

## AFTERWORD: CALIBRATING THE LEXICON OF CONDITIONAL PRICING PRACTICES

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As is clearer today than ever before, we are not always on the same page. With the rise—or perhaps just recognition—of communication “echo chambers,” it is increasingly important that policy discussions begin with linguistic calibration. Otherwise, we talk past one another and make sense only to those who already speak our language. As this Symposium demonstrates, the language of conditional pricing practices (CPPs) is in need of calibration.

The language of antitrust law and economics is dominated by degrees of change: “*Marginal* cost,” “cross-price *elasticity*,” “upward pricing *pressure*,” “substantially *lessen* competition,” “*tend* to create a monopoly.” Speaking in degrees of change often simplifies the legal and factual challenges of antitrust. A merger analysis, for instance, may turn on whether prices are likely to increase by a degree, but does not require agreement about the optimal level of competition in a particular market, the ideal number of competitors, or picking the exact price suppliers in an industry should be able to charge.

The language of CPPs is different—absolutes dominate. In *ZF Meritor*, the Third Circuit upheld a finding that Eaton unlawfully excluded a rival transmission manufacturer via loyalty rebates, citing evidence that “compliance with the market penetration targets was *mandatory*,” and that “Eaton leveraged its position as a supplier of *necessary* products to coerce the OEMs into entering the [long-term agreements].”<sup>1</sup> When it upheld a \$1.2 billion fine on Intel for use of loyalty rebates, the EU General Court stated that “it is inherent in a strong dominant position . . . that, for a substantial part of the demand, there are *no* proper substitutes for the product supplied . . . . The supplier in a

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<sup>1</sup> *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 278, 285 (3d Cir. 2012) (emphasis added).

dominant position is thus, to a large extent, an *unavoidable* trading partner.”<sup>2</sup> And in *PeaceHealth*, the Ninth Circuit stated that “*coercion* is often the touchstone issue in assessing a claim of illegal tying.”<sup>3</sup>

Paradoxically, the prevalence of absolutes can hamper our ability to communicate effectively about the law and facts of CPPs. This can be seen in the wide range of meanings imputed to the key terms. For instance, the plaintiffs’ expert in *Eisai v. Sanofi-Aventis*, Einer Elhauge, defined “incontestable demand” as the “units that the customer is less willing to switch to rival products” because of “unique indications, departmental preferences, and doctor habit.”<sup>4</sup> However, Benjamin Klein and Andres Lerner describe “incontestable sales” as “sales for which rivals cannot reasonably compete” in a recent article on loyalty discounts.<sup>5</sup> Different still, the European Commission defines the “non contestable” portion of demand as “the amount that would be purchased by the customer from the dominant undertaking in any event.”<sup>6</sup>

In the opening comments to the CPPs workshop jointly sponsored by the Federal Trade Commission and the Department of Justice Antitrust Division in 2014, Commissioner Maureen Ohlhausen commented that “treatment of conditional pricing practices under the antitrust laws is a complex and multifaceted issue that has challenged everyone in our bar for decades, and has engendered a variety of opinions and even a circuit split.”<sup>7</sup> The intervening years have brought little resolution. Indeed, it often feels as if everyone is speaking past one another; making sense only to those who agree on the meaning of terms like “necessary for competition.” The articles in this Symposium not only reflect this challenge, they offer steps and suggestions for linguistic level setting—serving as an essential first step for more collaborative and productive discussions in the future.

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<sup>2</sup> Case T-286/09, *Intel v. Comm’n*, ECLI:EU:T:2014:547, ¶ 91 (GC June 12, 2014), eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62009TJ0286&from=EN (emphasis added).

<sup>3</sup> *Cascade Health Sols. v. PeaceHealth*, 515 F.3d 883, 914 (9th Cir. 2008) (emphasis added).

<sup>4</sup> *Eisai Inc. v. Sanofi-Aventis U.S., LLC*, 821 F.3d 394, 401, 406 (3d Cir. 2016) (emphasis added).

<sup>5</sup> Benjamin Klein & Andres Lerner, *Price-Cost Tests in Antitrust Analysis of Single Product Loyalty Contracts*, 80 ANTITRUST L.J. 631, 639 (2016).

<sup>6</sup> Eur. Comm’n, *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, ¶ 39 (Dec. 3, 2008); see also Joshua D. Wright, Comm’r, Fed. Trade Comm’n, *Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts*, Remarks at the Bates White 10th Annual Antitrust Conference 18 (June 3, 2013), [www.ftc.gov/sites/default/files/documents/public\\_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf).

<sup>7</sup> U.S. Dep’t of Justice & Fed. Trade Comm’n, *Workshop Transcript: Conditional Pricing Practices: Economic Analysis and Policy Implications 7* (June 23, 2014), [www.ftc.gov/system/files/documents/public\\_events/302251/cpp\\_workshop\\_transcript.pdf](http://www.ftc.gov/system/files/documents/public_events/302251/cpp_workshop_transcript.pdf).

Richard Steuer keys into the importance of clarifying the language of CPPs in his article, *Musthavedness*.<sup>8</sup> As he explains, “[a]ll ‘conditional pricing’ cases, whether they involve bundled discounts, loyalty discounts, or tying by means of differential pricing, rest on evidence that the seller markets a ‘must have’ product or service, which confers market power.”<sup>9</sup> He also recognizes the weakness in these cases is that “the standard employed for determining ‘musthavedness’ sometimes is not much more exacting than the ‘I know it when I see it’ test.”<sup>10</sup> His article chronicles the use of “musthavedness” throughout the case law and then catalogs and describes the contours of what the concept seems to encompass. He also proposes a test for musthavedness that could—if adopted (or even if just debated)—serve as a level-setting framework for more structured and meaningful dialogue going forward.

Jonathan Jacobson and Daniel Weick tackle the meaning of “foreclosure.”<sup>11</sup> Quoting the 2001 U.S. *Microsoft* decision, they say “we know that ‘in all cases the plaintiff must both define the relevant market and prove the degree of foreclosure.’ But what does that mean?”<sup>12</sup> To answer this, Jacobson and Weick propose a shift in focus—looking beyond the allegedly “foreclosing” actions of the defendant to consider the capacity of the plaintiff to counteract the effects. The authors trace the evolution of “foreclosure” and find that “less attention has been paid to . . . whether any foreclosure can be defeated, or at least mitigated, by reasonable countermeasures.”<sup>13</sup> They highlight the dangers in drawing equivalence between “foreclosure” and “anticompetitive,” and argue that focusing on “Countering Exclusion” better deters actual competitive harm while not over deterring procompetitive vigorous competition.<sup>14</sup>

Taking care to detail the boundaries of key concepts and terms, Steven Salop argues for the abandonment of the price-cost test and adoption of a “Raising Rivals’ Costs Foreclosure Paradigm” to evaluate CPPs.<sup>15</sup> His proposed paradigm “generally describes exclusionary conduct that totally or partially ‘forecloses’ competitors from access either to critical inputs or customers, with the effect of causing them to raise their input prices or reduce their output.”<sup>16</sup> He goes on to clarify the scope of the terms “critical input”

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<sup>8</sup> Richard M. Steuer, *Musthavedness*, *supra* this issue, 81 ANTITRUST L.J. 447 (2017).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 448.

<sup>11</sup> Jonathan M. Jacobson & Daniel P. Weick, *Countering Exclusion: The Complainant’s Obligation*, *supra* this issue, 81 ANTITRUST L.J. 423 (2017).

<sup>12</sup> *Id.* at 424.

<sup>13</sup> *Id.* at 423–24.

<sup>14</sup> *Id.* at 437–40.

<sup>15</sup> Steven C. Salop, *The Raising Rivals’ Cost Foreclosure Paradigm, Conditional Pricing Practices, and the Flawed Incremental Price-Cost Test*, *supra* this issue, 81 ANTITRUST L.J. 371 (2017).

<sup>16</sup> *Id.* at 376.

and “customer foreclosure.” Critical inputs, he explains, “can involve manufacturing inputs, such as raw materials, intellectual property, or distribution.”<sup>17</sup> And foreclosure of critical inputs includes not only that which causes the rival to exit the market entirely, but also instances where “a rival can cover its costs and remain viable” or “be a weaker and less efficient competitor if its distribution or other input costs are higher.”<sup>18</sup> Similarly, foreclosure of customers encompasses scenarios where the rival “may remain viable, but . . . [must] limit its output to a low level and constrain its ability and incentive to expand profitably, by reducing its capacity or by raising its effective cost of expansion” or is “relegate[d] . . . to a niche position at low output level, where it will provide less of a constraint on the pricing of the excluding firm(s).”<sup>19</sup>

Chiara Fumagalli and Massimo Motta do not go as far as Salop and argue for a cautious use of the price-cost test.<sup>20</sup> They note that there are circumstances in which the test can have an important role to play. For example, as a safe harbor to prevent exposing “firms to potential antitrust liability for using across-the-board price cuts to steal business,” the price-cost test can prevent chilling legitimate competition.<sup>21</sup> The authors also argue that “even when inefficient exclusion does not require below cost pricing, the price-cost test remains a useful and informative tool” for assessing competitive effects of CPPs.<sup>22</sup>

Sean Durkin argues for use of the discount-attribution test (a form of the price-cost test) to evaluate the competitive effects of loyalty discounts.<sup>23</sup> He challenges arguments that the test is suited only for predatory pricing. Durkin explains that, while it may not produce dispositive evidence of a lack of foreclosure, the test retains probative value in loyalty discount cases.<sup>24</sup> His argument rests on two key findings. The first is that “loyalty discounts can increase competition because they induce the more preferred seller to compete for contested sales.”<sup>25</sup> The second is that “loyalty discounts cannot foreclose an equally efficient seller.”<sup>26</sup> As a result, Durkin argues, the discount attribu-

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<sup>17</sup> *Id.* at 384.

<sup>18</sup> *Id.* at 384–85.

<sup>19</sup> *Id.* at 386–87.

<sup>20</sup> Chiara Fumagalli & Massimo Motta, *On the Use of Price-Cost Tests in Loyalty Discounts and Exclusive Dealing Arrangements: Which Implications from Economic Theory Should Be Drawn?*, *supra* this issue, 81 ANTITRUST L.J. 537 (2017).

<sup>21</sup> *Id.* at 570.

<sup>22</sup> *Id.* at 539.

<sup>23</sup> Sean Durkin, *The Competitive Effects of Loyalty Discounts in a Model of Competition Implied by the Discount Attribution Test*, *supra* this issue, 81 ANTITRUST L.J. 475 (2017).

<sup>24</sup> *Id.* at 476.

<sup>25</sup> *Id.* at 501.

<sup>26</sup> *Id.*

tion test can play a key role in helping to assess whether a seller's loyalty discount harms competition and consumers.<sup>27</sup>

As Michael Salinger shows in his article on all-unit discounts, even the terms “discount,” “exclusion,” and “incontestable” demand precision.<sup>28</sup> His model indicates that all-units “discounts” may not be discounts at all, but could actually result in higher prices (relative to those that would obtain when incremental discounts are used) when an incumbent, who enjoys a portion of incontestable demand, competes with an entrant for the contestable portion of demand.<sup>29</sup> Moreover, the discount results in higher prices without causing any exclusionary effect. In Salinger's model “competitors are not excluded and they end up with a share that approximately equals (and may even exceed) the share” that would result from competition on the merits.<sup>30</sup> Salinger also recognizes the sensitivity of his analysis to the meaning imputed to the term “incontestable.” His model assumes “that 20 percent of the market is contestable and that the purchaser prefers the entrant's product for 10 percent of its total purchases.”<sup>31</sup> However, as he highlights, “the key parameters that are assumed to be known in the model are never known in real cases.”<sup>32</sup>

Another way to add precision and articulation to a theory of competitive harm is to examine the theoretical underpinnings in light of empirical evidence. This is particularly important because CPPs are used frequently in real-world transactions. Nonetheless, there has been a noticeable dearth of empirical evidence about the effects of CPPs, particularly when measured against the abundance of theoretical economic work on the topic. Bogdan Genchev and Julie Holland Mortimer's thorough review of empirical studies finds wide-ranging and mixed competitive effects associated with CPPs.<sup>33</sup> They find evidence of positive consumer welfare effects in the video rental industry, evidence of exclusionary effects but also increased variety and choice in the confectionary industry, and evidence of short-run injury to competitors paired with long-run entry incentives in the video game and smartphone industries.<sup>34</sup> Their analysis indicates that the circumstances of the industry, features of the market, and unique elements of the underlying contractual arrangements are highly determinative.<sup>35</sup> The ambiguity of the empir-

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<sup>27</sup> *Id.*

<sup>28</sup> Michael A. Salinger, *All-Units Discounts by a Dominant Producer Threatened by Partial Entry*, *supra* this issue, 81 ANTITRUST L.J. 507 (2017).

<sup>29</sup> *Id.* at 527–31.

<sup>30</sup> *Id.* at 533.

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

<sup>32</sup> *Id.*

<sup>33</sup> Bogdan Genchev & Julie Holland Mortimer, *Empirical Evidence on Conditional Pricing Practices: A Review*, *supra* this issue, 81 ANTITRUST L.J. 343 (2017).

<sup>34</sup> *Id.* at 355–57, 362–65, 366–69.

<sup>35</sup> *Id.* at 370.

ical results regarding the direction of the competitive effects of CPPs supports Genchev and Mortimer's recommendation that antitrust agencies and courts draw on empirical findings as a check on theory-based inferences. Their work also highlights the importance of developing additional empirical studies that help define and refine our understanding of CPPs.

Antitrust scholarship does not require that everyone agree with one another on a particular policy point. In an area as rapidly developing as CPPs, convergence in views about the optimal competitive framework, or ideal balance of regulatory certainty and flexibility, is improbable. Clarity of language, however, is within reach and worth pursuing for the sake of encouraging procompetitive use of CPPs (we are—after all—talking about discounts). A simple step towards a linguistically efficient legal framework for CPPs necessitates finding ways to communicate more clearly about the exclusionary acts and competitive effects that CPPs implicate. This Symposium hopes to offer contributions to that important effort.