Vol 19, No. 1 Spring 2010

The Journal of the Antitrust and Unfair Competition Law Section of the State Bar of California

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LOYALTY DISCOUNTS AND THE FTC'S LAWSUIT AGAINST INTEL

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I. Introduction.

Loyalty discounts are ubiquitous—from supermarkets to hospitals to airlines, and everywhere in between. They can take many forms, but their essence is to incent customers to purchase more of a product by rewarding those who buy multiple units. For example, a business may provide a per-unit discount to customers who purchase a certain volume of product. Another business may reward customers who make purchases from multiple product lines. A company may also provide a rebate to customers who purchase a certain percentage of their requirements from the firm.

But despite their pervasive presence throughout our economy, loyalty discounts may expose unsuspecting businesses to antitrust liability. Unfortunately, the antitrust law governing these discounts is unclear, confusing, and constantly changing. As a result, counsel who are not well-versed in the latest developments involving single-firm antitrust liability will likely be unable to adequately navigate a company through this minefield.

Indeed, the Federal Trade Commission recently complicated the task by suing Intel in a loyalty discount case that relies predominantly on Section 5 of the FTC Act, rather than the traditional antitrust laws.[1] This case is important to any loyalty discount analysis because the FTC's lawsuit relies on theories that would condemn conduct that traditional antitrust law might permit.[2] Thus, even if the FTC does not ultimately succeed, companies should consider the risk of an FTC investigation and the large costs such an investigation can entail.[3]

The purpose of this article is to provide some structure to the American law of loyalty discounts, which encompasses distinct but overlapping antitrust doctrines. My hope is to help businesses (and their competitors) understand when they should seek further antitrust counsel to fully analyze their particular circumstances in this rapidly developing area of law.

II. The Structure of Loyalty Discounts.

The antitrust treatment of loyalty discounts is possibly the most controversial issue

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1 *See* Complaint, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009), *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf.

2 As explained more fully in Section IV, the FTC's case against Intel does not limit itself to the traditional antitrust laws, but instead seeks to condemn Intel's behavior under Section 5 of the FTC Act. There is consensus that Section 5 is broader than the Sherman Act, but the question of how far Section 5 actually extends is not resolved.

3 "Even the most innocent companies shudder at the sound of the FTC knocking on the door." Carl W. Hittinger and Jarod M. Bona, *Section 5 Action Against Intel Shows FTC Seeks to Expand Power*, THE LEGAL INTELLIGENCER, January 4, 2010, at 5-6.

in contemporary antitrust practice.[4] As a threshold matter, loyalty discounts—even if offered by a monopolist—are not inherently suspect.[5] Indeed, these discounts permeate our economy and courts acknowledge that "[r]ewarding customer loyalty promotes competition on the merits."[6] It is only in certain circumstances that particular types of loyalty discounts lead to antitrust liability. The problem for companies that offer loyalty discounts is that these circumstances are not well-defined by antitrust law, and the FTC's action against Intel confuses the landscape even more.

The first, most obvious, issue is whether the company offering the discounts has market power. Absent any sort of market power or potential for market power, challenges to loyalty discounts will likely fail because an essential element of a monopolization claim is that the defendant possesses monopoly power.[7] Plaintiffs alleging attempted monopolization must show that the defendant has a "dangerous probability" of achieving monopoly power.[8] Although there are many instances where market power or lack of market power is obvious, this issue often requires a detailed analysis defining relevant product and geographic markets, and a firm's position within those markets.[9]

After determining market power issues, the analysis moves to the structure of the loyalty discounts, which can vary widely. The structure will determine which "pool" of law, as explained more fully below, a court will apply. One of the most important considerations is whether the loyalty discounts encompass more than one product. Discounts limited to a single product are more likely to survive scrutiny because they do not present the leveraging issues that could arise with multi-product discounts.[10] When customers must purchase products from more than one category to obtain the discounts, the program may be labeled as monopoly leveraging or bundling, and face the added scrutiny that comes with those

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4 *See* Gianluca Faella, *The Antitrust Assessment of Loyalty Discounts and Rebates*, 4 J. COMPETITION L. & ECON. 375, 376 (June 2008). Although the present article focuses on U.S. law, Faella explores recent developments involving the European Commission's treatment of loyalty discounts.

5 *See* ABA Section of Antitrust Law, ANTITRUST LAW DEVELOPMENTS (6th ed. 2007) at 252; *see also* Joshua D. Wright, *An Evidence-Based Approach to Exclusive Dealing and Loyalty Discounts*, GLOBAL COMPETITION POLICY (July 2009) (Noting that "there is little to no empirical evidence that loyalty discounts lead to anticompetitive outcomes" and that "loyalty discounts are passed on to consumers, and thereby increase consumer welfare.").

6 *Virgin Atlantic Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 265 (2d Cir. 2001).

7 *See* ABA Section of Antitrust Law, ANTITRUST LAW DEVELOPMENTS (6th ed. 2007) at 225; *Verizon Commc'ns. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

8 ABA Section of Antitrust Law, ANTITRUST LAW DEVELOPMENTS (6th ed. 2007) at 225; *Spectrum Sports v. McQuillan*, 506 U.S. 447, 456 (1993).

9 *Spectrum Sports*, 506 U.S. at 459.

10 *See* Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1694 (June 2005) (comparing single product and multi-product discounts).

labels. There are, however, efficiencies for multi-product discounts, and their use is both understandable and legal in most circumstances.[11] Of course, single-product discounts are not immune from scrutiny because companies that offer these discounts contingent upon the purchase of a large percentage of a product from that company may face a foreclosure analysis akin to an exclusive dealing claim.[12]

Another structural question involves the quantity the customer needs to purchase to receive the discount or rebate. This issue typically arises for volume-based or market-share discounts. A volume-based discount is adequately described by its name—a discount that customers receive for purchasing a particular volume of product. A market share discount compensates customers who purchase a specified percentage of their requirements from the company. Both structures are very common and are typically upheld by courts.

Finally, the amount of the actual discount or rebate may determine its legality. It is not the gross amount that matters, but the final ultimate price to the customer relative to the company's costs of producing the discounted goods. Although this analysis may sound simple, it oftentimes isn't. As explained more fully below, the appropriate measure of cost may vary by court and by the structure of the loyalty discount. It is often this "cost" measurement (relative to price) that in the end determines whether the discount survives antitrust scrutiny.

III. How Courts Analyze Loyalty Discounts.

There is no question that economic analysis informs the content of antitrust rules, including loyalty discount standards. Antitrust doctrine is highly influenced by economics, and the interpretation of the antitrust statutes evolves in a common-law fashion as economic theories progress.[13] As a result, lawyers and economists fill lots of space in both economic and law journals debating the procompetitive and anticompetitive effects of various agreements and actions. Indeed, the U.S. Supreme Court itself is very interested in the development of antitrust economics.[14]

But choosing the best rule is not just a matter of forbidding those actions that economic

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11 *See Cascade Health Solutions v. Peacehealth*, 515 F.3d 883, 895-96 (9th Cir. 2008) (explaining efficiencies and benefits of bundled discounts); Lambert, *supra* note 10 at 1726 ("an above-cost bundled discount always provides some procompetitive benefit."); Herbert J. Hovenkamp & Erik N. Hovenkamp, *Complex Bundled Discounts and Antitrust Policy* p. 2 (Univ. of Iowa Legal Studies Research Paper No. 09-07, March 2009) *available at* http://ssrn.com/abstract=1344536 ("Bundled discounting is an exceedingly common practice in commercial contracts involving suppliers of multiple interrelated products. Unquestionably, the great majority of such discounting practices are competitively harmless and should be lawful.").

12 *See* Section III.C.

13 *See Leegin Creative Leather Prod. v. PSKS, Inc.*, 551 U.S. 877, 889-91 (2007) (describing and relying upon economic literature on resale price maintenance to overrule a nearly-century-old antitrust precedent).

14 In *Pacific Bell Telephone Company v. Linkline Communications, Inc.*, ___ U.S. ___, 129 S.Ct. 1109, 1120 n.3 (2009), for example, the Supreme Court cited the "developments in economic theory and antitrust jurisprudence" to reject application of Judge Learned Hand's price-squeeze theory in his 1945 Second Circuit decision, *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416 (2d Cir. 1945). *See also* Thomas G. Hungar and Ryan G. Koopmans, *Appellate Advocacy in Antitrust Cases: Lessons from the Supreme Court*, ANTITRUST MAGAZINE (Spring 2009) v. 23 n. 2 at 53-59 ("The existence, or lack, of scholarly opinion addressing the issue presented in the petition appears to be one of the most important factors in the [Supreme] Court's decision whether to grant certiorari in an antitrust case.").

theory determines to be anticompetitive and permitting those that are procompetitive.[15] Justice Stephen G. Breyer—in deciding *Barry Wright Corporation v. ITT Grinnell Corpration* when he was a First Circuit judge—explained that "while technical economic discussion helps to inform the antitrust laws, those laws cannot precisely replicate the economists' (sometimes conflicting) views."[16] That is because "unlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients."[17] Indeed, "[r]ules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve."[18] Justice Breyer further developed this point years later in his dissent in *Leegin* where he explained that "[e]conomic discussion, such as the studies the Court relies upon, can *help* provide answers to these questions, and in doing so, economics can, and should, inform antitrust law. But antitrust law cannot, and should not, precisely replicate economists' (sometimes conflicting) views."[19]

Significant to actually deciding antitrust cases, Judge Frank H. Easterbrook pointed out in his seminal article, *The Limits of Antitrust*, that "judicial errors that tolerate baleful practices are self-correcting while erroneous condemnations are not."[20] In other words, monopoly is self-destructive because monopoly prices eventually attract entry, thus reducing the harm from erring by not condemning anticompetitive practices.[21] In contrast, courts that err by condemning competitive practices lose the benefits of that practice for good, and chill future competitive behavior through the *stare decisis* effect of the erroneous decision.[22]

The U.S. Supreme Court recognizes these administrative difficulties of antitrust regulation and the dangers of erroneous antitrust condemnation, repeatedly explaining that "Courts are ill suited 'to act as central planners, identifying the proper price, quantity, and other terms of dealing.'"[23] This is particularly true with regard to loyalty-discount antitrust claims—often centered on allegations that "prices that are too low"—because mistaken inferences of antitrust liability chill price cutting, which is "the very conduct the antitrust

15 *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.).

16 *Id.*

17 *Id.*

18 *Id.*

19 *Leegin*, 551 U.S. at 914-15 (Breyer, J., dissenting).

20 Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 3 (1984); *see also* Geoffrey A. Manne and Joshua D. Wright, *Innovation and the Limits of Antitrust*, forthcoming in JOURNAL OF COMPETITION LAW AND ECONOMICS (2010).

21 *See* Easterbrook, *supra* note 21 at 2-3.

22 *See id.*

23 *Linkline*, 129 S.Ct. at 1121 (quoting *Verizon Comm'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004)).

laws are designed to protect."[24] As the Supreme Court explained in *Atlantic Richfield Company v. USA Petroleum Company* (and repeated in its 2009 *Linkline* decision), "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition."[25]

Taking into account both economics and the administrative difficulties of regulating competitive behavior, courts have developed at least three distinct but overlapping categories of analysis to examine different loyalty discounts: (1) predatory pricing; (2) leveraging; and (3) foreclosure analysis. Predatory pricing analysis compares the price of the product to the customer (who may be the ultimate consumer or a distributor) with an "appropriate" measure of cost. A leveraging analysis—which also applies to bundling—is a variation of the predatory pricing doctrine that applies when the loyalty discount is available only to customers who purchase products from more than one market. Finally, a foreclosure analysis determines whether it is "probable that performance of the contract will foreclose competition in a substantial share of the line of commerce affected."[26]

A. Predatory Pricing.

An important category of analysis arises from the predatory pricing doctrine. A competitor or government agency may argue that prices after discounts or rebates are sufficiently low as to drive competitors from the market.[27] The argument is that "the predator reduces the sale price of its product (its output) to below cost, hoping to drive competitors out of business. Then, with competition vanquished, the predator raises output prices to a supracompetitive level."[28]

With the exception of defining the appropriate measure of cost, this analysis is relatively simple when loyalty discounts involve only one product. The Supreme Court's 2009 *Linkline* decision emphasized that to "avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low."[29] The Court then quoted the predatory pricing

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24 *Id.* at 1120 (quoting *Matsushita Elec. Ind. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986)); *see also Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993); *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 121-22 n. 17 (1986). Then Judge, now Justice, Breyer remarked that "a legal precedent or rule of law that prevents a firm from unilaterally cutting is prices risks interference with one of the Sherman Act's most basic objectives: the low price levels that one would find in well-functioning competitive markets." *Barry Wright Corp.*, 724 F.2d at 231.

25 495 U.S. 328, 340 (1990); *Linkline*, 129 S.Ct. at 1120.

26 *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961).

27 It is important to remember, however, that one of the most often uttered antitrust mantras in this country is that "the antitrust laws were passed for the protection of *competition*, not *competitors*." *Brooke Group*, 509 U.S. at 224 (emphasis in original). Thus, driving a competitor or competitors from the market is only relevant to the extent that competition itself is injured. *See id.* Commissioner Rosch's concurring and dissent statement accompanying the FTC's Complaint against Intel comes dangerously close to undercutting this "golden rule" of antitrust by arguing that the Intel case is "not a case where harm to competition can easily be segregated from harm to competitors." Concurring and Dissenting Statement of Commissioner J. Thomas Rosch, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009), *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelstatement.pdf.

28 *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 318 (2007).

29 129 S.Ct. at 1120.

standard outlined in its 1993 *Brooke Group* decision: "(1) 'the prices complained of are below an appropriate measure of its rivals costs'; and (2) there is a 'dangerous probability' that the defendant will be able to recoup its 'investment' in below-cost prices."[30]

The Supreme Court has purposely developed a very difficult standard for antitrust liability because "cutting prices in order to increase business often is the very essence of competition."[31] Besides trying to fix antitrust liability on the economically correct side of the competitive/anticompetitive conduct line, the Court is concerned about administrative mistakes that could chill competitively-beneficial activity.[32] The Court in *Brooke Group* explained that "the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting."[33]

Moreover, antitrust law is unconcerned with the effect of these price cuts on competitors, so it is irrelevant whether particular competitors can match them.[34] Indeed, "even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws."[35] It is only the effect on competition itself that matters.[36]

As explained above, the first element of a claim that prices are too low is that the prices are below "an appropriate measure" of the price-cutter's costs.[37] The Supreme Court has

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30 *Id.* (quoting *Brooke Group*, 509 U.S. at 222-24.). *Brooke Group* was actually a Robinson-Patman Act case, but the Supreme Court held that the standards for a primary-line Robinson-Patman Act claim are identical to the standards for a predatory-pricing claim under Section 2 of the Sherman Act. *See* 509 U.S. at 222.

31 *Linkline*, 129 S.Ct. at 1120 (quoting *Matsushita Elec.*, 475 U.S. at 594); *see also Virgin Atlantic*, 257 F.3d at 266 ("[T]he Supreme Court has expressed deep skepticism regarding the viability of proving a predatory pricing scheme."); *United States v. Microsoft*, 253 F.3d 34, 68 (D.C. Cir. 2001) ("The rare case of price predation aside, the antitrust laws do not condemn even a monopolist offering its product at an attractive price.").

32 *Linkline*, 129 S.Ct. at 1120 (quoting *Brooke Group*, 509 U.S. at 226); *see also Weyerhaeuser.*, 549 U.S. at 319 ("We were particularly wary of allowing recovery for above-cost price cutting because allowing such claims could, perversely, 'chil[l] legitimate price cutting,' which directly benefits consumers."). *See also Barry Wright Corp.*, 724 F.2d at 234 ("[W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesireable pricing behavior end up by discouraging legitimate price competition.").

33 509 U.S. at 223. The Court in *Linkline* reiterated that allowing antitrust suits for above-cost discounts might cause firms to "raise their retail prices or refrain from aggressive price competition to avoid potential antitrust liability." 129 S.Ct. at 1120.

34 *See Brooke Group*, 509 U.S. at 224-25.

35 *Id.* at 225.

36 *See id.* at 224-25.

37 *Brooke Group*, 509 U.S. at 222; *Linkline*, 129 S.Ct. at 1120; *Nicsand, Inc. v. 3M Company*, 507 F.3d 442, 452-53 (6th Cir. 2007) ("That 3M offered greater discounts, though still non-predatory discounts, to win the retailers' business does not offend the antitrust laws, much less undermine the competitive environment those laws were designed to foster.").

not yet decided what measurement of costs is "appropriate" in these circumstances,[38] but most courts agree that it is something similar to average variable cost or average avoidable cost.[39] In other words, if a dominant firm's price cuts cause it to lose money on incremental sales, there is a stronger likelihood that the firm is pricing for anticompetitive reasons. In contrast, any price above marginal cost—usually measured as average variable cost or average avoidable cost—will create a profit on each unit, so the price is competitively rationale, and an equally-efficient competitor could match the price. If the loyalty discounts involve only one product market, the proper analysis simply compares the ultimate price after the rebates or discounts to the appropriate measure of costs. Loyalty discounts involving required purchases from multiple product markets are discussed below in the section on leveraging.[40]

Even if the ultimate price is below the appropriate measure of cost, the loyalty discount may still survive antitrust scrutiny if the plaintiff or government agency cannot demonstrate that "there is a 'dangerous probability' that the defendant will be able to recoup its 'investment' in below-cost prices."[41] This prong of the test is necessary "because, without a dangerous probability of recoupment, it is highly unlikely that a firm would engage in predatory pricing."[42] That is because predatory pricing requires "definite, short-run losses" and recoupment signals the eventual return on the investment that is those loses.[43] Without recoupment, "predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced."[44] Indeed, "unsuccessful predation is in general a boon to consumers."[45]

Although some plaintiffs may bring a claim that specifically alleges "predatory pricing," the predatory pricing analysis (in some form) applies more broadly to "price-based"

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38 In *Brooke Group*, the Court declined to determine the appropriate measure of cost because the parties in that case agreed that the relevant measure of cost is average variable cost. *See* 509 U.S. at 223 n.1.

39 Marginal costs may be the most appropriate measure of costs, but since they are difficult to measure, many courts and commentators use average variable cost as the best substitute measure. *See, e.g.*, 3 P. Areeda & H. Hovenkamp, ANTITRUST LAW §§ 739-40 (2007) ("marginal-cost pricing is the economically sound division between acceptable competitive behavior and unlawful, 'below-cost' predation," but because marginal costs are usually difficult to measure, average variable cost may be a substitute test.); *Advo, Inc. v. Philadelphia Newspapers, Inc.*, 51 F.3d 1191, 1198 (3d Cir. 1995) ("As long as a firm's prices exceeds its marginal cost, each additional sale decreases losses or increases profits. Such pricing is presumably not predatory."); *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518, 532 (5th Cir. 1999) (average variable cost is the appropriate measure of cost); *In the Matter of ITT Corp.*, 104 F.T.C. 280 (FTC 1984); *St. Francis Med. Ctr. V. C.R. Bard*, No. 1:07cv0031 TCM, 2009 WL 3088814, at *23 (E.D. Mo. Sept. 28, 2009) (explaining the Eighth Circuit predatory pricing test, which creates different presumptions of legality based upon the price-cost relationship).

40 *See* Section III.B.

41 *Linkline*, 129 S.Ct. at 1120; *Brooke Group*, 509 U.S. at 224; *Weyerhaeuser*, 549 U.S. at 319; *see also NicSand*, 507 F.3d at 458 ("Success requires not just below-cost pricing, but a product market that will allow the would-be monopolist to raise prices later without the threat of new market entrants.").

42 *Weyerhaeuser*, 549 U.S. at 319; *see also Brooke Group*, 509 U.S. at 224 ("Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation.").

43 *Weyerhauser*, 549 U.S. at 319-20.

44 *Brooke Group*, 509 U.S. at 224.

45 *Id.*

antitrust claims. If there were any doubts about this broader use,[46] the Supreme Court in *Linkline* put them to rest when it decreed that the predatory pricing test from *Brooke Group* applies when plaintiffs attempt to "state a Sherman Act claim by alleging that prices are too low."[47] A few months after *Linkline* was decided, the Ninth Circuit in *Doe v. Abbott Laboratories* confirmed this interpretation when it cited *Linkline* to reject a "price-based" monopoly leveraging claim that failed the "below-cost pricing" prong of the test.[48]

B. Leveraging.

Many companies will offer loyalty discounts with the intent or effect of "leveraging" market power in one product market to monopolize or attempt to monopolize a distinct market.[49] For example, a customer may receive a stated discount only if it purchases two or more products from the company, which has monopoly power over one of the product markets.[50] Loyalty discounts that can trigger a leveraging analysis by a court include monopoly leveraging and bundling.[51]

Monopoly leveraging is a straight two-market event where a monopolist for one product seeks a competitive advantage in the second market by offering customers a discount or rebate only when products from the two markets are purchased together.[52] Importantly, monopoly leveraging requires some level of compulsion to purchase products from both markets to receive the discount.[53] In *Advo, Inc. v. Philadelphia Newspapers, Inc.*, for example, the Third Circuit distinguished a monopoly leveraging case from a situation where discounts are based upon "the total amount of dollars spent by a customer,"

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46 *See, e.g., LePage's Inc. v. 3M*, 324 F.3d 141, 152 (3d Cir. 2003) (narrowly interpreting *Brooke Group*); *see also* Carl W. Hittinger & Jarod M. Bona, *High Court's Recent Linkline Decision Casts Doubt on Viability of LePage's*, THE LEGAL INTELLIGENCER, May 4, 2009.

47 *Linkline*, 129 S.Ct. at 1120; *see also Brooke Group*, 509 U.S. at 222-24.

48 *Doe v. Abbott Laboratories*, 571 F.3d 930, 935 (9th Cir. 2009). The court held that "given Does' failure to allege the first prong of the test for a § 2 price-based claim (below-cost pricing), we have no need to reach the second (dangerous probability) prong, or to address whether Does have also failed to show antitrust injury or monopoly power. We simply hold that, in light of *Linkline*, Does have not stated a § 2 claim." *Id.*

49 *See Virgin Atlantic Airways*, 257 F.3d at 273 ("[T]o support a monopoly leveraging claim a plaintiff must show a defendant possesses monopoly power in one market and uses it to gain a competitive advantage in a different distinct market.").

50 *See Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1062 (8th Cir. 2000) (noting that leveraging cases like bundling and tying "cannot exist unless two separate product markets have been linked.") (quoting *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 21 (1984)).

51 Monopoly leveraging and bundling are distinguished from tying in that companies that tie products together do not offer customers the choice to purchase the multiple products separately. *See, Microsoft*, 253 F.3d at 85 (describing elements for tying). The Second Circuit in *Virgin Atlantic Airways* distinguished tying from bundling: "[a]n invalid tying arrangement conditions the purchase of one product to the purchase of a second product that the buyer either does not want or would have preferred to purchase elsewhere. In contrast, a bundling arrangement offers discounted prices or rebates for the purchase of multiple products, although the buyer is under no obligation to purchase more than one item." 257 F3J at 270.

52 *See id.* at 273.

53 *Advo*, 51 F.3d at 1203.

regardless of the product.[54] These "total quantity" discounts do not implicate the antitrust concerns of leveraging because a customer may receive the discount by purchasing any dollar amount from any of the two or more markets.[55] Thus, the company offering the loyalty discount does not utilize its monopoly power in one market to encourage or compel customers to purchase products from the more competitive markets. The customer receives the discounts regardless of how it distributes its purchases from the two markets.

In any event, following the U.S. Supreme Court's 2009 *Linkline* decision, the distinction between a total quantity discount and a monopoly leveraging discount may make less of a difference because plaintiffs asserting each type of price-based claim are subject to the *Brooke Group* predatory pricing elements of below-cost pricing and dangerous probability of recoupment.[56] As noted above, the Ninth Circuit in *Doe v. Abbott Laboratories* interpreted *Linkline* to also apply the *Brooke Group* framework to a monopoly leveraging claim.[57] In that case, plaintiffs alleged that Abbott Laboratories leveraged its monopoly in Norvir, a drug that boosted the effectiveness of certain protease inhibitors for HIV patients, to gain an advantage for Abbott's own protease inhibitor.[58] After describing *Linkline*, the Ninth Circuit rejected plaintiffs' claim because they did not allege below-cost pricing for Norvir (the boosting drug), as required by *Linkline*.[59]

A bundled discount occurs when a company offers a "bundle" of multiple products for a lower price than the aggregate price of the products if purchased individually.[60] Bundled discounts encompass monopoly leveraging, but typically entail discounts for packages of more than two products. Oftentimes, a company will charge lower prices on all of the products in the package if the buyer meets certain purchase targets in each of the multiple product lines, which may be measured by volume, dollar value or requirements percentage.[61]

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54 *Id.*

55 *See id.*

56 *See Linkline*, 129 S.Ct. at 1120; *Brooke Group*, 509 U.S. at 222-24. Even before *Linkline*, Judge Easterbrook of the Seventh Circuit recognized that below-cost pricing and recoupment should be a requirement of a monopoly leveraging claim. *See Schor v. Abbott Laboratories*, 457 F.3d 608, 613 (7th Cir. 2006) ("A price high enough to avoid condemnation under predatory-pricing rules cannot be condemned under a 'monopoly-leveraging' theory that is just a predatory-pricing variant without the intellectual discipline of that doctrine."); *see also Advo*, 51 F.3d at 1203 ("[L]everaging arguments like Advo's imply that a monopolist somehow can multiply monopoly power in one market into monopoly power in two markets. This makes no sense.").

57 *Doe v. Abbott Laboratories*, 571 F.3d at 935.

58 *See id.* at 932.

59 *Id.* at 935. Interestingly, the Ninth Circuit analogized plaintiffs' monopoly leveraging claim to the price squeeze claim rejected in *Linkline*, in that, however labeled, competitors are squeezed because their customers receive more value from the products in the competitive market when they also purchase a product from the monopolized market. *Id.*

60 *See* ABA Section of Antitrust Law, ANTITRUST LAW DEVELOPMENTS (6th ed. 2007) at 255 ("Bundled discounts or rebates are similar to volume discounts but they are awarded when customers make a sufficient number of purchases across multiple product lines, in contrast to traditional volume discounts calculated based on purchases of a single product (or product line)."); *see also* Lambert, *supra* note 10 (describing the many theories assessing the competitiveness of bundled discounts); Christine L. White & Heather Good, *All Together Now? Evolving Antitrust Approaches to Bundled Discounting*, 2 J. HEALTH & LIFE SCI. 47, 49 (April 2009) (analyzing bundled discounts in the health-care industry).

61 *See* Lambert, *supra* note 10 at 1693.

Not all bundled discounts create antitrust issues: "it is only when products that do not face competition are included in a bundle that the bundle can conceivably be anticompetitive."[62] Thus, at a minimum, for a bundling claim to survive, the "challenged prices must have the effect of excluding a single-product competitor."[63] If a competitor produces all of the products in a company's bundle, then it has the opportunity to match the discounts, and any failure to do so is a defect of the competitor not an injury to competition itself.[64]

As explained above, after the Supreme Court's decision in *Linkline*, it is unlikely that any court would permit a bundling claim to survive without some form of below-cost pricing.[65] Several years before *Linkline* (and *Weyerhaueser*), however, the Third Circuit issued its controversial *en banc* decision in *LePage's Incorporated v. 3M* that rejected 3M's argument that a plaintiff must demonstrate some form of below-cost pricing to prevail in a bundling case.[66] In *LePage's*, a private label transparent tape company challenged 3M's bundled rebate and exclusive dealing programs that offered retailers increasing levels of rebates for purchases of products that spanned a number of 3M's diverse product lines.[67] A retailer would not receive the full rebate unless it purchased products from all six product lines.[68] The Third Circuit explained that the "principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacturer an equally diverse group of products and who therefore cannot make a comparable offer."[69]

3M argued that *Brooke Group's* below-cost pricing and recoupment elements should preclude the bundled discount claim because plaintiff was asserting an antitrust claim premised on price-cutting, and 3M priced its transparent tape above its cost.[70] The Third

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62 *Masimo Corp. v. Tyco Health Care Group*, No. CV 02-4770 MRP, 2006 WL 1236666, at * 12 (C.D. Cal. March 22, 2006).

63 *Ramallo Bros. Printing, Inc. v. El Dia, Inc.*, 392 F.Supp.2d 118, 138 (D. P.R. 2005); *see also Invacare Corp. v. Respironics, Inc.*, No. 1:04 CV 1580, 2006 WL 3022968, at *12 (N.D. Ohio Oct. 23, 2006) ("[U]nlike in *Smithkline* or *LePage's*, Plaintiff manufactures the same products and can match the product bundles offered by Defendant."); *see also* Lambert, *supra* note 10 at 1695 (explaining that it is possible that a bundle may exclude more efficient rivals that do not produce all of the products in the bundle).

64 The antitrust laws were passed for "the protection of competition, not competitors." *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962); *see also Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050, 1055 (6th Cir. 1984) ("If a producer has achieved greater efficiency due to his economies of scale, it would be contrary to the purposes of the Antitrust laws to require that he price his product at a level higher than what he requires to make a profit."); Hovenkamp & Hovenkamp, *supra* note 12 at 4 ("In order to have antitrust significance a bundle must not merely keep one rival out of the market; it must exclude all of them.").

65 *Linkline*, 129 S.Ct. at 1120; *see also* Hittinger & Bona, (*Recent Linkline Decision*) *supra* note 46.

66 324 F.3d 141 (3d Cir. 2003). *LePage's* also involved exclusive dealing arrangements. *See id.* at 157-59.

67 *See id.* at 154.

68 *See id.*

69 *Id.* at 155.

70 *See id.* at 147 ("3M argues that its conduct was legal as a matter of law because it never priced its transparent tape below its cost.").

Circuit, however, rejected 3M's argument, holding that *Brooke Group* was not relevant and predicting that it would be inconsequential to the future of antitrust.[71] Indeed, in a detailed historical analysis of exclusionary conduct law, the Third Circuit was dismissive of *Brooke Group*, pointing out that since it was decided in 1993—*LePage's* was decided in 2003—*Brooke Group* had only been cited four times by the Supreme Court, and only once in an antitrust decision, which the Third Circuit explained was inapplicable.[72] Moreover, "nothing that the Supreme Court has written since *Brooke Group* dilutes the Court's consistent holdings that a monopolist will be found to violate § 2 of the Sherman Act if it engages in exclusionary or predatory conduct without a valid business justification."[73] The Third Circuit judged—incorrectly—that *Brooke Group* was an aberration, the end of a doctrine rather than the beginning.

After *LePage's* was decided, of course, *Brooke Group* flourished rather than floundering as the Third Circuit had predicted. The Supreme Court in *Weyerhaeuser* applied it to a predatory buying context, and stressed the importance of both the above-cost pricing and recoupment requirements because antitrust should not chill legitimate price cutting.[74] And *Linkline* explained that plaintiffs alleging that prices are too low must meet the *Brooke Group* requirements so as to avoid chilling aggressive price competition.[75]

Other circuits also departed from *LePage's*. For example, in *NicSand, Inc. v. 3M Company*, the Sixth Circuit sitting *en banc* held that a plaintiff cannot allege an antitrust injury based upon up-front discounts for a bundle of products unless those up-front payments led defendant to selling its products "below cost with the goal of recouping its losses by charging monopolistic prices later." 507 F.3d 442, 451-52 (6th Cir. 2007).

Similarly, the Ninth Circuit in *Cascade Health Solutions v. Peacehealth*[76] specifically rejected the Third Circuit's approach in *LePage's* to a bundled discounting claim. The court held that "bundled discounts may not be considered exclusionary conduct within the meaning of § 2 of the Sherman Act unless the discounts resemble the behavior that the Supreme Court in *Brooke Group* identified as predatory."[77]

Thus, even before *Linkline*, the Ninth Circuit recognized that *Brooke Group* and *Weyerhaeuser* suggest that "in the normal case, above-cost pricing will not be considered exclusionary conduct for antitrust purposes."[78] The Ninth Circuit in *Peacehealth* applied an interesting variation to the *Brooke Group* standard called a "discount attribution" test, which is a way to evaluate the price-cost relationship in a bundling case and is only relevant where competitors do not produce the same array of products in the challenged

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71 *See id.* at 147-152.

72 *See id.* at 152.

73 *LePage's*, 324 F.3d at 152.

74 549 U.S. at 1074-75.

75 129 S.Ct. at 1120.

76 515 F.3d 883, 903 (9th Cir. 2008).

77 *Id.*

78 *Id.* at 901.

bundle.[79] "Under this standard, the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products."[80] So a defendant that produces a product that is indispensible to the bundle and is not produced by its competitors must allocate the discount on that product to the products in the competitive market.[81] "If the resulting price of the competitive product or products is below the defendant's incremental cost to produce them, the trier of fact may find that the bundled discount is exclusionary for purposes of § 2."[82] The court applied this method because it believed that "a defendant offering a bundled discount, without pricing below cost either the individual products in the bundle or the bundle as a whole, can, in some cases, exclude a rival who produces one of the products in the bundle equally or more efficiently than the defendant."[83] The discount attribution test is designed to weed out those situations where a more efficient competitor cannot gain a foothold in the competitive market or markets because a monopolist is compelling buyers to purchase the monopolist's product in the competitive market to obtain an indispensible product from the monopolist that the competitor does not produce.

By allocating discounts from one product to another, the *Peacehealth* test does not truly measure the price-cost relationship that a party will use to make its pricing decisions. Instead, it creates a fictional measurement that may grossly understate a product's actual price by attributing discounts from other products without the benefit of incorporating the price and costs of those other products in the analysis.[84] That is not how businesses make decisions. Thus, part of the rationale for the tests described in *Brooke Group*, *Weyerhaeuser*, and *Linkline* are lost because the *Peacehealth* test does not distinguish between legitimately cutting prices to increase business—"the very essence of competition"—and cutting prices to eliminate competition with the dangerous probability of recouping the investment of taking losses through below-cost pricing.[85] That is because a party whose bundled pricing fails the *Peacehealth* test may still be making a profit on incremental units.

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79 *See id.* at 897.

80 *See id.* at 906.

81 The discount attribution test is unnecessary if competitors collectively produce all of the goods in the bundle because "bundle-to-bundle discount competition can occur" so the discount is not exclusionary "unless its *overall* price is below its costs." Hovenkamp & Hovenkamp, *supra* note 11 at 4.

82 *Peacehealth*, 515 F.3d at 906.

83 *Id.* 904.

84 *Cf.* ABA Section of Antitrust Law, ANTITRUST LAW DEVELOPMENTS (6th ed. 2007) at 274 ("Courts generally have held that the price-cost comparison should be made across entire product lines, rather than on a product-by-product basis.").

85 *Linkline*, 129 S.Ct. at 1119-20. The *Peacehealth* court also declined to adopt the recoupment element of the *Brooke Group* test, 515 F.3d at 910 n.21, but the Ninth Circuit's subsequent decision in *Doe v. Abbott Laboratories* made clear that the recoupment requirement described in *Linkline* does apply in the Ninth Circuit. *See* 571 F.3d at 935 ("Because we believe the outcome here follows from *Linkline*, we need not discuss [*Peacehealth's*] impact on this case or others pending in the district court.").

Peacehealth was concerned that more straightforward calculations of cost may allow some anticompetitive bundles to survive antitrust scrutiny.[86] But, as explained above,[87] antitrust law does not strictly follow economy theory. Instead, the *Brooke Group* and *Linkline* requirements incorporate institutional concerns about clear rules, the inability of courts to act as central planners, and the chilling effect on price cutting from the perception of false positives in enforcement.[88] For example, *Linkline* explained that it is important that firms have a safe harbor such that they "know that they will not incur liability as long as their retail prices are above cost."[89] The *Peacehealth* test, however, removes the safe harbor because instead of examining the relationship between cost and actual price—which businesses use to determine how to price their products—the test uses the relationship between cost and a fictional reduced price, which businesses do not employ when pricing their products.[90]

Although it is debatable whether *Peacehealth's* discount-attribution calculation deviates from the goals of *Brooke Group* and now *Linkline*, it is more clear that cases like *LePage's*—which reject the below-cost pricing and recoupment requirements altogether—are on a shaky foundation.[91]

C. Foreclosure.

Another class of loyalty discounts may reward customers with discounts for purchasing a percentage of their requirements from the company. These programs are often referred to as "market-share discounts" and may provide increasing levels of rebates as customers elevate the percentage of their requirements that they purchase. One common type of program compensates retailers for stocking a certain percentage of their shelf space in a product category with products from the company.[92] This compensation is often a rebate,

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86 515 F.3d at 896 ("[I]t is possible, as least in theory, for a firm to use a bundled discount to exclude an equally or more efficient competitor and thereby reduce consumer welfare in the long run.").

87 *See* Section III.

88 *See Linkline*, 129 S.Ct. at 1120-21.

89 129 S.Ct. at 1121. Justice Breyer, while sitting on the First Circuit, also expressed concern about creating rules that would confuse the advice that a lawyer could give a client considering procompetitive price-cutting. *Barry Wright*, 724 F.2d at 235.

90 The *Linkline* Court specifically rejected a test that followed a similar principal as the *Peacehealth* test when it declined to adopt the "transfer price" test that was proposed by certain amici. *Linkline*, 129 S.Ct. at 1121-22. Like the "discount attribution test," the Supreme Court stated that the "transfer price test" "lacks any grounding in our antitrust jurisprudence," and contradicts the Sherman Act principal of encouraging "aggressive price competition at the retail level, as long as the prices being charged are not predatory." *Id.*

91 *LePage's* also included exclusive dealing, tying, and recoupment evidence that may provide courts with plenty of opportunity to distinguish and narrow *LePage's* without specifically overruling it. *See* 324 F.3d at 155-57, 163.

92 For an excellent economic and empircal analysis of these type of contracts, *see* Joshua D. Wright, *Slotting Contracts and Consumer Welfare*, 74 ANTITRUST L. J. 439 (2007).

but may also including advertising and other non-monetary payments.[93]

Although not strictly exclusive dealing arrangements, market-share discounts may be analyzed with the same tools that courts use to analyze exclusive dealing—by determining whether the effect is to "foreclose competitors from any substantial market."[94] Of course, the foreclosure analysis for market-share discounts or incentive-based shelf-space programs is less likely to yield an anticompetitive result because exclusive dealing agreements foreclose one-hundred percent of a customer's requirements and typical loyalty discounts foreclose less than that.[95] Notably, manufacturers that offer these types of loyalty discounts to mass retailers may be especially likely to fend off an antitrust challenge because a very large retailer—Wal-Mart—does not, by policy, accept loyalty discounts.[96] Thus, competing manufacturers are necessarily not foreclosed from a substantial part of the market, which will be reflected numerically in the foreclosure analysis. Although courts often disagree about the exact percentage necessary to create antitrust problems, agreements with market foreclosure percentages of less than 30% or 40% usually survive antitrust scrutiny.[97]

One way to minimize antitrust risk is to make the loyalty discounts easily terminable and of short duration.[98] If customers are not "stuck" in the contract for a long period

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93 *See, e.g., Bayou Bottling, Inc. v. Dr. Pepper Co.*, 725 F.2d 300, 304 (5th Cir. 1984), *cert. denied*, 469 U.S. 833 (1984) (providing vending services); *Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co.*, 94 F.Supp.2d 804, 814-15 (E.D. Ky. 1999) (providing promotional payments for advertising and shelf-space). Indeed, for products where purchase decisions are often made at the point-of-sale, shelf-space agreements can be interpreted as purchases of advertising.

94 *Tampa Electric*, 365 U.S. at 327. Courts also examine these discounts under the predatory pricing framework by determining whether the final price is below cost. *See Concord Boat*, 207 F.3d at 1061; *Microsoft*, 253 F.3d at 69 ("Because an exclusive deal affecting a small fraction of a market clearly cannot have the requisite harmful effect upon competition, the requirement of a significant degree of foreclosure serves a useful screening function.").

95 *See R.J. Reynolds Tobacco Co. v. Phillip Morris, Inc.*, 199 F.Supp.2d 362, 387 (M.D.N.C. 2002) (holding that an incentive-based shelf-space program is less restrictive than an exclusive dealing arrangement, and should "face less scrutiny under antitrust analysis."), *aff'd per curiam*, 67 F.Appx. 810 (4th Cir. 2003). In *Natchitoches Parish Hospital. Service District v. Tyco International*, the District of Massachusetts noted that under "the emerging caselaw . . . without more, above-cost market share discounts cannot constitute improper exclusionary dealing that violates the Sherman Act." No. 1:05-CV-12024-PBS, 2009 WL 4061631, at *5 (D. Mass. Nov. 20, 2009).

96 *See* S. Robson (Rob) Walton, *Wal-Mart, Supplier-Partners and the Buyer Power Issue*, 72 ANTITRUST L. J. 509 (2004).

97 *See, e.g., B & H Med., LLC v. ABP Administration, Inc.*, 526 F.3d 257, 266 (6th Cir. 2008); *Natchitoches Parish Hosp.*, 2009 WL 4061631, at *3.

98 *See, e.g., Concord Boat*, 207 F.3d at 1063 (noting that customers—boat builders and dealers—were free to walk away from market share discounts at any time); *Paddock Publ'ns*, 103 F.3d at 47 ("[T]he FTC and the Supreme Court concluded that even exclusive dealing contracts are lawful if limited to a year's duration."); *Omega Environmental, Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1163 (9th Cir. 1997) ("[T]he short duration and easy terminability of these [exclusive] agreements negate substantially their potential to foreclose competition."); *Western Parcel Express v. United States Postal Service of Am.*, 190 F.3d 974, 976 (9th Cir. 1999); *Balaklaw v. Lovell*, 14 F.3d 793, 799 (2d Cir. 1994). *But see United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 194 n.2 (rejecting "short duration" safe harbor because dealers had a strong economic incentive to continue exclusive dealing contracts).

of time, then competitors have a legitimate opportunity to compete for the contract to provide a substantial share of a customer's requirements. Companies defending these types of loyalty discounts or exclusive dealing arrangements often quote Judge Easterbrook's statement in the Seventh Circuit's *Paddock Publications, Inc. v. Chicago Tribune Company* decision that "[c]ompetition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe and it is common."[99]

In January 2010, the Ninth Circuit in *Allied Orthopedic Appliances Inc. v. Tyco Health Care Group LP* upheld market share discounts offered by Tyco that allowed customers—small hospitals or groups of small hospitals—to purchase Tyco's products at discounts off list prices if they committed to purchase some minimum percentage of their pulse oximetry product requirements from Tyco.[100] Higher percentages would yield higher discounts.[101] Importantly, the Ninth Circuit noted that the "only consequence of purchasing less than the agreed upon percentage of Tyco's products was loss of the negotiated discounts."[102] These easily-terminable agreements did not foreclose competition and violate the antitrust laws because "a competing manufacturer need[ed] only offer a better product or a better deal to acquire their [business]."[103]

Finally, courts have repeatedly upheld "space-to-sales" contracts that offer rebates in exchange for shelf-space commitments that are equal to the company's market share.[104] For example, in *Bayou Bottling, Inc. v. Dr. Pepper Company*, the Fifth Circuit rejected an antitrust claim against a dominant soda distributor for its requirement in a contract with retailers that it receive shelf space "in proportion to market activity."[105] The court concluded that "[w]ithout anything more, these practices are not barred by the antitrust laws. They are competitive acts."[106]

Although there may certainly be instances where market-share loyalty discounts violate the antitrust laws, it should not be difficult for most companies to structure their programs in such a way to minimize risk under current antitrust laws.

IV. The FTC's Lawsuit Against Intel Increases Risk for Loyalty Discounts.

The FTC sued Intel Corporation in December 2009, setting the stage for what could be

99 103 F.3d at 45. In addition, although it is certainly not akin to immunity, the Ninth Circuit held in *Omega Environmental* that arrangements "imposed on distributors rather than end-users are generally less cause for anticompetitive concern." 127 F.3d at 1162.

100 Nos. 08-56314, 08-56315, 2010 WL 22693, at *2 (9th Cir. Jan. 6, 2010).

101 *See id.*

102 *Id.*

103 *Id.* at *4 (quoting *Omega Environmental*, 127 F.3d at 1164).

104 *See, e.g., Louisa Coca-Cola Bottling Co.*, 94 F.Supp.2d at 815 (upholding space-to-sales agreement where allotted shelf space is consistent with market share); *El Aguila Food Products, Inc. v. Gruma Corp.*, 301 F.Supp.2d 612, 630 (S.D. Tex. 2003), *aff'd*, 131 Fed. Appx. 450 (5th Cir. 2005) (upholding slotting agreements for shelf space for tortillas and explaining that plaintiffs had not demonstrated that defendants' shelf space was disproportionate to its sales); *R.J. Reynolds Tobacco Co.*, 199 F.Supp.2d at 388 (approving of program that paid retailers for advantageous display and signage space up to or less than market share).

105 725 F.2d at 304.

106 *Id.*

the best antitrust battle since the Microsoft cases.[107] There is some question about whether the FTC's lawsuit was necessary to protect consumers in light of Intel's global settlement a few weeks earlier with Advanced Micro Devices—the initial instigator of Intel's antitrust scrutiny. Intel was also fined $1.45 billion by competition authorities in Europe. In any event, the lawsuit provides the FTC with a vehicle to fulfill the stated goals of some of its commissioners to test and expand the Commission's use of section 5 of the FTC Act. It also presents the FTC with an opportunity to apply its own loyalty discount policies. The FTC's action is a clear warning to companies with market power that they may not be able to utilize compliance with existing antitrust law to avoid a costly FTC investigation and lawsuit. Even if the FTC has trouble persuading a court to accept its theories, the threat of FTC action is enough to make companies adjust their risk calculations.[108]

The FTC alleges that Intel took advantage of its powerful market position to stifle competition and strengthen its monopoly by waging a "course of conduct" to shut out its rivals' microchips by cutting off their access to computer manufacturers through loyalty discounts and other means.[109] Chairman Jon Leibowitz and Commissioner J. Thomas Rosch issued a statement with the Complaint claiming that "Intel fell behind in the race for technological superiority in a number of markets and resorted to a wide range of anticompetitive conduct, including deception and coercion, to stall competitors until it could catch up."[110] Intel's Answer accused the FTC of treating "Intel as if it were a public utility that has an ongoing duty to help competitors."[111] Moreover, Intel argues that the FTC "would employ Section 5 of the FTC Act to defy Supreme Court precedent and modern economics and punish Intel for conduct that has promoted competition and benefited consumers."[112]

An important aspect of the case against Intel focuses on loyalty discounts.[113] For example, the FTC alleges that "Intel offered market share or volume discounts selectively to OEMs [computer manufacturers] to foreclose competition in the relevant [Central

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107 *See* Hittinger & Bona (*Section 5 Action Against Intel*), *supra* note 3 .

108 *See* Carl W. Hittinger and Jarod M. Bona, *The Diminishing Role of the Private Attorney General in Antitrust and Securities Class Action Cases Aided by the Supreme Court*, 4 J. BUS. & TECH. L. 167 (Jan. 2009) (explaining how courts are increasingly relying more on government enforcement rather than the private attorney general model to enforce the antitrust and securities laws).

109 Complaint, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009), *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf.

110 Statement of Chairman Leibowitz and Commissioner Rosch, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009), *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelchairstatement.pdf.

111 Answer, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 31, 2009) at 5, *available at* http://www.ftc.gov/os/adjpro/d9341/091231respanswertocmplt.pdf. According to Intel, "the Complaint proposed to impose a regulatory regime on some of the world's most innovative and well-performing markets in place of the free-market competition that has produced those results and that the antitrust laws were designed to promote. The Complaint seeks to turn Intel into a public utility." *Id.* at 8.

112 *Id.* at 7.

113 Complaint, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009), *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf.

Processing Unit] markets."[114] Despite antitrust law's preference to encourage price-cutting, the FTC perversely characterizes these discounts to computer manufacturers as a "tax" that manufacturers incur if they purchase non-Intel products.[115] In apparent recognition of *Brooke Group* and *Linkline*, the FTC asserts that Intel priced its products "below an appropriate measure of cost," but adds an interesting twist.[116] Instead of measuring "cost" as some form of incremental cost, the FTC vaguely defines the measure of cost as "average variable cost plus an appropriate level of contribution toward sunk costs."[117] In other words, the FTC is measuring cost as some undefined level between average variable cost and average total cost. This aggressive and ambiguous position may make it difficult for antitrust counsel to provide adequate guidance to companies that are pondering loyalty discounts.[118]

The Complaint's Notice of Contemplated Relief provides further evidence of the FTC's views of loyalty discounts.[119] The FTC incorporates a variation of the *Peacehealth* discount aggregation standard into its description of possible relief: "Prohibiting Intel from pricing its microprocessors so that the incremental price to a customer of microprocessors or GPUs sold in competition with another competitor is below cost when such price includes all rebates, payments, or other price decreases on other products not in competition."[120] It is unclear how the FTC is defining "in competition," but one theory is that the FTC will compare Intel's base inelastic demand for a particular product with the requirements percentage necessary to receive the discount, then allocate the entire across-the-board discount that Intel provides to the difference between the inelastic demand and the level of purchases required to receive the discount.[121] For example, if Intel has a base demand of 60% of the market, but provides discounts on every product purchased if a buyer will purchase 70% of their requirements from Intel, the FTC (under this theory) might allocate the entire aggregate discount on all products to the 10% of products that makes up the increment between Intel's base demand and the level required to receive the discounts.[122]

Thus, under this theory, the FTC would apply *Peacehealth* to a single product market such that the discounts on units 1 through 70 percent of the buyer's purchases would

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114 *Id.* at ¶ 53.

115 *Id.*

116 *Id.*

117 *Id.*

118 It is possible that the FTC's decision to incorporate a cost definition above average variable cost is due to the unique nature of this technology industry where marginal costs are very low and much of the cost of the product is tied to research and development. But this is unclear from the Complaint and Commissioner statements.

119 *See id.* at p. 21.

120 *Id.*. Once again, the FTC interprets "cost" as average variable cost plus an appropriate contribution to fixed costs. *See id.*

121 Paragraph 7 of the Complaint states that "Intel offered market share or volume discounts selectively to OEMs to foreclose competition in the relevant CPU markets." Complaint, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009) at ¶ 7.

122 *See, e.g.*, Willard K. Tom, David A. Balto, and Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST LAW 615, 627 (2000) (describing this theory).

be attributed to the units between 60 and 70 percent of the purchases to evaluate costs. Not surprisingly, even companies making a healthy profit by pricing well-above actual incremental cost could find themselves pricing below cost—and subject to investigation and lawsuit—under this theory. In addition, the FTC's decision to define cost as somewhere between average variable cost and total fixed costs exacerbates the effect of applying *Peacehealth* to a single-market.

Although the FTC's complaint against Intel does not make clear how the FTC will define "in competition," current antitrust law does not appear to support this theory, which seems to discourage rather than encourage price-cutting, the "essence of competition."[123]

Perhaps recognizing the uphill battle it would face under the antitrust laws,[124] the FTC brought this case primarily as a stand-alone violation of Section 5 of the FTC Act.[125] Although there is general agreement that Section 5 may cover some conduct that is not covered by the antitrust laws, the FTC's invocation here is very aggressive, and may run into some trouble if this case ever reaches the courts.[126] It is unlikely that a court would allow the FTC enforce Section 5 against procompetitive conduct and courts are making it increasingly difficult to condemn price-cutting.

Regardless of how this battle ends, the fact of the lawsuit itself is enough to make companies think twice before cutting prices. Companies with market power should understand that keeping prices above costs—as a business would define "costs" and "prices"—may not be enough to avoid an expensive and risky government antitrust investigation.

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123 *Linkline*, 129 S.Ct. at 1120 (quoting *Matsushita*, 475 U.S. at 594).

124 Statement of Chairman Leibowitz and Commissioner Rosch and Concurring and Dissenting Statement of Commissioner J. Thomas Rosch, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009) at 21 (recognizing certain weaknesses of the case under current antitrust law).

125 Statement of Chairman Leibowitz and Commissioner Rosch, *In the Matter of Intel Corporation*, FTC Docket No. 9341 (Dec. 16, 2009). Interestingly, the Commissioners explain that "concern over class actions, treble damages awards, and costly jury trials have caused many courts in recent decades to limit the reach of antitrust." *Id.* Although those aspects of private antitrust litigation exacerbate the effects of falsely condemning procompetitive conduct as anticompetitive, it stretches the reasoning of recent antitrust jurisprudence to conclude that those are the reasons for the current state of antitrust law. More accurately, the courts have recognized the large costs to society of erroneously condemning procompetitive activity, particularly price-cutting.

126 The FTC brought this case under its recently adopted Part 3 rules of practice. *See* Statement of Chairman Leibowitz and Commissioner Rosch, *In the Matter of Intel Corporation*, FTC Docket No. 9341, p. 21 (Dec. 16, 2009). In the early 1980s, the FTC tested the boundaries of Section 5, with mixed results at best. *See Ethyl Corp. v. F.T.C.*, 729 F.2d 128 (2d Cir. 1984); *Official Airline Guides, Inc. v. F.T.C.*, 630 F.2d 920 (2d Cir. 1980); *Boise Cascade Corp. v. F.T.C.*, 637 F.2d 573 (9th Cir. 1980).