced transaction costs for businesses and consumers, and increased reliability for consumers.”<sup>212</sup> Courts should carefully examine whether any of these potential efficiencies plausibly relate to a particular bundled discount scheme. Where it is difficult to see how they could, sufficient foreclosure is more likely to raise an inference of anticompetitive effects.

#### IV. CONCLUSION

To a large degree, the selection of the appropriate legal rule for rebates is driven by prior beliefs regarding the efficacy of markets to self-correct, the ability of antitrust tribunals to discern anticompetitive conduct, and the potential procompetitive benefits of rebates.<sup>213</sup> The predatory pricing analogy would reflect prior beliefs that rebates are by-and-large procompetitive (e.g., simply a form of discounting), that without bright lines, antitrust tribunals are apt to get it wrong and chill procompetitive conduct, and that anticompetitive rebate schemes will eventually be overcome by market forces. These prior beliefs might drive one to conclude that the predatory pricing standard is appropriate even though the underlying rationale for the predatory pricing rule does not map well to the rebate structure. On the other hand, if one is skeptical that rebate schemes offered by firms with significant market power are little more than a means to exclude rivals, this prior belief might lead to the conclusion that the tying analogy and the modified per se rule are appropriate, despite the criticisms of that legal rule.

As a matter of analogical reasoning, however, the exclusive dealing analogy best fits loyalty rebates and the rule of reason tying analogy best fits bundled rebates. This is not surprising: “Economically, tying and exclusive dealing are very similar, and often the difference is no more than a name given to the practice.”<sup>214</sup>

This approach will not satisfy those looking for certainty and “safe harbors.” Proponents of the predatory pricing analogy, for instance, argue that

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<sup>212</sup> Evans & Padilla, *supra* note 160, at 90.

<sup>213</sup> See Sean Gates, *The DOJ Section 2 Report: It All Depends on Your Priors*, CPI ANTITRUST CHRON., Autumn 2008, Vol. 10, No. 1 (discussing effect of prior beliefs on antitrust rules); EVANS & PADILLA, *supra* note 160, at 90–95 (discussing priors regarding tying and effect on proposed design of legal rule).

<sup>214</sup> HOVENKAMP, *supra* note 137, at 200.

because rebates are (in their view) price discounts, prudential concerns call for bright-line rules to avoid chilling procompetitive conduct. But the lesson from exclusive dealing law shows otherwise. Exclusive dealing has long been recognized as potentially procompetitive. Yet the antitrust rule for exclusive dealing offers few bright lines. As one court put it, “There is no set formula for evaluating the legality of an exclusive dealing agreement . . . .”<sup>215</sup> Despite this lack of clarity, exclusive dealing is ubiquitous, and there is no empirical evidence that the flexible, rule of reason approach has chilled procompetitive conduct. Indeed, some argue that this approach is in fact biased toward nonintervention.<sup>216</sup>

In any event, the use of the multifactored, rule of reason approach would allow the courts to develop the legal rule for loyalty and bundled rebates without the predetermined bias of the predatory pricing and modified per se tying analogies. It is the better solution.

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<sup>215</sup> ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254, 271 (3d Cir. 2012).

<sup>216</sup> Stephen Calkins, *Wrong Turns in Exclusive Dealing Law*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK*, 156–63 (Robert Pitofsky ed., 2008).

