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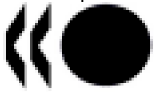

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**DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS**
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# ROUNDTABLE ON LOYALTY OR FIDELITY DISCOUNTS AND REBATES

**-- Note by the United States --**

*This note is submitted by the United States Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting on 5-6 June 2002.*

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1. Firms offer a wide range of discounting programs, from straight quantity discounts to programs involving minimum share requirements and/or multiple products. Such programs typically have procompetitive effects. The potential for anticompetitive effects will depend upon the specific details of the programs and the market power of the firms involved. It is thus important not to use terms such as "fidelity" discounts too loosely. If the term is meant generically to apply to any type of discount program, it cannot be used to infer that there is a likelihood of competitive harm from such discounts. If the term is meant to apply only to those types of programs that have the potential for competitive harm, it is important to distinguish what types of programs would be covered. Even in the latter case, a detailed, fact-based investigation of any particular program would be needed to assess its actual competitive effects. The U.S. antitrust agencies cannot recall any enforcement actions challenging "market share" discount schemes, but a number of recent private suits have started to develop the law in this area. In this paper, we summarize the private suits and then discuss some of the applicable economic theory with regard to discount programs. The U.S. agencies do not necessarily endorse the reasoning of the cases described, but the cases illustrate the issues well.

## US Antitrust Cases on Discount Programs

### *Single Product Discounts*

2. The few American antitrust decisions that have dealt with simple discounts or rebates illustrate both the importance of factual evidence of an anticompetitive effect (rather than simply of an effect on a competitor) and the substantial judicial concern about deterring beneficial price cuts. Courts are generally unwilling to assume these discounts are anticompetitive, even if the discounter has market power; they are reluctant to force monopolists to charge high prices.

3. In *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983), Pacific had most of the market for "snubbers" used in nuclear power plants because it was the only acceptable producer of mechanical scrubbers for U.S. nuclear plants. Grinnell, which accounted for about half of U.S. snubber purchases, had been working to help Barry Wright become an alternative source of these snubbers. Pacific then offered Grinnell a large discount on its total snubber purchases if Grinnell would promise to buy large quantities of snubbers from Pacific; Pacific offered the discount to get Grinnell's loyalty as a purchaser of snubbers. Grinnell agreed, with the result that Wright abandoned its attempt to enter the snubber business. Wright sued, alleging a violation of Section 2 of the Sherman Act. Both the district court and the court of appeals rejected this claim because, then Judge (now Supreme Court Justice) Breyer explained for the court of appeals, under conventional price/cost tests for predatory pricing, Pacific's discount was not predatory — the resulting price was above any relevant measure of Pacific's cost, and the theoretical possibility that such prices could harm competition did not justify the risk of deterring procompetitive pricecutting by entertaining that possibility in litigation. But even if that were not determinative, Judge Breyer noted that there was evidence that the discount enabled Pacific to operate its production capacity more efficiently, because it led to a firm order for an increased quantity.

4. *Barry Wright* is unusual in that the discount was offered only to a single customer. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000), may be a better example. Brunswick manufactured and sold stern drive engines for recreational boats; it had a large share of the market (e.g., 75% in 1983). Beginning in the early 1980s, Brunswick (like its competitors) offered market share

discounts. Boat builder customers who agreed to purchase a certain percentage of their engine requirements from Brunswick for a period of time (often a year, sometimes longer) received a discount off the list price for all engines purchased — for example, an agreement to buy 70% of engine requirements from Brunswick might result in a 3% discount, agreement for 65% a 1% discount, and an agreement for 60% a 1% discount. Since the boat builders' customers often preferred Brunswick engines, as a practical matter, boat builders had to purchase a reasonable percentage of their engine needs from Brunswick; the discounts might well have led them to purchase significantly higher percentages from Brunswick than they otherwise would have.

5. Some of the boat builders sued Brunswick, alleging among other claims that these discount programs excluded competing stern drive engine manufacturers from the market and amounted to monopolization in violation of Section 2 of the Sherman Act. The court of appeals did not quite say that the failure to show that Brunswick's prices were below its cost was fatal to the claim, but relied on a strong presumption that prices above costs are lawful and represent competition on the merits. And it found nothing to overcome that presumption, particularly since the agreements, which left the buyers free to purchase 40% of their requirements from other engine sellers while still receiving loyalty discounts from Brunswick, were not exclusive dealing agreements. And the court found that other engine sellers could compete with Brunswick by offering superior discounts. Brunswick offered testimony that the discounts served procompetitive purposes (beyond simply lowering prices) by increasing the predictability of demand and thus lowering manufacturing costs, but the court of appeals did not rely on this evidence, instead saying that "Brunswick's business justification in this case is that it was trying to sell its product" (207 F.3d at 1062) by cutting prices.

6. The discount programs in *Virgin Atlantic Airways Ltd. v. British Airways PLC*, 69 F. Supp. 571 (S.D.N.Y. 1999), *aff'd*, 257 F.3d 256 (2d Cir. 2001), received similar treatment. British Airways (BA) used incentive programs that provided travel agencies with commissions, and corporate customers with discounts, for meeting specified thresholds for sales of BA tickets (sometimes expressed in market share terms, sometimes not). The discounts or commissions, if earned, applied to all sales — including those made before the targets were met. Virgin Atlantic claimed that the result was below cost pricing on certain transatlantic routes where Virgin and BA competed, with BA's attendant losses subsidized by monopoly pricing on other BA routes. Virgin alleged that the below cost pricing slowed its expansion on the competitive routes. These Section 2 claims foundered, as both the district court and the court of appeals concluded that Virgin had failed to show below cost pricing. To show below cost pricing, Virgin's expert had compared the cost of incremental flights he assumed were entirely attributable to the incentive schemes with the incremental revenues the flights generated. The comparison depended on the assumption, and the courts were not sufficiently persuaded that the assumption reflected reality.[1]

### *Multiproduct (Bundled) Discounts*

7. Several well-known cases have dealt with a more complex form of discount programs. The firm offering the discount sells multiple products, has significant market power with respect to one or more of the products (but not all of them), and faces competition in a product or product line where it lacks significant market power. The firm bases the discount or rebate not solely on the product facing

[1] The court of appeals rejected Section 1 claims based on the same conduct because the agreements did not constrain the buyers — Virgin admitted on appeal that it was challenging unilateral conduct, not a Section 1 conspiracy. 257 F.3d at 263. But in an unnecessary discussion of what would be necessary to sustain a Section 1 claim had there been a conspiracy, the court added that "the efficiency argument in favor of incentive agreements like those used by British Airways is obvious . . . . These kinds of agreements allow firms to reward their most loyal customers. Rewarding customer loyalty promotes competition on the merits." *Id.* at 255. The court did not otherwise explain this point.

competition, but on other products as well. The practice is generally found not to constitute unlawful tying, because the seller is willing to sell the products separately. But courts examine these practices carefully to determine, based largely on the facts regarding competitive impact, whether there is a violation of Section 2 of the Sherman Act.

8. *SmithKline Corp. v. Eli Lilly & Co.*, 427 F. Supp. 1089 (E.D. Pa. 1976), *aff'd*, 575 F. 2d 1056 (3d Cir. 1978), is the first and most influential of these cases. In what was found to be the relevant market of sales of a class of antibiotics known as cephalosporins to nonprofit hospitals in the United States, 575 F.2d at 1058, Lilly sold four drugs on which it held the patent; it was the only lawful source of these drugs, *id.* at 1059. Like other pharmaceutical firms, Lilly used a volume rebate scheme for these products, intended to increase sales, at least in part at the expense of other antibiotics. *Id.* at 1059-60. Then, SmithKline licensed cefazolin, another cephalosporin, from a foreign company, and began selling it as Ancef; Lilly subsequently licensed the same drug, selling it as Kefzol. *Id.* at 1059. Cefazolin could substitute for Lilly's market-dominating cephalosporin Keflin and was cheaper, because Lilly and SmithKline competed. *Id.* at 1061. Since Lilly's profits on its patented Keflin were much higher than on its brand of cefazolin, Lilly would benefit from discouraging that substitution. *Id.*

9. Lilly responded by including Kefzol in a modified version of its preexisting rebate scheme. The new scheme reduced the basic rebate rate on the volume of Lilly cephalosporins a hospital bought by roughly 3%. But it added a "bonus dividend" of 3% on total Lilly cephalosporins purchases provided the hospital bought specified minimum quantities of each of any three of Lilly's five cephalosporins. 427 F. Supp. at 1105. (The group charged with devising Lilly's response had been instructed that the new scheme should cost Lilly no more money than did the preexisting rebate program. *Id.*) Lilly expected that almost all hospitals would buy the specified minimum quantities of Lilly's two most dominant patented cephalosporins, and that almost none would buy the specified minimum of the other two. *Id.* at 1106. Thus, whether a hospital received the 3% rebate on its total Lilly cephalosporin purchases depended on whether the hospital bought the specified minimum of Kefzol; Lilly viewed this rebate as an "inducement," *id.*, to buy Kefzol rather than Ancef. And Lilly expected that SmithKline, which a had higher cost of goods than did Lilly for cefazolin, *id.* at 1102, could match that inducement only by offering a rebate of more than 20% on sales of its only significant cephalosporins, Ancef, *id.* at 1106, since SmithKline's percentage rebate applied only to sales of the one product, unlike Lilly's.

10. This scheme had consequences for SmithKline and market competition. The court credited evidence that, absent the scheme, SmithKline would have had a pretax return on sales too low to justify staying in the market unless there were a potential for significant improvement, yet with the lower costs likely to result from greater manufacturing experience, the pretax return on sales in the future would be enough to justify staying in the business. *Id.* at 1122-23, 1108-09. Given the rebate scheme, however, SmithKline's return on sales was negative because it needed very large rebates to compete effectively, and even if it lowered its cost of goods to Lilly's level, SmithKline's Ancef could never be sufficiently profitable to justify remaining in the market. *Id.* at 1123.

11. In other words, the court concluded the evidence showed that Lilly used its "monopoly power" in two cephalosporins, *id.* at 1121, in a manner that not only excluded the less efficient SmithKline from the market, but would have excluded SmithKline if it were an equally efficient producer of cefazolin. And it did not matter that Lilly may have sold each of its products at a price above its average cost, because the unlawful conduct was not the pricing of individual products. *Id.* at 1128. The two opinions mention no efficiencies attributable to Lilly's revision of its rebate scheme. Lilly was held to have wilfully maintained its monopoly power in violation of Section 2 of the Sherman Act. We think the decisions turn on the scheme's ability to exclude an equally efficient competitor, but although the district court carefully established that the scheme could do so, neither court explicitly identified that as the appropriate standard.

12. A somewhat similar pricing scheme was held not to violate Section 2 in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, 920 F. Supp.455 (S.D.N.Y. 1996), because the evidence of competitive effect was quite different. The products were five "assays" used to test blood for the presence

of various viruses. Blood donor centers (BDCs) require all five. *Id.* at 458. Only defendant Abbott made and sold all five; it accounted for from 70 to 90 percent of the sales of each of four of them. *Id.* at 459. (For purposes of summary judgment, the court accepted the inference of market power. *Id.* at 463-65.) Its only significant competitor, Ortho, sold four assays, although one lacked widespread customer acceptance. *Id.* at 459. The Council of Community Blood Centers, to which many BDCs belong, solicited bids on a contract to supply assays (and certain equipment not discussed here) to member BDCs who chose to buy on the terms specified in the winning contract. The solicitation called for different pricing schedules depending on whether the BDC bought all the assays from the chosen seller or only any two or three of them. *Id.* at 459-60. Abbott won the contract, with pricing schedules that gave significant discounts on each of the assays for buying all of them from Abbott. *Id.* at 460. Particularly because, as a practical matter, BDCs had to buy from Abbott at least the two assays only Abbott supplied, the discount scheme created a very significant incentive to buy all five from Abbott and none from Ortho — in Ortho's view, the scheme effectively forced buyers to pay a financial penalty for buying any assays from Ortho, *id.* at 461. Ortho alleged the pricing scheme violated Section 2.

13. The court concluded that Ortho's Section 2 claims failed if Abbott's pricing was "legitimately competitive" because the offenses Ortho alleged all required a showing of "predatory or anticompetitive conduct or an inappropriate use of monopoly power by the defendant." *Id.* at 465. But what is "legitimately competitive" pricing? The court noted that the conventional "below cost" component of tests for unlawful predatory pricing is designed to identify pricing that threatens to "drive equally efficient competitors out of business, thus setting the stage for recoupment at the expense of consumers." *Id.* at 466. Ortho did not even contend that Abbott had priced below the conventional average variable cost standard. *Id.* at 467. But the court, drawing on *SmithKline*, concluded that "a firm that enjoys a monopoly on one or more of a group of complementary products, but which faces competition on others, can price all of its products above average variable cost and yet still drive an equally efficient competitor out of the market." *Id.* at 467. It thus held that liability for a multiproduct pricing scheme could be based not only on pricing below average variable cost, but also on other pricing that makes it unprofitable for an equally efficient producer of the defendant's competitive product to continue to produce that product. *Id.* at 469. Ortho, however, did not claim that Abbott's pricing left Ortho unable to sell its products at a profit, *id.* at 470, and so Abbot's pricing scheme would not exclude an equally efficient producer from the marketplace. Ortho also argued that the pricing of the five assay package would be legitimate only if the "incremental net revenue from selling the two additional tests is greater than the revenue forgone as a result of the price cuts of the three original tests." *Id.* at 470. The court neither accepted nor rejected this test (which somewhat resembles both the conventional predatory pricing cost test and the incremental cost test advocated by the DOJ in the *American Airlines* case) because Ortho, in evaluating Abbott's pricing, looked only at the prices charged, while ignoring any revenues attributable to increased sales volume induced by the price reductions. *Id.* at 470-71. That is, Ortho did not show that Abbott failed the test Ortho had proposed. The court accordingly concluded that Abbott's pricing was legitimately competitive. *Id.* at 471. There was, therefore, no need to consider any procompetitive benefits (beyond the simple fact of a lower price).

14. The latest prominent case in this line, *LePage's Inc. v. 3M*, 2000 WL 280350 (E.D. Pa. March 14, 2000), *aff'd in part, rev'd in part, and remanded*, 227 F.3d 365 (3d Cir. 2002), *reh'g en banc granted and opinion vacated* (Feb. 25, 2002), is still in litigation. 3M's Scotch brand dominated the transparent tape market in the United States, and 3M sold many other products as well. In the 1980s, LePage's and Tesa Tuck, Inc. became increasingly successful selling "second brand" and private label tape to chains like Staples and WalMart. Growth of this segment would hurt 3M's profits even if 3M supplied the tape, since margins on second brand and private label tape were significantly lower than 3M's margins on Scotch tape. LePage's claimed that 3M responded with rebate schemes, based on multiple products, that served to eliminate LePage's (and Tesa Tuck) as competitors in transparent tape. 3M's various schemes in general provided across the board rebates to customers who met growth targets 3M set for purchases of various kinds of consumer goods, the size of the rebate dependent on the number of goods categories in which the buyer met the target. Failure to meet the target in even one product line could result in a significant rebate

loss. The result, allegedly, was that, as a practical matter, customers would lose significant benefits unless they stopped buying tape from LePage's, in whole or significant part. And, as with the pricing schemes in *SmithKline* and *Ortho*, it would be difficult for LePage's to offer rebates on transparent tape alone that could offset the rebates a customer would lose on multiple products by buying tape from LePage's. Tesa Tuck left the market, and LePage's business in the market dropped substantially.

15. A jury found 3M liable for unlawful maintenance of monopoly power. The district court refused to throw out the verdict despite 3M's argument that, under *SmithKline*, LePage's was required to, but did not, show that it at least approached 3M's efficiency as a tape producer. The district court found no such requirement in *SmithKline*. It instead rested liability on the more general standard that "exclusionary conduct and predatory conduct comprehends, at the most, behavior that not only . . . tends to impair the opportunity of its rivals, but also . . . either does not further competition on the merits, or does so in an unnecessarily restrictive way."

16. On appeal, a divided three judge panel reversed, mainly because "LePage's did not demonstrate that 3M's pricing was below cost and, in the absence of such proof, the record does not supply a basis on which we can uphold the judgment." The court rejected the argument the district court had accepted, that LePage's did not have to show that 3M's pricing scheme could prevent an equally efficient firm from profitably competing, and then concluded that LePage's had failed to make the required showing. (The court hinted, however, that such a showing might not suffice if the defendants' prices were above average variable cost.) And the court suggested that there might have been legitimate, procompetitive, business justifications for the pricing scheme ("other than the obvious reasons such as increasing bulk sales, market share and customer loyalty, there are several other potential 'procompetitive' or valid business reasons for 3M's pricing structure and bundled rebates: efficiency in having single invoices, single shipments and uniform pricing programs for various products"), although it did not point to any evidence supporting these justifications.

17. The dissenting judge disagreed about almost everything. She read *SmithKline* as turning on simply the pricing scheme's linkage of a product facing competition with products facing none. She thus rejected any requirement that LePage's demonstrate that an equally efficient competitor could not profitably compete, given the pricing scheme — although she also thought the evidence showed that LePage's could not compete profitably. Moreover, she rejected the majority's suggestion that there can be no liability absent pricing below costs — in a multiproduct situation or otherwise, since she read the relevant Supreme Court decision, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), as not addressing pricing by "a monopolist with unconstrained market power."

18. The full Third Circuit agreed to rehear the case en banc, which has the effect of vacating the opinion of the panel. But the court will not hear argument until late October, so we will not know the result for perhaps a year. If the full court agrees with the panel's dissenting judge, the result could conceivably be what amounts to a rule that a monopolist in one product may not use discounts of this kind, the kind of rule that the other decisions discussed seem to have rejected.

19. Finally, the *Virgin Atlantic* case already discussed included a claim involving bundled airline routes. Some of the incentive agreements involved bundles of routes, so, allegedly, a customer who flew on BA monopoly routes had an incentive, because of bundling and the discounts, also to fly BA on routes where British Airways faced competition, even though the competing carrier charged less; to avoid this, the competing carrier (Virgin) would have to reduce the price of the tickets to match the incentive discounts involving other routes, and that would require it to sell below its cost. However, Virgin had little or no evidence that this theoretically possible situation ever actually arose in the exceedingly varied pattern of bundling that existed, and the courts found theory alone inadequate to hold British Airways liable.

**Procompetitive and Anticompetitive Effects of "Market Share" Discounts**

20. Some discount programs take the form of "market share"discounts where "market share" refers to the percentage of the customer's total purchases. To encourage customers to buy more from the discounting seller and less from rival sellers, a seller may grant discounts to a customer where the discount is tied to the proportion of the customer's total purchases from that seller. This was the discount scheme used in the Brunswick boat engines case described above. Thus a buyer might get a five percent discount from the seller if it buys fifty percent of its purchases from that seller, a ten percent discount for sixty percent, a twenty percent discount for seventy percent, etc.

21. Frequently market share discounts increase more rapidly than the market share thresholds. In this instance, for example, the discount increased by fifty percent (from ten to fifteen percent) when the market share threshold rose by only sixteen percent (from sixty to seventy percent). For customers seeking to meet market share thresholds, market share discounts may have disproportionately large effects in discouraging purchases from rival sellers. The rival seller must compete not simply on the price of the marginal unit purchased but must also compensate the customer for discounts lost on each inframarginal unit purchase. As market share thresholds increase and discounts deepen, rival sellers may find it very difficult to compensate customers for lost discounts.

22. Market share discounts can have either anti-competitive or pro-competitive effects. In order for market share discounts to have an anti-competitive effect, the firm offering such discounts must have market power in a relevant market. Thus the first step in investigating whether loyalty discounts have anti-competitive effects is to determine whether the firm offering such discounts has market power.

23. However, the fact that a firm has market power is not sufficient to prove that its loyalty discounts are anti-competitive. Here are some ways in which loyalty discounts, i.e., market share discounts, can be pro-competitive:

- When the manufacturer has significant fixed costs, average costs of production will exceed marginal costs, at least up to full capacity utilization. The manufacturer can reduce price and increase profits if the margin at the current price exceeds the inverse of the firm's own elasticity of demand. However lowering price (below current price) in order to sell more units of output can be even more profitable if the manufacturer can avoid lowering price on all units of output. The manufacturer could use volume discounts or loyalty discounts to avoid lowering the price on all units. Loyalty discounts will be more profitable and more efficient than volume discounts when customers' sales quantities vary greatly across customers (regardless of the size of the seller's fixed costs). Small customers may not be able to purchase sufficient quantities to trigger volume discounts but can receive loyalty discounts by committing to purchase a certain percentage of its inputs from the manufacturer. Indeed to the extent that disproportionate discounts under the loyalty program encourages the buyer to pass along those cost reductions, society may benefit from greater production due to the loyalty discount than would occur with a volume discount or an across-the-board price reduction. (To the extent however that loyalty discounts simply shift purchases amongst buyers, discriminating according to their demand elasticity without increasing total production, these shifts are simply transfers from one buyer to another and do not represent production efficiencies.)

- Society can also benefit if loyalty discounts also reduce costs of production. For example, suppose that loyalty discounts are introduced for market share levels at or near current levels. The effect will be to reduce the manufacturer's sales fluctuations. The reduced variance in sales will lower the manufacturer's inventory costs. If marginal costs are increasing with capacity utilization, then reduced variance in sales will also lower production costs. (For example, the average cost of production will be less if capacity utilization is at a steady

eighty percent per year rather than if it fluctuates unpredictably between seventy and ninety percent.) Finally the manufacturer's future sales (and profits) can be increased if loyalty discounts increase sales stability and prevent the manufacturer from being caught short by an unexpected increase in demand that harms its reputation for service and supply reliability.

24. On the other hand loyalty discounts can serve to exclude competitors and harm consumers. The necessary conditions include not only market power in the relevant market but also:

- Market share discounts would be sufficiently deep and triggered at market share thresholds close to 100% so that if the buyer attempted to buy a portion of its supplies from another supplier, the net effect of such a purchase would be a very large increase in price from the discounting manufacturer. The necessary condition is that the structure of the market share discounts have the effect of forcing the buyer to purchase a very large proportion, if not all, of its supplies from the manufacturer offering the discount or shifting a very large proportion, if not all, of its purchases to another supplier.

- Buyers must be unwilling or unable to rely upon alternative suppliers exclusively, thus remaining tied to the discounting manufacturer.

- Rival suppliers can't vertically integrate downstream into the business of the purchaser. If suppliers can so integrate, then the OEM stage is not the critical bottleneck that the discounting manufacturer would like it to be. Vertical integration of course requires that rivals have sufficient resources (including capital) to make the needed acquisitions. It also requires that the rivals can successfully make sales to final consumers relying on their own manufactured products rather than the products of the discounting manufacturer.

- No single buyer, or group of buyers, is willing to purchase sufficient volumes from an equally efficient rival of the discounting manufacturer to make sure that the rival survives. The discounting manufacturer can exacerbate this problem if it can create barriers that inhibit buyers from searching to find an alternative and equally efficient rival supplier and thereby circumvent the anti-competitive effects of loyalty discounts.

25. Discount programs can also appear in the form of unilateral practices such as the seller bundling its products (3M) and its services (British Airways). The effect of requiring the customer to purchase a bundle of products and services may be the same as requiring a market share commitment. The customer may find in either case that attempting to purchase from rival suppliers causes it to lose the savings associated with bundling or discounting and thus make the effective price of supplies from a rival supplier unacceptably high.

26. Antitrust enforcers are concerned whenever a firm as efficient as the most efficient in the market exits. We naturally wonder if there is some practice associated with one or more firms in that market that caused the exit. And we object if we find some practice adopted by such firm(s) that is responsible. However, as the checklist above suggests, it will be difficult to prove that a practice such as loyalty discounts or bundling is in fact responsible for such exit. that a practice such as loyalty discounts or bundling is in fact responsible for such exit. Moreover, depending on the extent to which such bundling leads to lower prices, as it very well can, antitrust enforcers must acknowledge that consumers may benefit despite the exit of the efficient competitor.

27. Recently three commentators argued that "market share discounts structured to produce total or partial exclusivity should be judged according to the same economic principles that govern exclusive dealing" and should be condemned under existing case law "if they produce anticompetitive effects

without counterbalancing procompetitive effects."[2] Those commentators noted in particular that "if the financial benefits of a market-share discount are effectively concentrated on the decision whether to buy a relatively small number of marginal units, even prices that technically are 'above cost' on average may be below cost as to those marginal units."[3] Where these discounts effectively lock up such a large portion of available business that competitors cannot achieve a minimum viable scale, the authors suggest that a rule of reason analysis might lead to the conclusion that on balance the antitrust laws should prohibit them. A response by Professor Dennis Carlton to this argument acknowledged that non-linear pricing could achieve the same ends as exclusive dealing, but suggested that antitrust intervention "should be used rarely and apply only to extreme pricing conditions (such as ... where the marginal price [of incremental purchases] is zero) where marginal pricing below marginal cost is unambiguous."[4] Volume discounts are very common, and "non-linear pricing can reflect real economic savings that are difficult to measure (lower inventory, promotional, or production costs) or simply may be ways that firms choose to compete for the most desirable customers. Attacking such common competitive behavior would likely create much turmoil and chill competition."[5] We believe that the Carlton response should be accorded substantial weight, given the strict conditions that must be met for a showing of anticompetitive harm stemming from a market share discount program.

28. All this suggests that antitrust enforcement is well-advised to analyze each case on its own merits, recognizing that discount and bundling programs typically have procompetitive features. Not all firms engaging in discount or bundling programs have market power and not all discount or bundling programs have an anticompetitive effect. The programs may be efficient and pro-competitive even in instances where the firm offering discounts and bundles possesses market power in the relevant market. The use of a per se rule outlawing such practices will be unnecessary in the first case and anti-competitive in the second.

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2 Willard K. Tom, David A. Balto, & Neil W. Averitt, Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing, 67 Antitrust L.J. 615 (2000).

3 Id. at 636.

4 Dennis W. Carlton, A General Analysis of Exclusionary Conduct and Refusal to Deal — Why Aspen and Kodak are Misguided, 68 Antitrust L.J. 659, 664 (2001).

5 Id.