What Can We Learn About the Application of the as Efficient Competitor Test in Fidelity Rebate Cases from the Recent US Case Law?

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It is accepted that the treatment of fidelity rebates is one of the most controversial topics in European Union competition law. It remains an outstanding issue despite the clear position of the Court of Justice in both the Intel and Post Danmark II judgments to depart from the strict form-based approach and to endorse an approach based on an evaluation of the possible anticompetitive effects of fidelity rebates. In particular, it remains unclear whether a price-cost test should be deployed. The conditions when a price-cost test should be applied to fidelity rebates as opposed to alternative approaches is a central issue in recent US case law of fidelity rebates and associated scholarly debate. This article examines the academic debate in US and compares the treatment of fidelity rebates on both sides of the Atlantic in an attempt to clarify under which circumstances a price-cost test should be used as a tool to determine anticompetitive effects of fidelity rebates and how this clarification can be translated into concrete lessons for European case-law. It reveals that the economic theory of raising rival's cost explains that the assessment of a strategy to exclude an as efficient competitor does not require a price-cost test.

1 INTRODUCTION

It is accepted that the treatment of fidelity rebates is one of the most difficult and controversial topics in EU competition law and US antitrust law. It is also suggested that it is an area where there is a larger divergence of opinion than with other topics.[1] This divergence derives from the different historical development and the different goals of two antitrust regimes.[2] The US approach emphasizes the importance of allowing dominant firms to compete aggressively in the US

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[1] W. Kolasky, *What is Competition-A Comparison of US and European Perspectives*, 49 Antitrust Bull. 29, 40 (2004).

[2] *Ibid.*; according to Kolasky: 'In Europe, national markets were formerly protected by internal trade barriers, resulting in more local monopolies, and many more government-owned monopolies. As a result, there may be more undertakings with dominant positions that are not the natural result of market dynamics than exist in the United States. If so, greater vigilance by competition authorities may well be warranted to assure that the competitive process can operate freely to restore or create competitive conditions.'

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and to condemn only conduct that has actual foreclosure effects to the detriment of consumers. This emphasis leads to a rule of reason approach adopted, at least in part, for the purpose of encouraging competition from dominant firms and firms that seek to supplant them.

However, the legal assessment of fidelity rebates in the US is still a debatable topic because the different courts analysed their effect on competition using different legal standards. Some courts have considered all the circumstances of the case using an exclusive dealing framework in order to decide on whether fidelity rebates would harm competition.[3] Others have used price-cost tests,[4] whereas some applied a mixture of the two frameworks using a price-cost test as a specific application of the rule of reason.[5] This diversity of legal standards has lead to intense academic debate in US scholarship.

Leading US economists, lawyers and academics have been engaged in controversies about whether the price-cost test is applicable only in predation cases or whether it should also apply to fidelity rebate cases. According to some leading commentators in the US, there are two paradigms for exclusionary conduct – predatory pricing (where the price-cost test is appropriate) and raising rivals' cost (RRC) (where the foreclosure should be analysed under exclusive dealing law).[6] They argue that fidelity rebates should be evaluated under the exclusive dealing standard because they can exclude an as efficient competitor without profit sacrifice, which means that a price-cost test is not relevant. The opposite view argues that 'exclusive dealing (and loyalty discounts) do require profit sacrifice to achieve exclusion in very similar circumstances as predation.[7] Thus, they support the view that a predatory pricing standard and the use of a price-cost test as a safe harbour is required as an appropriate measure to distinguish pro-competitive from anticompetitive rebates.

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3 *Conwood Co. v. U.S. Tobacco Co.*, 290 F3d 768 (6th Cir. 2002); *LePage's Inc. v. 3M*, 324 F3d 141 (3d. Cir. 2003).

4 *Virgin Atl. Airways Ltd. v. British Airways Plc*, 256 F3d 256 (2d. Cir. 2001); *Cascade Health Solutions v. PeaceHealth*, 515 F3d 883 (9th Cir. 2008).

5 *NicSand, Inc. v. 3M Co.*, 507 F3d 442 (6th Cir. 2007); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F2d 227 (1d Cir. 1983).

6 S. Salop, *Exclusionary Conduct, Effect on Consumers and the Flawed Profit-Sacrifice Standard*, Antitrust L.J. 311 (2006); J. D. Wright, 'Simple but Wrong or Complex but more Accurate? The Case for an Exclusive Dealing based Approach to Evaluating Loyalty Discounts' Speech delivered at the Bates White 10th Annual Antitrust Conference, Washington DC (2013); P. DeGraba & J. Simpson, *Loyalty Discounts and Theories of Harm in the Intel Investigations*, 2(1) J. Antitrust Enforcement 170 (2013).

7 T. Lambert, *Evaluating Bundled Discounts*, 89 Minn. L. Rev. 1688 (2004); H. Hovenkamp, *Discounts and Exclusions*, Utah L. Rev. 841 (2006); D. Crane, *Bargaining Over Loyalty*, 92 Tex. L. Rev. 253 (2013).

The recent split decisions by the US Third Circuit Court of Appeals in *ZF Meritor*[8] and *Eisai*[9] reflects this longstanding debate by showing how the development of the economic theories are influencing US case law. In both cases the primary dispute between the parties has been whether fidelity rebates have to be treated under the predatory pricing law, or whether they have to be treated under the law of exclusive dealing. In both cases, the Court rejected the relevance of the price-cost test but clearly stated that its application depends on whether the price is the mechanism of exclusion. The Court further clarified that in both cases the test was not relevant because the rebates were more similar to exclusive dealing than predatory pricing. In this sense, case law from the other side of the Atlantic raise the question of whether there is a place for the price-cost test in the assessment of fidelity rebates.

The EU approach, in contrast, imposes a special responsibility on a dominant company not to allow its conduct to impair genuine undistorted competition in the common market, leading to a strict approach, akin to 'per se' prohibition.[10] A long line of case law condemned fidelity rebates as abusive without engaging in a detailed economic analysis of the possible competitive effect of these practises.[11] The EU Courts distinguished between fidelity rebates linked to exclusivity obligations which was considered as abusive 'by object',[12] and the so-called fidelity-enhancing rebates, for which, an approach that evaluates their possible anticompetitive effect in the light of the 'all the circumstances' test was developed.[13] However, because the EU Courts set a very low threshold, above which every form of fidelity rebate, was equated to exclusive dealing and condemned as abusive with no further evaluation of their effect, some considered that fidelity-enhancing rebates should be categorized as 'by object' restriction of competition.[14] Finally, this line of case law had never considered the use of a price-cost test for the evaluation of fidelity rebates. For that reason, it was suggested that the treatment of fidelity rebates under EU

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8 *ZF Meritor LLC v. Eaton Corp*, 696 F3d 254 (3d. Cir. 2012) (*Meritor*).

9 *Eisai Inc v. Sanofi-Aventis U.S., LLC*, 821 F3d 394 (3d. Cir. 2016) (*Eisai*).

10 Case 322/81, *Michelin v. Commission* [1983] ECR 3461, para. 57 (*Michelin I*); *See also* L. Gormsen, *Are Anticompetitive Effects Necessary for an Analysis under Article 102 TFEU?*, 36(2) World Competition 223, 227 (2013).

11 Case 85/76 *Hoffmann-La Roche & Co AG v. Commission* [1979] ECR I-461 (*Hoffmann-La Roche*); *Michelin I*; Case C-310/93 P *BPB Industries plc and British Gypsum Ltd v. Commission* [1995] ECR I-865 (*British Gypsum*); Case C-497/99 P *Irish Sugar plc v. Commission* [2001] ECR I-5333 (*Irish Sugar*); Case T-203/01 *Michelin v. Commission* [2003] ECR II-4071 (*Michelin II*); Case T-219/99 *British Airways plc v. Commission* [2007] ECR I-2331; Case C-549/10 P *Tomra Systems ASA v. Commission* [2012] ECR I-221 (*Tomra*).

12 *Hoffmann-La Roche, British Gypsum.*

13 *Michelin I, Irish Sugar, British Airways, Michelin II* and *Tomra.*

14 L. Gyselen, *Rebates: Competition on the Merits or Exclusionary Practice?*, Eur. Competition L. Ann. 287 (2003).

competition law and US antitrust law is an area where there is a bigger divergence of agreement compared with other topics.

However, this strict approach has been followed by the EU Courts regarding fidelity rebates prior to the reform of Article 102 TFEU, introduced with the issuance of Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty [now Article 102 TFEU] to abusive exclusionary conduct by dominant undertakings.[15] The Guidance Paper outlines the effects-based approach to exclusionary abuses and introduces the 'As Efficient Competitor' (AEC) test, as a foundation of this approach. The development of recent EU case law of fidelity rebates reveals that this divergence is getting blurred, reflecting the clear position of the CJEU in both the *Intel* and *Post Danmark II* judgments to depart from the strict form-based approach and to endorse the effects-based approach – an approach based on an evaluation of the possible anticompetitive effects of fidelity rebates; an approach, which is in line with the rule of reason standard applied traditionally in the US.[16]

However, the legal assessment of fidelity rebates under EU competition law is still unclear due to the ambiguity related to the application of the AEC test as a tool to determine the anticompetitive effects of fidelity rebates. This issue remains outstanding despite the attention devoted to the application of the test in both the case law and academic debate following the judgments.

The GC in *Intel* rejected the implementation of the test and concluded that it is not required for finding an infringement of Article 102 TFEU.[17] On Intel's further appeal, the CJEU referred the case back to the GC, ordering it to examine the arguments as regard the validity of the price-cost test put forward by Intel.[18] The CJEU further stated that in cases in which the defendant provides supportive evidence that its conduct is not capable of restricting competition, the Commission is required to evaluate all the circumstances in order to assess the possible existence of a strategy aiming to exclude an as efficient competitor, mentioning explicitly the extent of the undertaking's dominant position on the relevant market, the coverage and the duration of the practice and the conditions and arrangements for granting the rebates. From this perspective, the CJEU confirmed that the AEC standard is the relevant benchmark.[19] However the CJEU did not clarify whether

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15 OJ C 45/7 (the Guidance Paper).

16 For similar interpretation *see* N. Petit, *The Judgment of the EU Court of Justice in Intel and The Rule of Reason in Abuse of Dominance Cases* (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3086402 (accessed 12 Dec. 2017).

17 Case T-286/09 *Intel v. Commission* [2014] ECR II-547 (GC judgment) para. 144.

18 Case C-413/14 P *Intel v. Commission* [2017] ECR I-632 (CJEU judgment) para. 150.

19 K. U. Kühn & M. Marinova, *The Role of the 'As Efficient Competitor' Test after the CJEU Judgment in Intel*, 4(2) Competition L. & Pol'y Deb. 64 (2018).

in the evaluation of a strategy aiming to exclude an as efficient competitor a price-cost test is required. The CJEU only clarified that if the defendant is able to provide evidence that its conduct is not capable of foreclosing competitors, it can rebut the presumption of illegality of its practice.

The CJEU in *Post Danmark II* also endorsed the effects-based approach for the evaluation of the legality of fidelity rebates.[20] It extended the criteria of 'all the circumstances' test from the settled case law, stating that not only the rules of granting rebates should be evaluated but also their duration, the extent of the dominant position and the conditions of competition on the relevant market. In this sense, the CJEU departed significantly from settled case law by introducing an in-depth effects analysis of the possible exclusionary effect of rebates.[21] However, the Court rejected the price-cost test as irrelevant in this particular case clarifying that it could be used as one tool amongst others. The CJEU nonetheless left the question open about under which circumstances the price-cost test could be useful.

Against this backdrop, this article aims to review the academic debate in US scholarship comparing the two paradigms for exclusionary conduct – predatory pricing and exclusive dealing – before describing how the recent US and EU case law have handled this debate differently. It will devote particular attention to understanding whether the US case law clarifies under which circumstances a price-cost test might be relevant as a part of the assessment of the legality of fidelity rebates; an issue which has not been addressed by the Commission and the EU Courts in the *Intel* and *Post Danmark II* judgments.

The structure of this article is organized as follows. The second section maps out the economic debate in the US. The third section will provide a description of the background and the legal assessment of the two US cases mentioned above in order to clarify how it reflects the debate outlined in the previous section. Finally, this article will compare the US and EU approach to price-cost tests in the assessment of fidelity rebates.[22] The goal is to shed light on to which circumstances a price-cost test should be used as a tool to determine an anticompetitive effect of fidelity rebates and how this clarification can inform the EU approach. Ultimately, this article aims to understand whether the economic theory of RRC may underlie the reasoning of the *Intel* and *Post Danmark II* judgments.

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[20] Case C-23/14, *Post Danmark A/S v. Konkurrenceradet* [2015] (*Post Danmark II*).

[21] P. Colomo, *Post Danmark II: The Emergence of a Distinct 'Effects-based' Approach to Article 102 TFEU*, 7(2) J. Eur. Competition L. & Prac. 113 (2016).

[22] The discussion of the Intel case will be focused on the GC judgment, because the CJEU has not discussed all of the aspects of the GC judgment.

2 THE DEBATE ABOUT THE APPROPRIATE TREATMENT OF FIDELITY REBATES IN US ACADEMIC SCHOLARSHIP

As already mentioned, the debate about the appropriate treatment of fidelity rebates in US academic scholarship is currently divided into two camps which broadly follow the opposing lines of reasoning and which we will now turn our attention to.

2.1 Fidelity rebates should be subject solely to price-cost test

The first camp holds that fidelity rebates are mainly pro-competitive discounting practices. Fidelity rebates will only be unlawful when a dominant company sets its prices below cost in order to exclude its competitors. Thus, the only mechanism of exclusion is predatory pricing, and fidelity rebates are to be subject to the law of predatory pricing where a price-cost test is applicable.[23]

Predatory pricing is a short-run conduct by a dominant company that lowers the price of its products below cost in order to exclude rivals from the market, after which it will be able to raise prices above the competitive level in order to recoup the losses from its predatory behaviour.[24] Under this framework, the relevant benchmark is whether the price charged by the dominant undertaking covers the costs that an equally efficient competitor would incur when producing the same goods/services. If the discounted price is above the discounter's own cost, such price could theoretically be matched by any rival that is as efficient as the discounter. As a result, an equally efficient competitor will not be excluded from the market; instead, a fidelity rebates scheme would lead to intense competition that would benefit consumers. If the discounted price is below this measure of costs, however, the price could serve as a mechanism to exclude a competitor, which is at least as efficient as the dominant company – thereby allowing for the acquisition of market power, the charge of higher prices, and the reaping of monopoly profits by a dominant undertaking.

According to the proponents of this view, exclusive dealing and loyalty discounts require profit sacrifices to achieve exclusion in very similar circumstances to predatory pricing. Thus, a predatory pricing standard and the use of a price-cost

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[23] Lambert, *supra* n. 7, at 1688; H. Hovenkamp, *Antitrust Law* (2d ed., Aspen 2004); Hovenkamp, *supra* n. 7; T. Lambert, *Appropriate Liability Rules for Tying and Bundled Discounting*, 72 Ohio St. L.J. 909, 980 (2011); H. Hovenkamp & E. Hovenkamp, *Complex Bundled Discounts and Antitrust Policy*, 57 Buff. L. Rev. 1227 (2009); D. Crane, *Bargaining Over Loyalty*, 92 Tex. L. Rev. 253 (2013); Brief for Eighteen Scholars as Amici Curiae in Support of Petitioner, *Eaton Corp. v. ZF Meritor LLC*, No 12-1045, 2013 WL 1309073.

[24] For the intensive overview of predatory pricing theory *see* in general P. Bolton, J. Brodley & M. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 Geo. L.J. 2239 (1999).

test as a safe harbour is required as an appropriate measure to distinguish pro-competitive from anticompetitive rebates.[25] Aggressive but above-cost pricing should be legal; and less efficient rivals who lose sales due to the superiority of the dominant company should not be 'able to turn their defeat in the market into an antitrust claim.'[26] If prices are above-cost, they will not amount to de facto exclusive dealing, and as such they should not be penalized.[27] In addition, the proponents of this view argue that the prohibition of above-cost pricing would amount to forcing firms to charge higher prices in order to protect less efficient rivals, which would result in immediate consumer harm.[28] Consequently, above-cost discounts 'of any kind should be per se lawful.'[29]

It has also been argued that fidelity rebates may generate pro-competitive effects and consumer benefits in ways that simple volume discounts cannot,[30] and that the lack of a reliable safe harbour such as a price-cost test is likely to discourage discounters from engaging in discounting that might be beneficial to consumers.[31] Such pro-competitive effects might occur in markets with high fixed costs and short product lifetimes, in which case the total costs of production are exceptionally sensitive to the volume sold and, as such, it would be cheaper and more efficient if one firm can secure a certain share of the market demand – such efficiencies cannot be achieved through volume rebates.[32] Arguably, there is substantial literature detailing with other pro-competitive effects of fidelity rebates, such as preventing dealers' free-riding,[33] stimulating retailers' effort or avoiding double marginalization, which provide further support to this opposition.[34] The argument further holds that, without a price-cost test, it will be difficult to distinguish between pro-competitive and anticompetitive discounting practices, which might result in mistaken jury findings. Thus, the absence of such a clear-

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25 D. Crane, *Bargaining Over Loyalty*, 92 Tex. L. Rev. 253 (2013); Hovenkamp, *supra* n. 7; Lambert, *supra* n. 7.

26 Brief for Eighteen Scholars in *ZF Meritor*, *supra* n. 23, at 14.

27 *Ibid.*; *see also* H. Hovenkamp, *Exclusion and the Sherman Act*, 72(1) U. Chi. L. Rev. 147, 154 (2005); Hovenkamp, *supra* n. 7.

28 H. Hovenkamp, *The Federal Trade Commission and the Sherman Act*, 62 Fla. L. Rev. 871, 887 (2010).

29 D. Crane, *Multiproduct Discounting: A Myth of Non price Predation*, 72(1) U. Chi. L. Rev. 27, 29 (2005); *See also* Brief for Amici Curiae Morgan Stanley et al. at 5, *3M v. LePage's Inc.*, 124 S. Ct. 2932 (2004) (No. 02-1865) 2003 WL 22428378.

30 Brief for Eighteen Scholars in *ZF Meritor*, *supra* n. 23, at 15.

31 Lambert, *supra* n. 7, at 1716.

32 Hovenkamp, *supra* n. 28, at 889.

33 D. Mills, *Inducing Downstream Selling Effort with Market Share Discounts*, 17(2) Int'l J. Econ. Bus. 129 (2010); H. Marvel, *Exclusive Dealing*, 25(1) J.L. & Econ. 1 (1982); B. Klein & A. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 74(2) Antitrust L.J. 473 (2007).

34 S. Kolay, G. Shaffer & J. Ordover, *All-unit Discounts in Retail Contracts*, 13(3) J. Econ. & Mgmt. Strategy 429 (2004); D. Spector, *Loyalty Rebates and Related Pricing Practices: When should Competition Authorities Worry?*, Global Competition Policy: Economic Issues and Impacts 317 (2004); D. O'Brien, *All-Units Discounts and Double Moral Hazard*, 170 J. Econ. Theory 1 (2017).

cut test will deter companies from providing pro-competitive rebates, which will result in an outcome typically described as a chilling competition effect. In short, the price-cost test provides an administrable approach that creates legal certainty and can identify and condemn only practices that 'could injure consumers by excluding rivals that are, or are likely to become, as efficient as the discounter.'[35]

However, an important observation is that the proponents of the first camp consider the application of a price-cost attributable to predatory pricing only in a single product loyalty rebates and only if all sales are contestable, which means that competitors are able to compete for the whole demand (not only for the non-contestable base of sales).[36] For that reason, some of the proponents of this approach suggest that in some cases, customer preferences (or the unavoidable trading partner status of the discounter) might lead to the establishment of a non-contestable part of the demand, for which competitors would not be able to compete. This in general, makes the applicability of predatory pricing price-cost test not relevant,[37] because the demand is separated into non-contestable and contestable parts and the real competition is only for the latter.[38] They further considered that the effect of a rebate scheme should be analysed only on contestable share, which requires a modification of the test. This modified price-cost test aims to compare the price with the loyalty discount for the whole purchased units attributed only for the contestable sales with the costs of providing these incremental units.[39] The rationale behind this argument is that if the attributed price is above the costs for the contestable part of sales, any as efficient as the discounter competitor will be able to compete for the contestable sales.[40]

This position is in line with the position adopted by the Commission's Guidance Paper of Article 102 TFEU and tested in the Commission's decision in the *Intel* case. However, no US court has endorsed the application of this modified test to single product fidelity rebates so far.

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35 Lambert, *supra* n. 7, at 1757.

36 B. Klein & A. Lerner, *Price-Cost Tests in Antitrust Analysis of Single Product Loyalty Contracts* 631, 633 (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2775455 (accessed 1 Dec. 2017).

37 *Ibid*.

38 J. Jacobson, *A Note of Loyalty Discounts*, 9(5) The Antitrust Source – ABA (2010); Klein & Lerner, *supra* n. 36, at 633.

39 Initially, the modified price-cost test for fidelity rebates was recommended by P. Areeda & H. Hovenkamp, *Antitrust Law* 341 (3d ed., Little Brown 2008) and later on supported by Klein & Lerner, *supra* n. 36. *See also* D. Waelbroeck, *Michelin II: A Per Se Rule Against Rebates by Dominant Companies?*, 1(1) J. Competition L. & Econ. 149 (2005); G. Federico, *When are Rebates Exclusionary?*, 26(9) Common Mkt. L. Rev. 477 (2005). The test was proposed by the US DoJ, Competition and Monopoly: Single-Firm Conduct Under s. 2 of the Sherman Act 101 (Sept. 2008) and withdrawn one year later.

40 The Economics of Alternative Legal Standards for Loyalty Discounts, presentation by B. Klein at FTC/DOJ Workshop on Conditional Pricing Practices (23 June 2014).

3.2 Fidelity rebates should be subject solely to the rule of reason approach applicable to exclusive dealing

The second camp supports the opposite view, that fidelity rebates should be treated under the law of exclusive dealing – where a rule of reason standard applies.

Proponents of this view argue that fidelity rebates might lead to foreclose by increasing the costs of the dominant company's competitors and, as such, they claim that the exclusionary conduct can be explained through the framework consistent with the economic theory of RRC.[41] The RRC theory provides a theoretical foundation of how the conduct by a dominant company can deprive its rivals of access to crucial sales or inputs, causing them to raise their price or reduce their output and exit the market in the long run. This, in turn, allows the dominant company to price at an above competitive level to the detriment of consumers.[42]

First, the RRC theory explains that by adopting fidelity rebates a dominant company can exclude its competitors from sufficient access to markets/clients, which deprives them of the opportunity to compete and to achieve sufficient scope of sales. Achieving a certain level of output/minimum efficient scale (MES) is necessary for a competitor or an entrant to realize economies of scale in order to compete effectively with the dominant company. The relevant level of MES varies depending on the industry.[43] In some markets, the MES could be very low and each competitor is able to easily obtain enough sales to reach MES and to compete successfully with the dominant undertaking. In others – e.g. innovative industries – the level of MES will likely be higher because the ratio between fixed and variable costs is high, which means that a competitor or entrant needs to significantly increase its level of output in order to minimize its average costs (since average costs fall with the increase of output), otherwise 'the likelihood of the firm surviving would presumably be lower.'[44] Admittedly, technology industries with high costs for development and research (which can be associated with sunk costs) can reach large economies of scale, which might create significant entry barriers.[45]

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[41] J. D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19(5) Geo. Mason L. Rev. 1163 (2012).

[42] S. Salop, *The Raising Rivals' Cost Foreclosure Paradigm, Conditional Pricing Practices and the Flawed Incremental Price-cost Test* (2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2381016 (accessed 3 May 2017); D. Moore & J. D. Wright, *Conditional Discounts and the Law of Exclusive Dealing*, 22 Geo. Mason L. Rev. 1205 (2014).

[43] R. Arnold, *Microeconomics* 190 (Cengage Learning 2008).

[44] D. Audretsch end others, *The Post-Entry Performance of New Firms*, in *Market Evolution: Competition and Cooperation* vol. 20, 248 (Arjen van Witteloostuijn ed., Springer Science & Business Media 2013).

[45] D. Harbord & T. Hoehn, *Barriers to Entry and Exit in European Competition Policy*, 14(4) Int'l Rev. L. & Econ. 411 (1994).

In markets characterized by high fixed costs and constant demand, it may be difficult for a competitor to achieve MES by serving only part of the market.[46] If the dominant company is engaging in practices that make it difficult for a competitor to achieve MES, its marginal cost would be higher than the dominant supplier and he will be inefficient, marginalized as a competitor even if not completely excluded from the market.[47] An even worse outcome occurs if fidelity rebates preclude a competitor from achieving minimum viable scale (MVS), which is the minimum scale of output (breakeven output) that a company needs to achieve in order to cover its costs (average cost equals price). If a company cannot reach MVS, it will exit the market.

Second, the RRC theory might also explain that even if the modified discount-attribution test proposed by the proponents of the first camp is passed by the dominant company, there still might be an exclusionary effect if the contestable share of the sales is insufficient to allow the competitors to operate profitably, given their fixed costs.[48] In markets where achieving MES is crucial, the discounter has to target only a part of the sales open to competition that is large enough to prevent the rivals achieving MES.[49] In those cases, whether the price for the contestable part of demand is above or below cost is not relevant, because even if a competitor can offer a price that can compensate the customer for the loss of rebates, the competitor might still not be in position to reach MES in order to be profitable and to compete effectively with the dominant company. If a competitor is not able to achieve MES, its cost will rise, being higher than that of the dominant company. It makes no economic sense to compare a dominant firm's cost with the price in order to assess whether a competitor can off-set the effect of rebates.

A body of literature regarding RRC models shows that above-cost fidelity rebates can potentially lead to anticompetitive foreclosure.[50] It was also argued that

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[46] On this point *see* R. O'Donoghue & J. Padilla, *The Law and Economics of Art. 102 TFEU* 470 (2d ed., Hart Publishing 2013). They explain that if demand is constant, competitors are dependent on the existing customer base, whereas if demand is growing competitors have opportunities to achieve minimum efficient scale and to minimize the effect of fidelity rebates.

[47] Salop, *supra* n. 42, at 16; Wright, *supra* n. 41, at 1166.

[48] OECD Report, Fidelity rebates, DAF/COMP(2016).

[49] OECD Report, Loyalty and Fidelity Discounts and Rebates, DAFFE/COMP (2002), UK contribution.

[50] E. Elhauge, *How Loyalty Discounts Can Perversely Discourage Discounting*, 5(2) J. Competition L. & Econ. 189 (2009); E. Elhauge & A. Wickelgren, *Anticompetitive Market Division Through Loyalty Discount without Buyer Commitment*, Harvard Discussion Paper No 723 (2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2125428 (accessed 2 Oct. 2017); E. Elhauge & A. Wickelgren, *Robust Exclusion and Market Division through Loyalty Discounts with Buyer Commintment*, Harvard Discussion Paper No 722 (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2125398 (accessed 2 Oct. 2017); G. Bulkley, *The Role of Loyalty Discounts when Consumers are Uncertain of the Value of Repeat Purchases*, 10 Int'l J. Indus. Econ. 91 (1992); J. Simpson & A. Wickelgren, *Naked Exclusion, Efficient Breach, and Downstream Competition*, 97 Am. Econ. Rev. 1305 (2007); J. Simpson & A. Wickelgren, *Exclusive Dealing and Entry, When Buyers Compete: Comment*, University of Texas at Austin Working Paper (2005); J. M. Abito & J. Wright, 'Exclusive Dealing and Entry, when Buyers Compete: Comment' mimeo, National University of Singapore (2005).

fidelity rebates can exclude or marginalize competitors by raising their costs without sacrifice the ability by the dominant company to make a profit.[51] The RRC literature demonstrates that fidelity rebates can exclude an equally efficient competitor even if the effective price is above the incremental cost of the dominant company,[52] which makes the price-cost test inappropriate.[53]

Another important consequence from RRC theory is that some discounting practices can be anticompetitive even if they do not completely exclude a rival from the market.[54] In these cases, a practice can be anticompetitive because by raising competitors' costs, their ability to compete effectively and to impose competitive constraints on the dominant company is reduced, which suggests that the degree of foreclosure might not be determinative.[55] In others, the degree of foreclosure might be significant but the lack of evidence that competitors' cost are raised leading to negative effect on price, output or other parameters of competition suggests no basis for liability.[56] Thus, the key issue is not the level of foreclosure, but whether rival's costs are raised, which suggests that although the level of foreclosure might be a proxy for a possible anticompetitive harm, it might be not enough basis for claim under the RRC theory.[57] The fact that rival are not eliminated makes these strategies less detectable and less likely to invite prosecution than predatory pricing and, thus, they may even be preferable for a dominant company as a way of maintaining or enhancing its dominant position.[58]

Two types of raising rivals' costs are conceivable in the context of rebates. If a rebate makes a rivals' access to crucial inputs more difficult or even impossible, this might result in raising rivals' input costs (input foreclosure); if it forecloses rivals' access to customers instead, it might result in reducing rivals' revenues (customer

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[51] T. G. Krattenmaker & S. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 234 (1986); A. Abbott & J. D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing*, in *Antitrust Law and Economics* 183 (Keith N. Hylton ed., Edward Elgar 2010); E. Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 315 (2003); W. Tom, D. Balto & N. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 Antitrust L.J. 615, 627 (2000); E. Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 Harv. L. Rev. 397 (2009); T. Brennan, *Bundled Rebates as Exclusion rather than Predation*, 4 J. Competition L. & Econ. 335 (2008); N. Economides & I. 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, 544 (2009); N. Economides, *Loyalty/Requirement Rebates and the Antitrust Modernization Commission: What Is the Appropriate Liability Standard?*, 54 Antitrust Bull. 259, 268 (2009).

[52] Economides, *Loyalty/Requirement Rebates and the Antitrust Modernization Commission*, *supra* n. 51, at 259.

[53] Moore & Wright, *supra* n. 42, at 1218.

[54] OECD Report (2016).

[55] J. Jacobson, *Exclusive dealing, Foreclosure and Consumer Harm*, 70(2) Antitrust L.J. 311, 349 (2002).

[56] *Ibid.*, at 362.

[57] *Ibid.*; *see also* OECD Report (2016), para. 57.

[58] Hovenkamp, *Exclusion and the Sherman Act*, *supra* n. 27, at 158.

foreclosure).[59] In both cases, competitors might be foreclosed from the market, or become marginalized and less competitive.

In an input foreclosure scenario, an agreement with the suppliers of a crucial input might substantially raise the input costs of the purchaser's competitors, as they have to 'shift to a higher cost supplier or less efficient inputs.'[60] In this case, the rivals might keep its output at the MES, but their costs will be higher (because of the higher cost of the input) – with the result that they will become weaker and less efficient competitors.[61] Input foreclosure will also raise the prices charged to customers, which means that consumer harm will be simultaneous.[62] In effect, this means that input foreclosure can reduce competition in situations 'not limited to failure to achieve MES or MVS.'[63] For that reason, in evaluating input foreclosure the issue is not the degree of foreclosure but merely whether the foreclosure will raise rivals' costs.[64]

In a customer foreclosure scenario, a fidelity rebate might foreclose competitors' access to a significant customer base. This will prevent them from reaching MVS – which will force them to exit the market – or from reaching MES – in which case they might remain in the market, but will become marginalized as competitors.[65] According to Salop, an anticompetitive effect can occur even if the rival can achieve MES or MVS because customer foreclosure might restrain the competitors' ability to expand profitably (i.e. it will limit the incentives to invest or innovate), and reduce the competitive constraints on the dominant company's pricing.[66]

Input and customer foreclosure can occur at the same time if the exclusive agreement is between a dominant company and its distributors, which would reinforce the impact of the conduct.[67] In that case, the distributors are both customers and input providers – since they are the direct customers of the relevant product, but they also provide distribution services that are an important input for making the product reach final consumers.[68] Exclusive agreements with

59 S. Salop, *Conditional Pricing Practices and the Two Anticompetitive Exclusion Paradigms*, Georgetown University Law Center, Presentation at the DOJ/FTC Workshop on Conditional Pricing Practices (23 June 2014); Salop, *supra* n. 42.

60 Krattenmaker & Salop, *supra* n. 51, at 234.

61 Salop, *supra* n. 42, at 18.

62 S. Salop (7 June 2013), https://truthonthemarket.com/2013/06/07/wright-is-right-and-price-cost-safe-harbors-are-wrong-the-raising-rivals-cost-paradigm-loyalty-discounts-and-exclusive-dealing/ (accessed 13 Feb. 2018).

63 Salop, *supra* n. 42, at 19.

64 S. Salop, https://truthonthemarket.com/ (accessed 15 Feb. 2018).

65 D. Crane & G. Miralles, *Toward a Unified Theory of Exclusionary Vertical Restraints*, 84 S. Cal. L. Rev. 605, 639 (2011).

66 Salop, *supra* n. 42, at 21.

67 *Ibid.*, at 23.

68 *Ibid.*

distributors may ‘cause rivals to incur greater costs in seeking out new avenues of distribution or in using higher cost distributors or methods of distribution.’[69] As a result, the dominant company may use an exclusive agreement with its distributors to exclude or hinder competitors by locking up a sufficient part of the distribution.[70]

In both cases – input and customer foreclosure – competitor’s cost are raised, i.e. he becomes less efficient and can be excluded or marginalized without the dominant company being required to set prices below cost. If a dominant company enters into agreements with its distributors, even small discounts might lead to de facto exclusivity.[71]

The proponents of the RRC theory have recognized that raising rival’s cost alone is not sufficient to establish that behaviour is anticompetitive and causes consumer harm.[72] In practice, the relevant benchmark for whether a strategy of raising rival’s cost might result in competitive harm is whether that conduct forecloses a sufficient share of the market to deprive competitors of the possibility of achieving a MES so as to remain able to impose competitive constraint.[73] Apart from evidence of a significant degree of foreclosure, the analysis requires an assessment of the duration of the agreements, barriers to entry, the ability of a competitor to compete, and consideration of pro-competitive efficiencies.[74] Ultimately, the rationale behind this approach is that a dominant company can use fidelity rebates in order to induce their customers to purchase exclusively from it and to harm competition especially in cases when the dominant supplier’s product is essential for the buyers and there are significant economies of scale.[75]

Supporters of the RRC theory go as far as to reject the view that foreclosure can lead to an anticompetitive effect only if an equally efficient competitor is excluded from the market. This is because in some cases, even entry of a less efficient competitor into the market can impose competitive constraints in monopoly markets which will lead to price decreases and, as such, consumer benefits.[76] For that reason, it was suggested that the ‘liability for exclusionary conduct should not turn on the entrant’s efficiency but rather on ‘how large a penalty the incumbent is placing on entrant.’[77] In these cases, focusing on an equally efficient competitor will lead to under-deterrence.[78]

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[69] Jacobson, *supra* n. 55, at 352.
[70] S. Gates, *Antitrust by Analogy: Developing Rules for Loyalty Rebates and Bundled Discounts*, 79(1) Antitrust L.J. 99 (2013).
[71] S. Salop, https://truthonthemarket.com/ (accessed 15 Feb. 2018).
[72] Krattenmaker & Salop, *supra* n. 51, at 255.
[73] Wright, *supra* n. 6, at 24.
[74] *Ibid.*
[75] *Ibid.*, at 21; *see also* Moore & Wright, *supra* n. 42, at 1215.
[76] Salop, *supra* n. 42, at 28.
[77] F. S. Morton & Z. G. Abrahamson, *A Unifying Analytical Framework for Loyalty Rebates* (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2833563 (accessed 1 Dec. 2017).
[78] Salop, *supra* n. 42, at 46.

A last argument in favour of RRC approaches to fidelity rebates is that this standard has administrative advantages over a complex price-cost test, because the assessment is over the terms and conditions under which rebates are granted rather than the price ultimately charged.[79] Underlying this argument is the insight that the price-cost test applied for fidelity rebates is not the traditional price-cost test (which compares the average price with average variable cost), which is administratively efficient.[80] The price-cost test applied to fidelity rebates is a 'modified' test that must compare the costs and prices for that part of demand that can realistically be switched to a competitor, the so-called 'contestable share'. The test asks whether the price for the contestable sales is predatory, in which case the rival may be forced to offer very low or even negative price in order to compete with the dominant company, which could force the competitor to exit the market or to become inefficient (or to deter entry).[81] With this strategy, it will be impossible for a competitor to compete with the dominant company for this part of demand because he cannot match the rebates of the dominant company without losses. On the other hand, the dominant supplier does not incur losses as far as it can recoup the rebate on its whole range of sales.[82] The rationale behind this argument is that if the attributed price is above the costs for the contestable part of sales, any as efficient as the discounter competitor will be able to compete for the contestable sales.[83]

However, although this logic seems reasonable, many have questioned the usefulness of this modified test, arguing that it is subject to significant implementation errors, for a number of reasons.[84] Firstly, the accuracy of the test depends on the proper estimation of the contestable share of sales, which is a difficult, expensive and unpredictable task.[85] This raises the question as to how to identify the contestable share of demand. One may argue that contestable share is equal to the market share of the dominant company, i.e. if a dominant company has 70% market share, it means that contestable part is 30%, or as an alternative, contestable share may relate to the dominant company discount level, i.e. if the threshold for obtaining rebates is 80%, then the contestable part is 20%.[86] Others, may argue that contestable share is the difference

[79] *Ibid.*, at 37.
[80] *Ibid.*, at 44.
[81] O'Donoghue & Padilla, *supra* n. 46, at 469.
[82] D. Geradin, *A Proposed Test for Separating Pro-Competitive Loyalty Rebates from Anticompetitive Ones*, 32 World Competition 41, 58 (2009).
[83] B. Klein, *The Economics of Alternative Legal Standards for Loyalty Discounts*, presentation at FTC/DOJ Workshop on Conditional Pricing Practices (23 June 2014).
[84] Salop, *supra* n. 42.
[85] H. Zenger *Loyalty Rebates and the Competitive Process*, 8(4) J. Competition L. & Econ. 717 (2012); Moore & Wright, *supra* n. 42, at 1242; R. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?*, Utah L. Rev. 863, 880 (2006).
[86] Moore & Wright, *supra* n. 42, at 1243.

between non-contestable units and the threshold for obtaining the discounts, i.e. if non-contestable share is 60% and the threshold for obtaining rebates is 80%, it means that contestable share is 20%.[87] Thus, the uncertainty of defining contestable share may lead to an unpredictable outcome, leading to disagreement between the two sides relying on different calculations.[88] For these reasons, the application of the test in practice is questionable. Secondly, the identification of the appropriate measure of cost might be an issue in industries with high fixed costs and relatively low marginal costs and with corresponding difficulties in accounting sunk costs.[89]

In short, this school of thought believes that RRC and predation are two completely different mechanisms of exclusion, and that each requires a different analytical framework.[90] Some fidelity rebates are similar to exclusive dealing and should be analysed under the same legal standard as exclusive dealing rather than predatory pricing[91] – with the presence or absence of profit sacrifice as the element that distinguishes the RRC and predatory pricing.[92] Some go as far as to argue that since such a conduct does not require a dominant company to suffer losses during the initial period that have to be recouped in the later stage – because the recoupment occurs simultaneously – non-predatory pricing may not only be a successful strategy but may even be more likely to harm consumers than predatory pricing.[93]

3 RECENT US CASE LAW ON FIDELITY REBATES

3.1 *ZF Meritor* v. Eaton

3.1[a] *Background*

The factual background of this case is as follows. Eaton dominated the heavy-duty-truck transmissions market from 1950 to 1989, when Meritor entered the market. By 1999, Meritor had achieved a 17% market share. In mid-1999, Meritor formed

[87] N. Economides, *Tying, Bundling and Loyalty/Requirement Rebates*, in *Research Handbook on the Economics of Antitrust Law* 130 (E. Elhauge ed., Edward Elgar 2012).

[88] Salop, *supra* n. 42.

[89] Jacobson, *supra* n. 38.

[90] Contrast Krattenmaker & Salop, *supra* n. 51; Moore & Wright, *supra* n. 42; Tom, Balto & Averitt, *supra* n. 51; Wright, *supra* n. 6 with C. Fumagalli & M. Motta, *On the Use of Price-Cost Tests in Loyalty Discounts: Which Implications from Economic Theory?* (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2596630 (accessed 10 May 2017), arguing that exclusive dealing, including fidelity rebates and predation, could be interpreted through a common mechanism.

[91] Tom, Balto & Averitt, *supra* n. 51; Wright, *supra* n. 6; Brennan, *supra* n. 51, at 335; Moore & Wright, *supra* n. 42.

[92] S. Salop & D. Scheffman, *Raising Rivals' Costs*, 73 Am. Econ. Rev. 267, 268 (1983). They distinguish predatory pricing from raising rivals' costs using economic models; *see also* Krattenmaker & Salop, *supra* n. 51.

[93] Salop, *supra* n. 42.

a joint venture with ZF, aimed to introduce innovative transmissions called 'FreedomLine' into the North American market – which occurred in 2001.

Truck buyers have the ability to choose many of the components used in their trucks, including transmissions, from manufacturers catalogues called 'data books'. These catalogues list 'standard' offerings of components that will be provided to final truck buyers unless such buyers expressly select another supplier's product. Catalogues also list 'preferred' offerings, which are the lowest priced components in the data book among comparable products. Truck buyers may also request components that are not published in a data book, even though such requests will tend to increase the cost of the component. Analysis of the retail market found that data book positioning is essential in the industry.

Eaton entered into new long-term agreements (LTAs) with truck manufacturers that were unprecedented in terms of their duration – at least five years – and market coverage. The LTAs included up-front payments, and a conditional rebate provision according to which a purchaser would receive rebates only if its purchases reached a specified percentage of its requirements from Eaton. Such requirements were between 70% to more than 90% depending on the manufacturer. The LTAs could be terminated if the target requirements were not met, upon which all payments and contractual saving had to be paid back to Eaton.

Before the renewed LTAs were adopted, Meritor's products were listed in the component data books of all manufacturers, in some cases with preferred positioning. All LTAs required the truck manufacturers to include Eaton as the standard offering in its data book; two of the four LTAs required the truck manufacturers to remove competitors' products from their data books entirely. Finally, each LTA contained a 'competitiveness' clause according to which each of the manufacturers could purchase transmissions from another supplier if that supplier offered a lower price or a better product, which Eaton was unable to match.

Following these agreements being entered to, Meritor's market share had dropped to 4%. In January 2007, Meritor exited the market.

3.1[b] *Assessment*

In its decision, the Third Circuit found that the most significant issue was whether the antitrust analysis of rebates should be subject to the price-cost test applicable to predation, or to the 'rule of reason' approach applicable to exclusive dealing – an issue reflecting the academic debate outlined in the previous section.

The majority of the Third Circuit court rejected the application of the price-cost test in this case, stating that the test is appropriate only in 'a case in which price is the clearly predominant mechanism of exclusion.'[94] The Third Circuit

[94] *Meritor*, para. 275.

distinguished between pricing practices, which are 'unlikely to exclude equally efficient rivals unless they are below-cost', and non-pricing practices/exclusive dealing arrangements which 'can exclude equally efficient rivals, and thereby harm competition, irrespective of below-cost pricing.'[95] In this regard, the Court identified a number of anticompetitive provisions in the LTAs, in order to classify the conduct as non-price practice in showing that price was not the predominant mechanism of exclusion. First, some of the agreements required Meritor's products to be removed from the manufacturers' data books, thereby preventing competing products – and particularly FreedomLine transmissions – from being promoted.[96] Second, if the manufacturers failed to meet the target sale requirements the contract could be terminated. Thus, the cost of breaching the agreement was very high, which amounted not only to a penalty in the form of a rebate but losing Eaton as an unavoidable supplier. Further, the Court considered that Eaton was a supplier of necessary products (unavoidable trading partner), the contracts lasted at least five years, market had very high barriers to entry, highly concentrated, with no significant external supplier having entered the market during the last twenty years.

The majority therefore reached the conclusion that Eaton's conduct constituted an unlawful exclusive-dealing arrangement.[97] The Court considered that 'exclusive dealing will generally only be unlawful where the market is highly concentrated, the defendant possesses significant market power, and there is some element of coercion present.'[98] For that reason, the Court declined to apply a price-cost test, clarifying that in this case Eaton's competitors 'may be driven out not because they cannot compete on a price basis, but because they are never given an opportunity to compete, despite their ability to offer products with significant customer demand'.[99] Further, the Court observed that in those cases, a dominant firm may be able to hinder rivals ability to reach a large enough portion of the market to achieve the minimum economies of scale necessary to compete by locking up a sufficient part of demand, which would allow the discounter to successfully protect or enhance its market power.[100] From this perspective, the Court's position is 'based upon theories of economic harm grounded on the RRC framework' reflecting the position of the proponents of the second camp.[101]

However, the position of the proponents of the first camp can be found in Judge Greenberg's dissenting opinion. He disagreed with the majority's decision to

[95] *Ibid.*, para. 281.
[96] *Ibid.*, para. 277.
[97] *Ibid.*, paras 282–283.
[98] *Ibid.*, para. 284.
[99] *Ibid.*, para. 281.
[100] *Ibid.*
[101] Moore & Wright, *supra* n. 42, at 1208.

reject the price-cost test, concluding that Meritor did not suffer antitrust injury because the LTAs provided discounted but above-cost prices, which any equally efficient competitor could match.[102] The reasons for this conclusion were as follows. Firstly, the price-cost test is relevant and had a dispositive effect in this case[103] because of 'the fundamental and broader principle that above-cost pricing practices, even those embodied in discount and rebate programs memorialized in written agreements, generally are not anticompetitive.'[104] Secondly, the non-price aspects of the LTAs – such as market-share targets and the data book placement provisions – would not have been adopted without the reduced prices offered as an incentive for the truck manufacturers to accept entering into the LTAs.[105]

However, he recognized that in concentrated markets with high barriers to entry and long-term duration of buying commitments, as well as when the large firm can offer a larger variety of products than competitors, above-cost rebates are most plausible for competitive injury.[106] In this sense, he distinguished between single-item rebates, which can be anticompetitive only if they are predatory and rebates conditional on purchasing different products produced by a single producer or when they are aggregated over a longer period as more problematic even when they remain above cost.[107] This statement reflects the position of the proponents of the first camp and their observation that the price-cost is applicable only in single product loyalty rebates and only if all sales are contestable. As outlined above, Eaton was considered by the Court as an unavoidable trading partner, which means that competitors were able to compete only for the non-contestable base of sales, which substantiates the rejection of the price-cost test. In this regard, it should be noted that the allegation was whether the rebate scheme could be tested under a standard predatory pricing price-cost test. The application of the modified price-cost test to single product fidelity rebates has never been discussed.

3.2 Eisai Inc. v. Sanofi-Aventis

3.2[a] *Background*

The facts of this case were as follows. Sanofi had a market share from up 81.5% to 92.3% on the anticoagulant drugs market with the brand name Lovenox, whereas the second largest competitor – Eisai's brand name drug Fragmin had a market

[102] *Meritor*, para. 333.
[103] *Ibid.*, paras 311–312.
[104] *Ibid.*, para. 320.
[105] *Ibid.*, para. 321.
[106] *Ibid.*, para. 323.
[107] *Ibid.*

share up from 4.3% to 8.2%. From September 2005 until July 2010, Sanofi offered to US hospitals the 'Lovenox Acute Contract Value Program' (Program). Under the terms of the Program, hospitals received price discounts of 1% if the volume of Lovenox they purchased was below 75% of their total purchases and increasingly higher discounts, ranging from 9% to 30% (in 2008), if they increased their purchases above this threshold.[108] Hospitals were not contractually bound by these conditions: the only consequence of not reaching the 75% threshold was that the hospital would receive only the 1% discount.[109] Contracts could be terminated with 30 days' notice, after which future purchases would be for Lovenox's wholesale price.

Eisai claimed that Sanofi harmed competition in the market for anticoagulant drugs by preventing hospitals from replacing Lovenox with competing drugs.

3.2[b] *Assessment*

The Third Circuit had to determine whether Sanofi's program constituted exclusive dealing arrangements or simply pricing practices.[110] In this regard, the Court declined to characterize the conduct as pricing practice and rejected the application of the price-cost test. It clarified that a price-cost test is applicable as a specific application of the rule of reason only when the price is the predominant mechanism of exclusion, and explained that the price itself did not function as the exclusionary tool in those cases.[111] In contrast, the District Court had found that the price was the predominant mechanism of exclusion under Sanofi's practices and decided that a price-cost test was applicable.[112] Since Sanofi's prices had never been below costs, summary judgment was granted in favour of Sanofi holding that the LTAs were not anticompetitive because they were above cost. Eisai argued that Sanofi offered discounts that bundled incontestable and contestable demand and it was this bundling, not the price, that served as an exclusionary tool.[113] The Court accepted the argument that the price was not the mechanism of exclusion but rejected the bundling claims stating that: 'Even if bundling of different types of demand for the same product could, in the abstract, foreclose competition, nothing in the record indicates that an equally efficient competitor was unable to compete with Sanofi.'[114] In this regard, the Court held that the facts showed that Eisai failed

[108] *Eisai*, para. 400.
[109] *Ibid.*
[110] *Eisai*, para. 408.
[111] *Ibid.*, para. 409.
[112] *Eisai INC v. Sanofi-Aventis LLC et al.,* No. 3:08-cv-04168, District Court of New Jersey (28 Mar. 2014).
[113] *Eisai*, para. 409.
[114] *Ibid.*, para. 406.

to prove the existence of non-contestable demand for Lovenox, which made it a must-stock product on the basis of its unique indication and customer preferences. For that reason, the Court found that Eisai was able to compete for the whole demand.

The Court rejected Eisai's argument that the Program at issue substantially foreclosed the market for the following reasons. Firstly, the coverage of the agreement was limited to a few dozen hospitals out of almost 6,000 in the US, which was considered not enough to demonstrate substantial foreclosure.[115] Secondly, customers were free to switch to a competitor's product without risk of penalty or of supply shortages.[116] For that reason, the Appeals Court affirmed the District Court's order, granting summary judgment in favour of Sanofi holding that the LTAs were not anticompetitive under the rule of reason analysis.

4 COMPARATIVE ANALYSIS

4.1 The framework to assess fidelity rebates and the relevance of the price-cost test in the recent EU case law on fidelity rebates

In *Intel*, the European Commission chose to apply the modified price-cost test for the evaluation of the anticompetitive effects of fidelity rebates.[117] On appeal, the GC considered that, the test is irrelevant for the assessment of exclusivity rebates for two reasons. First, the GC clarified that the test is limited to pricing practices and as such not relevant for the evaluation of exclusivity rebates, which in the Intel case were considered not related to pricing conduct. This statement is in line with the Third Circuit's argument to reject the price-cost test in both of the cases discussed in the previous section. Second, the GC clarified that the price-cost test cannot capture the rebates' anticompetitive nature and the foreclosure effects could arise even if an as efficient competitor could theoretically enter the market. This statement indicates that the GC considered that the test is prone to false negatives in holding that even if a competitor is able to cover its costs, this does not mean that there is no foreclosure effect.[118] This statement could be interpreted as suggesting that even if the test is passed by the dominant company, the existence of other evidence, such as unavoidable trading partner status, significant part of demand secured for the dominant company, retroactivity of rebates in combination with

[115] *Ibid.*, para. 404.
[116] *Ibid.*, para. 408.
[117] *Intel* (Case COMP/37.990) Commission Decision [2009] OJ C227/13.
[118] GC judgment, para. 150.

additional anticompetitive conditions – the naked restrictions, would be sufficient for considering Intel's practice as capable of harming competition.

Next, the GC held that the price-cost test is also not required for the evaluation of the 'other' types of rebates because the assessment of all the circumstances was considered enough to demonstrate the existence of a loyalty mechanism, which was deemed to amount to an anticompetitive effect, that did not have to be demonstrated by means of a price-cost test. This position was adopted in AG Kokott's opinion[119] and repeated in the *Post Danmark II* judgment where the CJEU considered the AEC test neither legally required nor decisive for establishing an abuse, which might be seen as limiting its usefulness in general.[120] The CJEU considered the application of a price-cost test as irrelevant for this particular case for two main reasons. Firstly, the Court considered that the characteristics of the market under consideration in this particular case could not accommodate a competitor as efficient as Post Danmark, in which case the presence of a less efficient competitor still might impose a competitive constraint on the dominant company. Secondly, the CJEU held that the application of the AEC test does not constitute a necessary condition for a finding of abuse, which means that there is no legal obligation to make use of that test. However, the CJEU held that the test could be used as one tool amongst others without providing much clarity when this might be the case. Similarly, the CJEU in *Intel* clarified that the effect of fidelity rebates require evaluation of all the circumstances in order to assess the possible existence of a strategy aiming to exclude an as efficient competitor, but did not clarify whether a price-cost test is required.

In contrast, while the Third Circuit in *Meritor* rejected the price-cost test, it clarified that the existence of anticompetitive provisions (combined with discounts) made the rebates at issue 'de facto' exclusive dealing. For that reason, the price was not considered to be the mechanism of exclusion, which substantiates the classification of the conduct as non-price practices and as such, a price-cost test was deemed irrelevant. The Third Circuit further clarified that a price-cost test might be useful in pricing practices in 'a case in which price is the clearly predominant mechanism of exclusion.'[121] The Court further explained that in those cases, the price-cost test might be applied as a specific application of the rule of reason. However, a clear indication as to when the price is the predominant mechanism of exclusion, or in other words, how to distinguish between pricing and non-pricing practices, is put aside.[122] Similarly, in *Eisai*, the Court clarified that the price itself

[119] Case C-23/14 *Post Danmark A/S v. Konkurrenceradet*, Opinion of AG Kokott, para. 56.

[120] J. Venit, *Making Sense of Post Danmark I and II: Keeping the Hell Fires Well Stoked and Burning*, 7(3) J. Eur. Competition L. & Prac. 165 (2016).

[121] *Meritor*, para. 275.

[122] Moore & Wright, *supra* n. 42, at 1244.

did not function as the exclusionary tool in those cases and rejected the application of the price-cost test.

In *Intel* the GC also observed that the rebates granted by Intel made it possible 'to use the non-contestable share of the demand of the customer as leverage to secure also the contestable share.'[123] In doing so, Intel made it more difficult for its competitors to compete for the contestable share of demand, because its competitors not only had to make an attractive offer for the contestable portion of the market, but also had to compensate the customer for the loss of the exclusivity rebate.[124] This position might be interpreted as saying that the GC considered Intel's rebates as de facto exclusive dealing, which can substantiate the rejection of the price-cost test in line with what the Third Circuit held in *Meritor*. The similarity is even more apparent in *Eisai* where the Third Circuit discussed the bundling of non-contestable and contestable demand and clarified that such bundling might, in the abstract, foreclose competition if the review of the evidence shows that an equally efficient competitor was unable to compete for the contestable share of sales because of the bundling. It also might be suggested that under different facts, 'the theory of bundling premised on non-contestability' may support a finding of liability, which nonetheless substantiates the irrelevance of the price-cost test in those circumstances.[125]

4.2 Price-cost tests and raising rivals' costs

Another way through which the American experience can contribute to understanding developments in the EU is by reference to the US academic debate, and particularly the importance of the RRC theory. In *Intel*, the GC observed that an anticompetitive effect occurs 'not only where access to the market is made impossible for competitors, but also where that access is made more difficult.'[126] This statement might be interpreted as shifting the focus of analysis from the exclusion of rivals to their marginalization. In this regard, the relevant theory of harm seems to fit with the RRC framework explaining that when the rivals are not able to compete and to reach a large enough portion of the market to achieve MES, the dominant company would be in a position to successfully protect or enhance its market power. As discussed above, RRC theory foresees situations in which a dominant company restricts its competitors' access to crucial inputs (input foreclosure) or customers (customer foreclosure), causing them to raise their costs

[123] GC judgment, para. 103.
[124] *Ibid.*, para. 93.
[125] Morton & Abrahamson, *supra* n. 97, at 701.
[126] GC judgment, para. 88.

or reduce their output. As a result of that conduct, competitors might not be excluded from the market but they become less efficient, which ultimately decreases their ability to impose competitive constraint on the dominant company pricing.

In effect, Intel's rebate schemes fit very neatly with this theory. First, Intel produces central processing units (CPUs), which are a key component in the overall performance of a computer. Intel's customers are original equipment manufacturers (OEMs) such as Dell, HP, NEC and Lenovo, and one retailer, Media-Saturn Holding GmbH (MSH). Because of the strong dominant position of Intel, its customers obtained a substantial part of the demand (the 'non-contestable' share) from it. Intel's competitors could only compete for that portion of demand that exceeds Intel's non-contestable share, i.e. the 'contestable' share of demand.[127] The exclusivity agreements between Intel and the OEMs were condemned because they denied Intel's competitors access to the market, preventing them from competing for the contestable share. Intel's exclusivity rebates could foreclose its competitors' access to a significant customer base, which might prevent them from reaching MES, which would ultimately raise its costs – in which case it might remain on the market but be marginalized as a competitor, thereby providing a lesser competitive constraint on the dominant firm's pricing. Thus, achieving MES is crucial for the successful performance of a company.

The industry in the *Intel* case was characterized by significant costs to enter the market and 'an enormous combination of ingenuity, time and capital to develop the required know how to design 86 CPUs or to obtain a license from Intel.'[128] In industries with these characteristics, achieving MES is a necessary prerequisite for a competitor or an entrant to become as efficient as the dominant company. The presence of a dominant company with unavoidable trading partner status means that a significant part of demand is secured for the dominant company and only a small part is open to competition. In those cases, even a small amount of foreclosure might deprive a competitor or an entrant to reach MES and as such, to create strategic barriers that might be enough to marginalize them. This interpretation seems to be in line with the GC's position that the coverage of the rebate schemes was irrelevant, and with the CJEU's refusal to consider the second ground of Intel's appeal, which dealt with the market coverage.[129]

If rivals' costs are raised due to an inability to reach MES in the context of economies of scale, rivals would always be inefficient and as such, its 'higher costs would not be well accounted for by a price-cost test.'[130] Thus, because of its cost/

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[127] *Ibid.*, para. 92.
[128] *Ibid.*, para. 129.
[129] GC judgment, para. 114; CJEU judgment, para. 147.
[130] S. Salop, https://truthonthemarket.com/2013/06/07/wright-is-right-and-price-cost-safe-harbors-are-wrong-the-raising-rivals-cost-paradigm-loyalty-discounts-and-exclusive-dealing/ (accessed 15 Feb. 2018).

efficiency advantage over its competitors, a dominant company might charge prices below which those competitors can charge without engaging in below-cost pricing (i.e. without profit sacrifice). This also means that anticompetitive behaviour may be pursued which is not caught by the price-cost test – making this test unsuitable as a legal standard. This may explain the GC's position regarding the irrelevance of the AEC test in the assessment of the legality of fidelity rebates in *Intel*.

A second way in which the condemnation of Intel's practices by the GC is in line with RRC theory is in the compounded impact of providing discounts to distributors. Intel's customers are OEMs, which manufacture computers and sell them to final consumers. In order to get its products to final consumers, Intel's competitor ADM needed access to the OEMs – because final consumers were only interested in purchasing computers, and not components such as CPUs. Access to OEMs may therefore be the only possible distribution channel for ADM, providing a crucial input for the ultimate marketing of CPUs. In providing OEMs with an incentive to purchase exclusively from it, Intel engaged not only in customer foreclosure of ADM (regarding direct purchasers), but also in input foreclosure (regarding final consumers). According to RRC theory, in cases of input foreclosure even if rivals achieve MES their costs will be higher. The fact that a competitor is still present in the market but its performance is made more difficult means that its competitiveness is reduced. Therefore, there is not actual foreclosure but the competitive process is nonetheless harmed because the competitor, even if he is still on the market, cannot impose competitive constraints on the dominant company. Input foreclosure may lead to reduced incentives to innovate and to an increase in prices charged to the customers. Thus, input foreclosure can reduce competition even if the competitor's performance is at MES. This might explain the GC's observation that the anticompetitive effect occurs 'not only where access to the market is made impossible for competitors, but also where that access is made more difficult.'[131]

From the above, it can be suggested that the EU Courts 'allegations appear consistent with an analytical approach based upon a raising rivals' cost theory of exclusion.'[132]

5 CONCLUSION

The aim of this article was to compare the treatment of fidelity rebates in the recent federal courts judgments in *Meritor* and *Eisai*, and in the academic debate in the US, with the EU Courts' judgments in *Intel* and *Post Danmark II*. The goal was

[131] GC judgment, para. 88.
[132] Wright, *supra* n. 6, at 29.

to obtain insights regarding the available tools to distinguish anticompetitive rebates from effective competition and the role of price-cost tests in the context of these tools.

The debate about the appropriate treatment of fidelity rebates under the US antitrust law is longstanding. The primary dispute has been whether fidelity rebates have to be treated under the predatory pricing law where the price-cost test is applicable, or whether they have to be treated under the law of exclusive dealing where the rule of reason is applicable. The recent split decisions by the Third Circuit in *ZF Meritor* and *Eisai* reflects this longstanding debate. In both cases, the Third Circuit declined to adopt the price-cost test while clarifying that the test might be applied as an element of the rule of reason only when the price is the predominant mechanism of exclusion, which according to the Court was not the case at issue.

Rule of reason analysis evaluates whether fidelity rebates are anticompetitive in a similar way to which the 'all the circumstances' test evaluates whether fidelity rebates have a fidelity-enhancing effect, which makes them anticompetitive. In both *Meritor* and *Eisai*, the Third Circuit rejected the application of the price-cost test because the price was not the predominant mechanism of exclusion in these cases – instead, the rebate schemes could exclude equally efficient rivals irrespective of whether the pricing is below-cost. In both judgments, the Third Circuit was clear that the evaluation of illegality of fidelity rebates can be based on their actual anticompetitive effect without performing a formal price-cost test, which confirms that the AEC framework is not reliant exclusively on a price-cost test.[133] It seems that this is exactly the position of the CJEU in *Intel* by saying that the assessment of fidelity rebates requires evaluation of all the circumstances in order to assess the possible existence of a strategy aiming to exclude an as efficient competitor without mentioning the requirement for a price-cost test to be carried out. However, the main lesson from the recent US case law is that the application of the price-cost test depends on whether the conduct could be classified as pricing practice, which requires the application of the test, or non-pricing, which makes the application of the test irrelevant.[134]

Lastly, the discussion of the RRC theory explains how this approach holds that fidelity rebates can be assessed without a need to undertake a price-cost test. The RRC theory is based on the assumption that a fidelity rebate scheme can foreclose a competitor (or potential entrant) access to market/customers without pricing below cost. In addition, a successful RRC strategy does not

[133] According to Kühn & Marinova, *supra* n. 19: 'The AEC test should be interpreted as a concept, not as a formal price-cost test.'

[134] A recent study conducted by Jessen reach to the similar conclusions that a clear-cut categorization of when conditional rebates are price or non-price conduct is crucial for the proper assessment of their legality. *See* A. Jessen, *Exclusionary Abuse after the Post Denmark I Case: The Role of the Effects-Based Approach under Article 102 TFEU* (Wolters Kluwer 2017).

necessarily require profit sacrifice, which means that a dominant company might set its prices above costs but still make competitors' access to input/ customers more difficult and thereby marginalize them as competitors. By raising rivals costs, a dominant company can hinder competitor's possibility to compete effectively and to expand their market performance. Hence, the competitive process could be harmed due to competitors' inability to impose competitive constraint on the dominant company. The economic theory of RRC provides an alternative interpretation of why fidelity rebates can be anticompetitive even if the price is above costs, and provides a framework to understand the underlining rationale behind the rejection of the price-cost test in the GC judgment *Intel* and the CJEU judgment in *Post Danmark II*.