CLIENT ALERT

DOJ and FTC Hold Joint Workshop on Conditional Pricing Practices

June 27, 2014

Low and discounted pricing programs, often involving product bundles and customer loyalty provisions, are a cornerstone of competition for many. Because such programs most often involve pro-competitive behavior and deliver benefits to consumers, they are likely to foster competition, the key goal of the antitrust laws. When implemented by firms with "market power," however, they may result in anticompetitive effects that remain a concern for antitrust enforcers. The issue of distinguishing pro-competitive from anticompetitive "conditional pricing practices" was the subject of a day-long workshop sponsored jointly by the U.S. Department of Justice (DOJ) and Federal Trade Commission (FTC) (together, the "Agencies") on June 23, 2014.

Businesses often offer discounted prices because commitments from customers—to purchase a particular product or mix of products, or a specified volume or share, or for a certain period of time—allow the business to make investments, count on returns, lower its own costs, and confidently plan for the future. Conditional pricing practices, common in the health care, life sciences and many other sectors, are thus almost always output enhancing and good for sellers and consumers alike.

But under certain circumstances that the antitrust Agencies wanted to explore in the workshop, conditional pricing can be harmful to competition in ways that have been analogized to tying, exclusive dealing, or predatory pricing. Loyalty discounts, for example, may induce a buyer to purchase most or all of its needs from a single seller and thereby have the potentially anticompetitive effect of depriving a competitor of sales sufficient to effectively compete. Similarly, bundled rebates or discounts conditioned on a buyer's purchase of multiple products can leave a competitor that offers only one of the bundled products unable to profitably match the discount—a result that can arguably reinforce or even strengthen that seller's market power. Finally, such practices can prevent new entrants from gaining traction in a market. Most commentators suggested that enforcement policy should focus on the rare cases where discounting practices primarily result in harm to the competitive process. How to identify those instances that warrant enforcement attention was the focus of discussion during the workshop.

Both the FTC and the DOJ have taken enforcement actions against certain conditional pricing practices in recent years. For example, DOJ reached a settlement of its civil Sherman Act Section 2 claims with United Regional Health Care System in Wichita Falls, TX in February 2011. DOJ's lawsuit alleged that United Regional maintained its inpatient and outpatient hospital services monopoly by requiring most commercial health insurers to enter into contracts that effectively prohibited them from contracting with the hospital's competitors, or face much higher prices. DOJ argued these exclusivity provisions effectively prevented payors from contracting with competing hospitals because (a) United Regional was a "must-have" provider of essential medical specialties and (b) the exclusionary discounts were so deep that payors could not afford to give them up in order to contract with competing hospitals.

To explore the economic and legal policy conundrum presented by conditional pricing practices, the FTC and DOJ invited a distinguished group of lawyers, economists, and academic thought-leaders to discuss the state of the law and to present new research on conditional pricing practices. In his opening remarks, William Baer, Assistant Attorney General for the Antitrust Division, recognized both the lack of clarity and the need to avoid over-deterrence of pro-competitive discounting practices:

"Unfortunately, it is not always easy to draw the line between pricing practices that injure competition and those that do not. We want to be especially careful when drawing that line, because we do not want to discourage legitimate discounts that benefit consumers. We also must make sure that our approach protects competition, not individual competitors."

FTC Commissioner Maureen K. Ohlhausen stated that in shaping effective competition rules, policymakers should aspire toward predictability, transparency, and fairness. She recognized that proper treatment of conditional pricing has challenged practitioners for decades. Ms. Ohlhausen noted the concerns with the Third Circuit's widely criticized approach to bundled rebates and loyalty discounts in *LePage's, Inc. v. 3M Co*., 324 F.3d 141 (3d Cir. 2003) (en banc), in which the Third Circuit allowed monopolization claims to proceed based only on the potential for exclusion, despite the lack of evidence showing the defendant had engaged in below cost pricing. She also noted that the discount attribution cost test adopted by the Ninth Circuit in *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir.2007), has also been criticized and, because appropriate measures of costs can be difficult to calculate, may not provide the panacea of administrability that many want.

Overall, there were no broad areas of consensus among the workshop participants. Participants generally agreed that conditional pricing practices only trigger antitrust concerns when used by monopolists or firms with substantial market (or pricing) power—*PeaceHealth* and *LePage's* both involved claims against alleged monopolists. No commentators at the workshop endorsed the *LePage's* approach. And most were critical of the use of price cost tests, such as the one employed in *PeaceHealth*. Such a test can both over-deter and under-deter truly anticompetitive uses of conditional pricing, they argued, and does a poor job of tracking the line between such uses and pro-competitive ones. Instead, conditional pricing practices' competitive effects, good and bad, should be examined and balanced under the antitrust law's "rule of reason"—a fact-intensive, and costly, inquiry for litigants. Some presenters expressed concern, however, that businesses in the real world need clearer guidance on whether their pricing practices may run afoul of regulators and risk lawsuits from competitors, and that a price cost test could provide a helpful, relatively straightforward guide.

The presenters varied in the analytical approaches they propose for examining potential competitive effects of conditional pricing. For example, Joseph Farrell, economics professor at the University of California, Berkeley, took the position that practices by a dominant firm that work as an effective "tax" on the sales of rivals should be discouraged by antitrust law, and can harm competition in ways more like collusion than exclusion. Daniel A. Crane, law professor at the University of Michigan, emphasized that, though antitrust intervention may occasionally be warranted, the tradition of hospitality afforded by the antitrust law to low prices should be extended to loyalty discounts. His approach would tend to create a kind of "safe haven" for most such programs. Steven C. Salop, law and economics professor at Georgetown University Law Center, proposed that conditional pricing should be viewed not through a paradigm of predatory pricing, but rather from the perspective of whether the practice tends primarily to raise a rival's costs—an analytical approach that tends to indicate such pricing practices pose greater competitive concerns. In his view, antitrust law should employ a more intrusive, rule of reason test that examines competitive effects more broadly rather than an incremental cost test like that used in *PeaceHealth*.

Overall, the legal and economic principles that distinguish pro-competitive from anticompetitive conditional pricing remain murky, at best. The lack of clarity and certainty pose particular challenges for businesses that enjoy significant market share in a particular product and seek to adopt a conditional pricing program, while at the same time minimizing the risk of a competitor lawsuit or agency investigation.

Further clarity may have to await additional decisions by courts in the context of real cases, or enforcement action or additional guidance from the DOJ and FTC. Nevertheless, the concepts explored during the June 23rd workshop should help practitioners develop workable frameworks for counseling clients in this area. The Agencies are accepting comments on conditional pricing practices for sixty days after the workshop, until August 22, 2014. Copies of presentations used during the workshop are available here.

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