CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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September 22, 2014

Donald S. Clark
Secretary
Federal Trade Commission
Room HB 113 (Annex X)
600 Pennsylvania Avenue, NW
Washington, DC 20590

Re: Conditional Pricing Practices Workshop, Project No. P141200

Dear Secretary Clark:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of every size, sector, and region, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, welcomes the opportunity by the Federal Trade Commission (FTC) and the Department of Justice (DOJ) to comment on conditional pricing practices (CPP).

The Chamber appreciates the opportunity to submit its views on the proper legal treatment of CPPs. The law in this area is unsettled, and the Chamber welcomes the joint efforts by the FTC and DOJ to develop a unified approach to these practices. The Chamber endorses the agencies' desire to provide predictable, transparent and fair rules that are grounded in economic efficiency and administrable by agencies and courts.[1] This is especially important given the divergent position on this topic in the EU and the developing state of the law in this area in other jurisdictions around the world.

For the reasons outlined below, the Chamber supports the use of a price/cost predation test for evaluating CPPs by antitrust agencies and courts. Although the price/cost test may be imperfect, it is the best standard available for providing predictable guidance to the business community while not chilling procompetitive discounting practices.[2] Without its use the

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[1] *See* Commissioner Maureen Ohlhausen, Opening Statement at Conditional Pricing Practices Workshop (June 23, 2014) (hereafter "CPP Workshop").
[2] *See* Brief for Eighteen Scholars as *Amici Curiae* in Support of Petitioner, *Eaton Corp. v. ZF Meritor*, 133 S. Ct. 2025 (2013), *denying cert. to ZF Meritor v. Eaton*, 696 F.3d 254 (3d Cir. 2012); *see also* Herbert J. Hovenkamp,

Chamber believes that any other framework for analyzing CPPs is too unpredictable and difficult to administer, leaving businesses without clear guidance on how legally to structure their discounting practices. Although the U.S. agencies and commentators hold diverse viewpoints, everyone recognizes that CPPs can generate many procompetitive benefits. The agencies and courts should be cautious in fashioning any approach that could discourage legitimate discounting practices that benefit consumers.[3] The Chamber believes there is far more potential for damage to consumer welfare by attempts to remove, circumvent, or replace the price/cost predation test in favor of an alternative analysis.

Procompetitive Benefits of CPPs

CPPs, like other discounting practices, are generally procompetitive and result in numerous efficiencies that enhance output and lower prices to consumers.[4] These are the very types of efficiencies that the Supreme Court has long sought to protect by requiring a price/cost test in other circumstances. Like other discounting practices, CPPs can promote brand loyalty, prevent free riding, facilitate the introduction of new products, and reduce transaction costs.[5]

CPPs also generate unique efficiencies that do not ordinarily result from other discounting practices. For example, market share discounts may allow buyers and sellers to share risk when volumes are difficult to predict.[6] In such cases, CPPs may be used by smaller buyers

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"The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal," Univ. of Iowa Legal Studies Research Paper (June 2014), at pp. 17-18 (While discussing the limitations of the price cost test, Professor Hovenkamp noted that it survives because "no one has been able to come up with something better"); *see also* 3 Phillip Areeda & Herbert Hovenkamp, Antitrust Law ¶749 (2014) ("The reason these tests for predatory pricing were adopted was not because there is widespread consensus that above-cost pricing strategies can never be anticompetitive in the long run. Rather, it is because our measurement tools are too imprecise to evaluate such strategies without creating an intolerable risk of chilling competitive behavior").

[3] Assistant Attorney General William Baer, Opening Remarks at CPP Workshop ("[I]t is not always easy to draw the line between pricing practices that injure competition and those that do not. We want to be especially careful drawing that line, because we do not want to discourage legitimate discounts that benefit consumers"); Commissioner Joshua Wright, "Simple but Wrong or Complex but more Accurate? The case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts," Remarks of Joshua D. Wright at Bates White 10th Annual Antitrust Conference (June 3, 2013) ("Although exclusive or partial exclusive arrangements, including loyalty discounts, have the potential to foreclose or exclude rivals, they are generally a byproduct of the normal competitive processes"); Presentation of Steven Salop at CPP Workshop, at p.28 (noting that conditional pricing practices can lead to efficiencies).

[4] *See* Areeda & Hovenkamp, Antitrust Law ¶749 ("The great majority of discounting practices are procompetitive. Through discounting businesses induce customers to purchase from them rather than someone else or to purchase more than they otherwise would. Most of these practices reflect hard bargaining. Many are explained by economies of scale or scope in either manufacturing or transacting. Some, such as market share or quantity discounts, aid sellers in long-run output planning. Most are output-increasing and thus at least presumptively procompetitive").

[5] *See* Presentation of Leah Brannon at CPP Workshop, at p.3.

[6] *See* Daniel A. Crane, "Bargaining over Loyalty," 92 Tex. L. Rev. 253, 260-261 (Dec. 2013).

to protect themselves from a fall in demand that would make them ineligible for a quantity based discount. In addition, CPPs may be used by smaller buyers, who might not ordinarily qualify for a volume discount, to obtain price concessions in consideration for their supplier loyalty.[7] According to Michigan Law School Professor Daniel Crane, this occurs because, "[b]y foregoing its variety preferences and focusing on a single seller, the buyer effectively elasticizes the demand facing the seller and, hence, can obtain a better price."[8]

Additionally, CPPs can help align the incentives of buyers and sellers by ensuring, in times of strong demand, that a buyer will retain an incentive to sell its products even after its purchases have passed what might otherwise be a maximum quantity threshold. CPPs may also be used to protect a seller by guaranteeing the seller a minimum volume of sales when the requirements of a set of customers is unpredictable.[9] Where a seller can predict the aggregate demand from a group of customers, CPPs can help sellers plan for a known sales volume even though the market shares within the group of customers may shift due to competition among purchasers.

CPPs designed as bundled discounts can also result in numerous efficiencies. For example, bundled discounts can lower a firm's costs. They also can be used to induce existing customers to try new products or services, to instill customer loyalty, and to incentivize a retailer to promote particular products. Further, unlike single product CPPs, bundled discounts have the potential to eliminate double marginalization (*i.e.*, where both firms in a vertical relationship have market power) and to allow firms to price discriminate in a way that increases output and efficiency.[10]

Judicial Treatment of CPPs

Vigorous price competition is an essential component of competitive markets. Accordingly, the Supreme Court, in varying contexts, has expressed a strong preference for preserving pricing freedom and encouraging discounting practices.[11] To that end, the Court has long

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[7] *See e.g., Smith Wholesale Co. v. R.J. Reynolds Tobacco Co.*, 477 F.3d 854, 864-65 (6th Cir. 2007) ("Market-share discounts theoretically level the playing field by allowing competing purchasers of like commodities to participate on equal terms, regardless of size, because such discounts depend not on volume purchase, but on the percentage of purchases of a particular category of products").
[8] *See* Daniel A. Crane, "Bargaining over Loyalty," 92 Tex. L. Rev. 253, 262 (Dec. 2013).
[9] *Id.* at 261.
[10] *See* Daniel A. Crane, "Mixed Bundling, Profit Sacrifice, and Consumer Welfare," *55 Emory L.J. 423*, 425 (2006).
[11] *See, e.g.*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) ("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 procompetitive price cutting"); *see also Pacific Bell Telephone Co. v. Linkline Communications*, 555 U.S. 438 (2009); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007); *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990);

required plaintiffs challenging pricing practices to show that the challenged prices were below an appropriate measure of the seller's cost.[12] The Court's reasoning stems from concerns that condemning above-cost discounting could "'perversely, chill legitimate price cutting,' which directly benefits consumers."[13]

Although the Supreme Court has not directly ruled on the antitrust treatment of CPPs, the Court has applied a price/cost test in a variety of other circumstances. For example, in *Brooke Group Ltd. v. Brown & Williamson Corp.*, the Court held that a plaintiff seeking to establish competitive injury resulting from a rival's low prices under either Section 2 or the Robinson-Patman Act must, first, prove that the prices complained of are below an appropriate measure of its rival's costs and, second, must demonstrate that the competitor had a dangerous probability of recouping its investment in below-cost prices.[14] Likewise, in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, the Court rejected the plaintiff's claim of predatory overbidding, finding that the plaintiff failed to show that the alleged overpayments for inputs resulted in below-cost pricing of the defendant's outputs.[15]

Most recently, in *Pacific Bell v. Linkline*, the Court rejected a "price squeeze" theory of liability because the plaintiff failed to allege that the defendant was pricing its services below cost.[16] In both *Linkline* and *Weyerhaeuser*, the Court emphasized the importance of providing clear guidance to companies to avoid chilling procompetitive pricing practices. For example, in *Linkline* Chief Justice Roberts stressed the "importance of clear rules in antitrust law" and noted that the Court was reluctant to chill aggressive price competition.[17] Ultimately, this line of Supreme Court decisions evidences a clear preference for applying a price/cost test to above-cost pricing practices.[18] The majority of district and circuit courts that have addressed this issue apply some form of a price/cost test—both to single product and bundled discounts.[19] For example, the First, Second, and Eighth Circuit Courts of Appeal have

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Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104 (1986); *Matsushita Elec. Industrial Co v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

[12] *See, e.g.*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

[13] *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 319 (2007) (citations omitted).

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

[15] *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007).

[16] *Pacific Bell Telephone Co. v. Linkline Communications*, 555 U.S. 438 (2009) ("To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim").

[17] *Id.* at 451-452.

[18] *See ZF Meritor v. Eaton,* 696 F.3d 254, 317, (Greenberg, J. dissenting) ("The Supreme Court's decisions in the above cases require that inferior courts recognize that in general above-cost pricing practices are not anticompetitive and thus do not violate the antitrust laws. Time and time again, the Court has made clear that above-cost pricing practices generally do not threaten competition in the marketplace").

[19] *See, e.g., Southeast Missouri Hosp. v C.R. Bard, Inc.*, 642 F.3d 608 (8th Cir. 2011) (applying price/cost test to dismiss claims that defendant gave discounts in exchange for exclusive listings of its products); *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008) (applying price/cost to dismiss claim that defendant offered bundled discounts to customers); *NicSand, Inc. v. 3M Co.*, 507 F.3d 442 (6th Cir. 2007) (applying price/cost test to dismiss claim that defendant made payments in exchange for exclusivity at retailer stores);

applied a price/cost test to single product discounts.[20] The Ninth Circuit has applied a variation of the price/cost test—the discount attribution test—to bundled discounts.[21] A modified version of the discount attribution test was endorsed by the DOJ Antitrust Division in *U.S. v. United Regional Health Care*, where the Division took the position that conditional discounts can have exclusionary effects when they result in pricing below an appropriate measure of cost after discounts given on incontestable business are reallocated to contestable business.[22]

Those courts endorsing the use of a price/cost test recognize the Supreme Court's strong preference for preserving pricing freedom. As aptly summarized by the Ninth Circuit in *PeaceHealth*, where the court adopted a variation of the price/cost test:

> One of the challenges of interpreting and enforcing the amorphous prohibitions of §§ 1 and 2 of the Sherman Act is ensuring that the antitrust laws do not punish economic behavior that benefits consumers and will not cause long-run injury to the competitive process. A bundled discount, however else it might be viewed, is a price discount on a collection of goods. The Supreme Court has undoubtedly shown a solicitude for price competition . . . . . Given the endemic nature of bundled discounts in many spheres of normal economic activity . . . 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.[23]

The Third Circuit, in comparison, applies a bifurcated standard that focuses on whether price or non-price conduct is the predominant method of exclusion. In 2003, in *LePage's Inc. v. 3M*, the Third Circuit declined to apply the price/cost test to the defendant's use of

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Virgin Atlantic Airways v. British Airways PLC, 257 F.3d 256 (2d Cir. 2001) (applying price/cost test to dismiss claim that defendant awarded discounts to agents and customers that encouraged them to meet certain targets); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000) (applying price/cost test to dismiss claim that defendant gave discounts that increased as customers bought greater percentages); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983) (applying price/cost test to dismiss claim that defendant gave discount to customer to incentivize it to buy several years worth of customer's needs for the product).

[20] *Virgin Atlantic Airways v. British Airways PLC*, 257 F.3d 256 (2d Cir. 2001); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983).

[21] *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008) (Under the discount attribution test, the full amount of the discounts given by a defendant are allocated to the competitive product. If the resulting price of the competitive product is below the defendant's incremental cost to produce them, then the trier of fact may find the bundled discount exclusionary under Section 2).

[22] *U.S. v. United Regional Health Care Sys.*, No. 7:11-cv-00030, at pp. 14-15 (Feb. 25, 2011).

[23] *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 902-903 (9th Cir. 2008).

bundled discounts. Instead, the court held that bundled discounts offered by a monopolist are unlawful where they substantially foreclose portions of the market to a competitor that does not provide an equally diverse group of services.[24] This case was widely criticized for not providing a workable and predictable standard to the business community.[25] More recently, in *ZF Meritor v. Eaton*, the Third Circuit distanced itself from the *LePage's* decision, finding that the price/cost test could be applicable in limited circumstances.[26] In *ZF Meritor*, the Third Circuit observed that the Supreme Court's recent decisions in *Weyerhaeuser* and *Linkline* reinforced the importance of the price/cost test and concluded that the test should apply in single product cases where price is "clearly the predominant mechanism of exclusion."[27] Where price is found not to be the predominant mechanism, the court held that a rule of reason analysis should apply. Subsequently, in *Eisai v. Sanofi-Aventis*, a district court within the Third Circuit applied the price/cost test to dismiss a challenge to a market share discount program after finding that price was clearly the predominant mechanism of exclusion.[28]

The Chamber believes that the Third Circuit's "predominant mechanism of exclusion" screen is not a workable standard for determining whether the price/cost test or the rule of reason should apply in cases involving both price and non-price conduct. The notion of predominance is inherently vague, it is difficult for businesses to predict how a future court would select the predominant element, and the court's application of the concept in *ZF Meritor* underscores the ambiguity and lack of predictability afforded by this screen.[29]

Under the rule of reason test applied in *ZF Meritor*, the Third Circuit concluded that the totality of Eaton's conduct – including the conditional pricing terms and other non-price conduct – amounted to *de facto* exclusive dealing.[30] This exclusionary "broth" analysis

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[24] *LePage's Inc. v. 3M* , 324 F.3d 141 (3d Cir. 2003).
[25] *See, e.g.*, Brief for United States as *Amicus Curiae*, *3M v. LePage's Inc.*, 542 U.S. 953 (2004), *denying cert. to* 324 F.3d 141 (3d Cir. 2003) (criticizing the Third Circuit's decision for providing little guidance on how Section 2 should be applied to bundled discounts, failing to explain why 3M's conduct was unlawful, and potentially encouraging challenges to procompetitive bundled rebate programs); *see also Cascade Health Solutions*, 515 F.3d 833, 903 (9th Cir. 2008) (declining to endorse the Third Circuit's definition of when a bundled discount constitutes exclusionary conduct under Section 2 because of the risk of condemning procompetitive discounting).
[26] *ZF Meritor v. Eaton*, 696 F.3d 254 (3d Cir. 2012).
[27] *Id.* at 275.
[28] *Eisai v. Sanofi-Aventis*, NO. 08-4168 (D.N.J. Mar. 28, 2014).
[29] In rejecting application of the price/cost test, the court looked to the plaintiffs' characterization of the case ("Plaintiffs consistently argued that the LTAs, in their entirety, constituted *de facto* exclusive dealing contracts…."). *ZF Meritor*, 696 F.3d at269.
[30] *Id.* at 289, n. 20 ("Rather than analyzing the alleged exclusionary provisions in a vacuum, we analyze these provisions in the larger context of the LTAs as a whole, and we recognize that Eaton maintained above-cost prices. We conclude that ZF Meritor presented sufficient evidence for the jury to find that, even though not every provision was exclusionary, the LTAs as a whole functioned as exclusive dealing agreements that adversely affected competition").

harkens back to the D.C. District Court's opinion in *United States v. Microsoft* in which the court concluded that Microsoft could be held liable under Section 2 both for its individual actions and for its collective course of conduct.[31] The alternative course-of-conduct holding was later reversed by the D.C. Circuit Court, which instead analyzed the competitive effects of each type of conduct engaged in by Microsoft.[32] As discussed later in this paper, the Chamber believes the better approach is to apply a price/cost test to CPPs and the rule of reason to other non-price conduct.

Economic Commentary Regarding CPPs

Outside the courts there is a diverse set of viewpoints on how to analyze CPPs. On one side of this debate, there are many economists, academics and practitioners who believe that a price/cost test should be used to evaluate the exclusionary potential of CPPs. For example, the *amici curiae* brief supporting Eaton's petition for certiorari in the *ZF Meritor* case argued, *inter alia*, that above-cost market share discounts do not constitute de facto exclusive dealing and do not threaten equally efficient competitors.[33] This brief was submitted on behalf of 18 noted scholars, including Professor Hovenkamp and former FTC Chairman William Kovacic. The Antitrust Modernization Commission recommended using a variation of the discount attribution test to evaluate bundled discounts. [34] Likewise, many practitioners, including Workshop participant Leah Brannon, argue that the price/cost test provides the most predictable standard to the business community without stifling procompetitive discounting.[35]

Other commentators, including FTC Commissioner Joshua Wright, reject use of the price/cost test and, instead, propose applying the rule of reason to CPPs. Commissioner Wright, for example, has proposed applying an exclusive dealing type of foreclosure analysis to loyalty discounts.[36] He believes that a properly structured foreclosure inquiry would do a

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[31] *United States v. Microsoft*, 87 F.Supp. 2d 30, 32 (D.D.C. 2000) ("[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").
[32] *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001).
[33] Brief for Eighteen Scholars as *Amici Curiae* in Support of Petitioner, *Eaton Corp. v. ZF Meritor*, 133 S. Ct. 2025 (2013), *denying cert. to ZF Meritor v. Eaton*, 696 F.3d 254 (3d Cir. 2012).
[34] The Antitrust Modernization Commission, a bipartisan Congressionally chartered group of experts, recommended a three-part test for bundled discounts, requiring a plaintiff to show: (1) after allocation of all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses; and (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.
[35] *See* Presentation of Leah Brannon at CPP Workshop.
[36] Commissioner Wright, "Simple but Wrong or Complex but more Accurate? The case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts," Remarks of Joshua D. Wright at Bates White 10th Annual Antitrust Conference (June 3, 2013) ("In deciding whether or not to pursue an action based upon

better job of minimizing the risks of false negatives and false positives.[37] Commissioner Wright also commented that the price/cost test might be more difficult to administer than originally thought especially in high-fixed cost industries.[38]

Some critics have suggested that loyalty discounts may not even be true discounts; rather, the buyer is being penalized (charged a price higher than the but-for price) if it fails to meet the loyalty conditions. In effect, the disloyalty price would exceed the monopolist's profit maximizing price and the loyalty discount or rebate would be at or near the profit maximizing (or but-for) price.[39] These and other theories have been put forward as reasons for abandoning a price/cost test and examining the totality of the defendant's conduct.

The *ZF Meritor amici* brief took issue with the theory that loyalty discounts are often disguised penalties, based on the assumption that the loyalty price is simply a discount back to the profit maximizing level (or the price that would prevail in the absence of the CPP), calling that assumption "not economically plausible. . . ."[40] Professor Crane, who signed the brief and participated in the workshop, has written more extensively about the penalty theory and believes that such a pricing strategy, if it exists, would harm a monopoly seller by encouraging buyers to seek alternative sources of supply, whether at the profit maximizing discount price or the higher disloyalty price.[41] While Professor Elhauge and others argue that the penalty theory is real and not just hypothetical,[42] recent published decisions such as *ZF Meritor* do not reveal facts consistent with this theory.[43] For example, while not dispositive, the Third Circuit noted that "Eaton's prices were generally lower than Plaintiffs'

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loyalty discounting by a dominant firm, an antitrust enforcement agency ought to focus primarily on three issues. First, the agency should select an appropriate theoretical model of harm . . . . Second, the agency must consider whether the loyalty discounts have resulted in efficiencies… . Finally, the agency must ask and answer whether the discounting has resulted in anticompetitive effects"); Workshop participants Jonathan Jacobson and Professor Steven Salop endorsed similar approaches. *See* Presentations of Jonathan Jacobson and Professor Steven Salop at CPP Workshop.

[37] Commissioner Wright, "Simple but Wrong or Complex but more Accurate? The case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts," Remarks of Joshua D. Wright at Bates White 10th Annual Antitrust Conference (June 3, 2013).

[38] *Id.*

[39] *See* Presentation of Einer Elhauge at Conditional Pricing Practices Workshop (June 23, 2014), at p.4; Presentation of Steven Salop at Conditional Pricing Practices Workshop (June 23, 2014), at p.11.

[40] Brief for Eighteen Scholars as *Amici Curiae* in Support of Petitioner, *Eaton Corp. ZF Meritor*, 133 S. Ct. 2025 (2013), *denying cert.* to *ZF Meritor v. Eaton*, 696 F.3d 254 (3d Cir. 2012).

[41] Daniel A. Crane, "Bargaining over Loyalty," 92 Tex. L. Rev. 253 (Dec. 2013).

[42] Presentation of Einer Elhauge at Conditional Pricing Practices Workshop (June 23, 2014), at p.4.

[43] In his workshop presentation, Professor Elhauge references a case in which he testified as an expert on behalf of the plaintiff. *See* Presentation of Einer Elhauge at Conditional Pricing Practices Workshop (June 23, 2014), at 4, *citing Retractable Technologies Inc. v. Becton Dickinson*, No. 2:08-CV-16 (E.D.Tex). Elhauge claims that the defendant raised disloyalty prices 187 times but never lowered loyalty prices. Although the jury returned a verdict in favor of the plaintiff on some counts, it ruled against the plaintiff on the pricing claims (including a penalty theory). There is no published decision summarizing the facts.

prices" during the relevant period.[44] Certainly, a key objective of the price/cost test is to avoid chilling procompetitive discounts that result in lower prices. However, adopting a rule that permits CPPs to be challenged under a penalty theory is not as straightforward as it might seem and inevitably opens the door to a more expansive inquiry that will not be limited to whether the seller has given a real discount. One has to look no further than the Third Circuit's decision in *ZF Meritor*, which characterized Eaton's withholding of rebates for failure to meet loyalty conditions as a penalty.[45] Given the questionable prevalence of this practice and the incentives it creates for new and existing competitors, an exception to the application of the price/cost test does not seem warranted.[46]

While it is clear there is some dissatisfaction with the price/cost test, as the workshop highlighted, there is little convergence among those dissatisfied with the test as to how a rule of reason analysis might be structured. In fact, as Professor Hovenkamp recently noted in an article discussing the weaknesses of the price/cost test, the test survives because "no one has been able to come up with something better."[47]

Finally, outside the United States, the treatment of CPPs is much different. For example, in its recent *Intel* decision, the European Commission condemned exclusivity rebates as virtually *per se* unlawful when undertaken by a company in a position of dominance.[48] The court explicitly found that it was not required to make an assessment as to whether the rebates actually foreclosed competition as the rebates were by their very nature capable of restricting competition. Such a rationale that short-cuts real analysis and instead relies on *per se* like approaches represents a real threat to the development and application of evidence based economic analysis in jurisdictions around the world. The Chamber is deeply concerned when this kind of approach is taken and believes that poorly supported decisions are among the greatest concerns in international competition enforcement. Given that the

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[44] *ZF Meritor v. Eaton*, 696 F.3d 254, 266-267 (3d Cir. 2012). In the FTC's 2010 *Intel* case (which was settled by consent order), the Commission claimed in its Analysis of the Proposed Consent Order that, through its market share discounts and rebates, Intel effectively raised the prices of its competitors' products "rather than lowering the effective prices of its own." However, in the same discussion, the Commission states that Intel's "retroactive quantity rebates were of a type that could readily disguise effective below-cost pricing, which would, under the circumstances, present a strong risk of predatory effects." *See* Analysis of Proposed Consent Order & Aid Public Comment, *In re Intel*, Dkt No. 9341 (Aug. 4, 2010). Of course, this is all speculation because the case was never litigated, but the Commission's own description of Intel's alleged conduct does not fit the penalty theory.

[45] *See* Brief for Eighteen Scholars as *Amici Curiae* in Support of Petitioner, *Eaton Corp. v. ZF Meritor*, 133 S. Ct. 2025 (2013), *denying cert. to ZF Meritor v. Eaton*, 696 F.3d 254 (3d Cir. 2012), at pp. 8-13.

[46] In certain circumstances, it may be appropriate to apply rule of reason principles to other types of penalties that are not part of the pricing terms offered by sellers.

[47] Herbert J. Hovenkamp, "The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal, " Univ. of Iowa Legal Studies Research Paper (June 2014), at pp. 17-18.

[48] *See Intel v. European Commission*, case no. T-286/09 (2014).

law outside the EU is far less developed,[49] the approach that the U.S. antitrust agencies ultimately take can have an influential impact on the enforcement policies adopted by these other jurisdictions. Consequently, should the U.S. create an unworkable approach, undermining the significant value of the cost-price test, other jurisdictions will find their practices validated, which will hurt consumers around the world and subject businesses to a lack of certainty.

CPPs Should be Evaluated Solely Under a Sherman Act, Section 2-Type Analysis

CPPs have the potential to harm competition only where certain market conditions are present. Namely, unless a firm possesses substantial market power, the likelihood of exclusionary effects as a result of CPPs are very low. [50] Thus, CPPs should be evaluated solely under a Section 2-type analysis and plaintiffs should be required to show that the defendant possesses market power.[51] Where a firm does not possess market power, CPPs are highly unlikely to result in exclusionary effects and should be found lawful.[52] Accordingly, a market power screen should be applied before application of the price/cost test to eliminate those cases where exclusionary effects are improbable.[53]

Application of Section 2 to CPPs is consistent with Supreme Court guidance. Although the Court has not directly evaluated this issue, in *Brooke Group* the Court held that the same predation standard that applies in Section 2 cases should also apply in Robinson-Patman primary line discrimination cases.[54] Consistent with this approach, the same standard that is applied to predatory pricing under Section 2 should apply to CPPs as well.

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[49] In a 2009 report on loyalty discounts and rebates, prepared by the ICN's Unilateral Conduct Working Group, the report noted that, of the 34 agencies responding to a questionnaire, "[m]any responses acknowledged a lack of experience in evaluating single-product loyalty discounts and rebates." During the preceding 10 years, the 34 responding agencies (including the US and EC) brought a total of approximately 45 cases in which a violation was established. Similar limited agency experience was noted in a separate 2009 ICN report on tying and bundled discounts, which observed that few of the 35 responding agencies had conducted five or more in-depth tying and bundled discount investigations over the preceding decade.

[50] AAG William Baer, Opening Remarks to Conditional Pricing Practices Workshop (June 23, 2014) ("Concerns arise when a monopolist uses loyalty or bundled pricing to restrict competition and maintain its market power within a supply chain").

[51] Areeda & Hovenkamp, Antitrust Law ¶749 ("[T]he ordinary tools of §2 analysis are usually sufficient to enable an understanding of likely competitive effects").

[52] *Id.* ("Discounting is presumptively procompetitive and should be condemned only in the presence of significant market power and proven anticompetitive effects").

[53] Some participants in the workshop suggested that CPPs could also harm competition under a collusive effects theory, even where a seller does not enjoy monopoly or near-monopoly power. These comments do not address that theory and, absent evidence of conduct that violates Section 1 of the Sherman Act, it is difficult to imagine how workable antitrust rules could be applied to such non-exclusionary conduct.

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

The Chamber strongly believes that Section 2 is a sufficient enforcement tool to analyze CPPs. Application of the FTC's Section 5 authority to CPPs is unwise and unnecessary. Courts have successfully addressed CPPs under a Sherman Act Section 2 standard. There is no gap in the reach of Section 2 that warrants developing a new jurisprudence for CPPs based on Section 5. Indeed, while the Commission's 2009 case against Intel, which was the most important Section 5 case in several decades, was based on both Section 5 and Section 2, the reference to Section 5 was unnecessary because, as Commissioner Rosch noted in his Concurring Statement, all of the offenses alleged were subject to Section 2.

Moreover, unlike Section 2 application, application of Section 5 to CPPs would create considerable uncertainty within the business community. Firms would be reluctant to discount if those practices were subject to an open-ended, unstructured, and quite difficult-to-predict Section 5 standard. As several courts have noted over the years, the use of Section 5 may lead to unpredictability by upsetting settled antitrust principles.[55] Adding to the uncertainty and unpredictability, the use of Section 5 would also subject CPPs (and possibly even direct competitors employing them) to different legal standards depending on which antitrust agency is investigating the practice. It is critical to the business community that the agencies adopt a unified approach to their treatment of CPPs; application of a pure Section 5 approach would do just the opposite.

The Chamber Believes that a Price-Cost Test for Analyzing the Exclusionary Effects of CPPs is Preferable to Other Theories of Liability

As noted above, the Workshop presentations and the economic/legal literature on CPPs reflect a robust ongoing debate over the competitive effects of these pricing practices and the appropriate antitrust principles for evaluating such conduct.

Although the Chamber recognizes that the price/cost test may have some limitations, it strongly believes that the test does the best job of balancing the risk of false positives and false negatives while not discouraging procompetitive discounting. A rule of reason type analysis would subject a multitude of CPP practices to the caprices of the fact finder. Although this may arguably reduce false negatives, it would almost certainly increase false positives and discourage firms from discounting. In a recent paper,[56] Professor Hovenkamp expressed similar views. While noting that "there is a great deal not to like about the Areeda-Turner test," it survives mainly for two reasons:

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[55] *See, e.g., E.I. DuPont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984).

[56] Herbert J. Hovenkamp, "The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal," Univ. of Iowa Legal Studies Research Paper (June 2014) ; *see also* Commissioner Wright, "Simple but Wrong or Complex but more Accurate? The case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts," Remarks of Joshua D. Wright at Bates White 10th Annual Antitrust Conference (June 3, 2013).

> First, it tends to keep predatory pricing cases out of court and away from juries, two properties that make it attractive to judges. *Second, and more importantly, no one has been able to come up with something better.* A superior test would have to correct for the Areeda-Turner test's false negatives without going in the other direction and producing excessive false positives. Second, it would have to be administrable by the full range of tribunals authorized to hear predatory pricing cases, which today includes jury trials.[57] (emphasis added)

Limitations of a Rule of Reason-Type Analysis

Advocates of an alternative legal standard to the price/cost test often propose substituting a rule of reason analysis based on principles applicable to exclusive dealing. Professor Salop, a leading proponent of this approach, outlined at the workshop a four-part legal standard for evaluating CPPs, pursuant to his raising rivals costs paradigm.[58] This analysis would look at a variety of competitive issues, including (1) whether "reasonable counterstrategies" were tried by competitors, (2) the extent to which competitors were harmed (*e.g.*, magnitude of lost sales, cost increases attributable to lost distribution, marginal cost increases from lower scale, foreclosure), and (3) harm to competition (*e.g.*, increase in rivals' costs, likely impact on market prices, likelihood that competition will be softened or coordination occur, market power of the excluding firm(s), sufficiency of non-excluded competitors). Salop's standard would also take into account the price/cost test, but it would no longer be dispositive as to the legality of the pricing practices.

Commissioner Wright advocates a similar approach that relies on exclusive dealing law and "moves the legal and economic analyses of the underlying conduct (*i.e.*, discounting and exclusivity) closer together rather than further apart."[59] Wright cites the *Intel* and *Transitions Optical* cases as examples of the Commission moving in the direction he is suggesting, at least in terms of the general legal approach.[60]

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[57] Herbert J. Hovenkamp, "The Areeda-Turner Test for Exclusionary Pricing: A Critical Journal," Univ. of Iowa Legal Studies Research Paper (June 2014), at pp. 17-18.
[58] Presentation of Steven Salop at CPP Workshop, at p.25.
[59] Commissioner Joshua Wright, "Simple but Wrong or Complex but more Accurate? The case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts," Remarks of Joshua D. Wright at Bates White 10th Annual Antitrust Conference (June 3, 2013), at p.33.
[60] Because both cases resulted in consent orders, it is difficult to know precisely how the FTC treated the pricing conduct in each case. In the *Transitions Optical* case, the Commission focused primarily on contractual exclusivity agreements but also alleged that bundled discounts contributed to the exclusivity. No reference is made in the complaint or consent order analysis as to whether a price/cost test was considered. *See* Analysis to Aid Public Comment, *In re Transitions Optical*, Dkt No. C-4289 (Mar. 3, 2010). In the *Intel* case (which involved both price and non-price conduct), the Commission noted in its Analysis of Proposed Consent Order that it applied a *PeaceHealth* price/cost test for certain types of bundled discounts. However, the

The *LePage's* and *ZF Meritor* decisions provide real-world examples of litigated cases where a rule of reason analysis was applied to the defendants' CPPs. In *LePage's,* the Third Circuit stated that the "relevant inquiry is the anticompetitive effect of 3M's exclusionary practices considered together."[61] The court went on to note that the analysis should focus on "the monopolist's conduct taken as a whole rather than considering each aspect in isolation."[62] The *amicus* brief filed by the United States in connection with 3M's petition for certioriari in that case, while asking the Supreme Court to deny the petition, nevertheless criticized the Third Circuit's analysis. For example, the brief pointed out that the court "provided few useful landmarks on how Section 2 should apply as a general matter in future cases involving bundled rebates."[63] The *amicus* filing further noted that "the court of appeals failed to explain precisely why the evidence supported a jury verdict of liability in this case, including what precisely rendered 3M's conduct unlawful."[64]

In *ZF Meritor*, the court limited the reach of the *LePage's* holding in cases involving single product loyalty discounts. While holding that the price/cost test should apply in such cases where price is clearly the predominant mechanism of exclusion, the court concluded that price was not the predominant mechanism of exclusion in the case. As noted above, this blurring of the price and non-price allegations in the case (which carried over to the rule of reason merits analysis applied by the court) puts in doubt the application of the price/cost test in any situation where non-price conduct is an element of the case, including the terms of the conditional pricing itself.

While the rule of reason analysis suggested by Professor Salop, Commissioner Wright, and others represents a significant improvement over the reasoning in these cases, it still entails a complicated multi-faceted analysis that is likely to create considerable uncertainty for companies that possess some degree of market power and wish to implement CPPs. This concern is heightened by the fact that most of the cases in which CPPs are challenged involve private litigation where juries are being asked to resolve complex factual and economic issues.

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agency further commented that it might apply other legal standards in the future, including a *LePage's*-type standard. *See* Analysis of Proposed Consent Order & Aid Public Comment, *In re Intel*, Dkt No. 9341 (Aug. 4, 2010), at p.10.

[61] *LePage's Inc. v. 3M* , 324 F.3d 141, 162 (3d Cir. 2003).

[62] *Id.*

[63] Brief for United States as *Amicus Curiae*, *3M v. LePage's Inc.*, 542 U.S. 953 (2004), *denying cert. to* 324 F.3d 141 (3d Cir. 2003), at p.16.

[64] *Id.*

Price/Cost Test is a superior test

The Areeda-Turner predatory pricing test is well-established and has been widely adopted by many courts, not only for simple linear price discounts but also for CPPs. While the test is not perfect and can raise challenging accounting issues, it still provides greater predictability than other multi-factor legal standards. That is because firms that are potentially subject to Section 2 scrutiny are in a position to know their own costs and determine with some degree of confidence whether their pricing conforms to the price/cost test, including any applicable variations of that test. A broad rule of reason analysis that examines not only the defendant's conduct but also a host of external factors presents an entirely different picture. That kind of analysis is appropriate for evaluating the competitive implications of most firm conduct, but it raises more serious predictability and administrability concerns in the pricing context.

Although the Supreme Court has endorsed the use of a price/cost test on many occasions, it has not yet determined how that test should be applied. The average variable cost test ("AVC") developed by Areeda and Turner has been generally accepted by the courts as the standard for judging predatory pricing, but variations of that standard have emerged in the past several years. As noted above, in *PeaceHealth*, the Ninth Circuit applied a discount attribution test to a bundled discount, whereby the discounts for non-competing business were applied to the competing business. In 2009, the Antitrust Division applied a variation of the discount attribution test in a consent decree involving United Regional Health Care Systems, with the attribution linked to contestable products instead of the potentially broader category of all competitive products.

Another variation of AVC is a pricing test based on average avoidable cost ("AAC"). This test focuses on the costs incurred (variable and fixed) in pursuing an alleged predatory strategy. Thus, if a firm expands output or redeploys assets to respond to a competitive threat, the AAC test would examine whether the incremental revenues generated by this strategy exceed the incremental costs, not just the cost of the last unit. The Antitrust Division unsuccessfully pursued this theory in a 2003 case against American Airlines, in which the Division alleged that the airline responded to new entry on certain routes by reducing pricing to match the new entrant's prices, adding flights or larger planes and increasing the number of seats offered at the reduced prices.[65] The government further alleged that the predatory strategy resulted in the new entrants exiting the routes and the defendant recouping its investment by raising prices, reducing flights and returning to its prior marketing strategy.[66]

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[65] *United States v. AMR Corp*., 335 F.3d 1109 (10th Cir. 2003).
[66] Without rejecting the AAC theory, the court concluded that the alternative tests advanced by the government for measuring incremental costs were "fatally flawed in their application, and fundamentally unreliable." *Id.* at 1120.

The Chamber recognizes that modifications to the AVC may be appropriate in certain circumstances but cautions that additional analysis is needed to better understand the practical and competitive implications of any such changes. For example, in applying a discount attribution test to market share discounts that cover a variety of related products or services, it may be difficult to determine which are contestable and which are not. Competitor strategies and other market conditions complicate the analysis, and the proper allocation of costs is highly sensitive to that analysis and the determination of what is contestable.

Finally, the Chamber would note that use of a price/cost test does not preclude application of the rule of reason to allegations of exclusionary non-price conduct in cases where CPPs are also being challenged. However, the price/cost test should apply to the CPPs, including the conditional terms of those pricing practices. Indeed, many of the cases dealing with CPPs in recent years (*e.g.*, *ZF Meritor* and the FTC's *Intel* and *Transitions Optical* consent orders) included allegations relating to non-price conduct distinct from CPPs.

Conclusion

For the foregoing reasons, the Chamber believes that an appropriate price/cost test should continue to be applied to all types of CPPs, as the majority of courts already do, pursuant to a Sherman Act, Section 2-type analysis. Other non-price conduct (*i.e.*, conduct separate and apart from the CPPs) would be subject to a rule of reason analysis under Section 2 standards that examines the competitive effects of each type of alleged exclusionary conduct.

Sincerely,

Sean Heather