COMMENT

LEPAGE'S v. 3M: AN ANTITRUST ANALYSIS OF LOYALTY REBATES

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In its en banc decision in LePage's Inc. v. 3M, *the Third Circuit held that a 3M loyalty rebate program, which provided above-cost price discounts to customers who purchased multiple 3M product lines, violated section 2 of the Sherman Act. Prior to this decision, many practitioners and scholars understood the antitrust case law to hold that a strategic pricing scheme would not violate section 2 so long as the discounted prices remained above cost. The Third Circuit found that this test applies only to predatory pricing cases, and ruled that claims alleging exclusionary conduct other than predatory pricing—as it characterized 3M's loyalty rebate program—are cognizable under section 2 even without a showing of below-cost pricing. The Supreme Court recently denied certiorari in* LePage's, *leaving the issue in the hands of the lower courts. In this Comment, Joanna Warren criticizes the Third Circuit's decision as lacking sufficient economic analysis of the rebate scheme and providing unclear guidance for addressing future claims. She argues for the adoption of a test that would recognize above-cost pricing as generally legitimate while invalidating schemes that threaten to eliminate equally efficient competitors from the marketplace.*

INTRODUCTION

On March 25, 2003, the Third Circuit issued an en banc opinion in *LePage's Inc. v. 3M*,[1] and, in doing so, added fuel to the debate over the antitrust implications of a business practice known as a loyalty rebate.[2] 3M, the producer of a wide variety of products, including Scotch transparent tape, developed a loyalty rebate program to induce office supply stores to purchase more 3M products at the expense of 3M's competitors.[3] LePage's, a producer of second-brand and private-label transparent tape,[4] sued 3M, claiming the rebate scheme was

 J.D., 2004, New York University School of Law. I would like to thank Professors Eleanor Fox and Daniel Rubinfeld for their guidance in shaping this Comment. I would also like to thank the members of the *New York University Law Review*, especially Derek Tarsy, Hallie Goldblatt, and Jesse Devine, for their excellent suggestions and hard work.

[1] 324 F.3d 141 (3d Cir. 2003).

[2] Loyalty rebates are also commonly referred to by other names such as "bundled rebates," "fidelity rebates," "market share discounts," "package pricing," or "bundle pricing."

[3] *LePage's*, 324 F.3d at 145.

[4] "Private label" refers to a product sold under the name of the retailer rather than the name of the manufacturer. *See id.* at 144. "Second brand" refers to the practice of

an illegal attempt to squeeze LePage's out of the market.[5] The court found that 3M's loyalty rebate program constituted exclusionary conduct in violation of section 2 of the Sherman Act[6] and upheld a treble damage award of over $68 million against the company.[7] 3M immediately petitioned for certiorari, presenting the question "[w]hether a dominant firm's discounted but above-cost prices for volume purchases, of either individual products or multiple products, may be condemned as unlawful under section 2 of the Sherman Act based on the incentive such low prices offer to shift purchases away from smaller rivals."[8] On June 30, 2004, the Supreme Court denied certiorari.[9]

As used in this Comment, the term loyalty rebate refers to a bundled discount program in which a buyer's discount is conditioned on its purchasing more than one product line from the seller. This practice is distinguishable from a straightforward volume rebate in which the seller offers a discount based on the number of units purchased of a single product. In a loyalty rebate scheme, a buyer receives a lower overall unit price if it buys a package of two or more of the seller's product lines. While the buyer has the option to purchase only one product line, the rebate structure rewards the buyer based on its level of loyalty to the multi-product manufacturer.[10]

Prior to the *LePage's* decision, many practitioners and scholars read the case law to hold that, while there were few bright lines to follow, strategic pricing practices such as price-cutting and bundling would not be found to violate section 2 of the Sherman Act as long as prices did not drop below a certain measurement of cost.[11] In particular, the most recent Supreme Court case on predatory pricing,

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targeting a single manufacturer's products to different segments of the market. While second-brand products are sometimes sold at a premium—for example, Volvo is one of Ford's second brands—in this Comment the term is used solely to describe products sold at a discount to the name brand.

[5] *Id.*

[6] 15 U.S.C. § 2 (2002).

[7] *LePage's*, 324 F.3d at 144–45.

[8] Petition for a Writ of Certiorari at i, 3M Co. v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865).

[9] 3M Co. v. LePage's Inc., 124 S. Ct. 2932 (2004). The Court denied 3M's petition one month after the Solicitor General and the Federal Trade Commission urged it not to grant review. Brief for the United States as Amicus Curiae.

[10] For a more detailed description of this type of practice, see Ronald W. Davis, *Pricing With Strings Attached: At Sea in* Concord Boat *and* LePage's, 14 ANTITRUST 69, 69–70 (2000). *See generally* 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).

[11] *See, e.g.*, David A. Balto, *LePage's v. 3M*, NAT'L L.J., Aug. 11, 2003, at 25.

Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.,[12] contained strong language indicating that "above-cost prices that are below general market levels or the costs of a firm's competitors [do not] inflict injury to competition cognizable under the antitrust laws."[13] However, in *LePage's*, the Third Circuit allowed a finding of illegal monopoly maintenance in the absence of a showing of below-cost pricing. Following the decision, businesses and practitioners called for the Supreme Court to clarify the law of exclusionary conduct under section 2 of the Sherman Act.[14] Otherwise, many argued, businesses would be hindered in their ability to compete aggressively, and, in particular, allegedly dominant firms would be deterred from engaging in price cutting or bundling, to the detriment of consumers.[15]

This Comment addresses the implications of the *LePage's* decision on the antitrust analysis of loyalty rebate schemes. It concludes that *LePage's* was poorly reasoned and has created confusion over what types of conduct by firms possessing high degrees of market share will be found to be predatory and exclusionary rather than legitimate competition on the merits. Now that the Supreme Court has denied certiorari, other circuit courts have the opportunity to develop a more reasoned analysis. Part I of this Comment begins with an overview of the applicable antitrust law and a discussion of the different types of claims at issue, in particular, predatory pricing and exclusionary conduct claims. Part II details the rebate scheme at issue in *LePage's* and analyzes the Third Circuit's opinion in the case. Part III reviews the economic implications of loyalty rebates and proposes a test courts might use to determine when such schemes violate section 2 of the Sherman Act.

I

Section 2 of the Sherman Act provides: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States" shall be guilty of illegal antitrust acts and subject to imprisonment and fines.[16] In *United States v.*

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12 509 U.S. 209 (1993).

13 *Id.* at 223.

14 *See* Balto, *supra* note 11; Brief for Amici Curiae BellSouth Corp. et al. in Support of Petitioner, 3M Co. v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865); Brief for Amici Curiae Boeing Co. et al. in Support of Petitioner; Brief for Amicus Curiae The Business Roundtable in Support of Petitioner; Brief for Amici Curiae Morgan Stanley et al. in Support of Petition for Certiorari; Brief of Amici Curiae Washington Legal Foundation and National Association of Manufacturers in Support of Petitioner.

15 *See, e.g.*, Balto, *supra* note 11.

16 15 U.S.C. § 2 (2002).

Grinnell Corp.,[17] the Supreme Court explained that, because monopoly power itself is not necessarily unlawful, a section 2 violation requires two elements: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[18]

While the first prong of the *Grinnell* test often is vigorously contested in litigation,[19] this Comment focuses on the second prong. Specifically, when should conduct by a monopolist be found to be a "willful acquisition or maintenance" of monopoly power, rather than "growth or development as a consequence of a superior product, business acumen, or historic accident"? The difficulty in distinguishing between legal and illegal conduct stems from the desire to promote competition that is beneficial to consumers while deterring conduct which has no legitimate business justification and merely seeks to maintain a firm's dominant position in the market.

Courts variously have described conduct that violates section 2 as "anticompetitive," "exclusionary," "predatory," and "abusive."[20] However, there are no bright line rules as to what types of conduct may constitute section 2 violations.[21] Predatory actions such as, among other things, unlawful acquisitions,[22] predatory pricing,[23] refusals to deal,[24] and leveraging[25] have been found illegal under section 2.[26] Claims involving loyalty rebates have been analyzed primarily as either predatory pricing or exclusionary conduct claims.[27] The following two Sections examine each of these claims in more detail.

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17 384 U.S. 563 (1966).

18 *Id.* at 570–71.

19 *See* Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 COLUM. L. REV. 1805, 1807 (1990).

20 *See* 2 JULIAN O. VON KALINOWSKI ET AL., ANTITRUST LAWS AND TRADE REGULATION § 25.04[3] (2d ed. 2003).

21 Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 253 (2003) ("Monopolization doctrine currently uses vacuous standards and conclusory labels that provide no meaningful guidance about which conduct will be condemned as exclusionary.").

22 *See, e.g.*, Standard Oil Co. v. United States, 221 U.S. 1, 73-75 (1911).

23 *See, e.g.*, Utah Pie Co. v. Cont'l Baking Co., 386 U.S. 685, 688 (1967).

24 *See, e.g.*, Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 586 (1985); Lorain Journal Co. v. United States, 342 U.S. 143, 143 (1951).

25 *See, e.g.*, United States v. Griffith, 334 U.S. 100, 100 (1948); Eastman Kodak Co. v. Image Technical Servs., 504 U.S. 451, 452 (1992).

26 For a helpful annotation of predatory market behavior, see Patrick Lynch, *Sherman Act § 2 Offenses, in* 41ST ANNUAL ANTITRUST LAW INSTITUTE 303, 316–24 (PLI Corp. Law & Practice Course, Handbook Series No. 1180, 2000), WL 1180 PLI/Corp 303.

27 *See* K. Craig Wildfang & Christopher W. Madel, *Predatory Conduct Under Section Two of the Sherman Act: Dead or Alive?*, 2 SEDONA CONF. J. 73, 78–84 (2001).

A. Predatory Pricing

Plaintiffs can bring predatory pricing claims under the Sherman Act,[28] the Robinson-Patman Act,[29] or the Federal Trade Commission Act.[30] The essential claim of a plaintiff in a predatory pricing case is that the defendant set prices too low in order to harm its competitors. Of course, the antitrust laws exist not to protect competitors but rather to protect competition.[31] In a predatory pricing scheme, the economic theory holds that once the defendant has driven its competitors out of business it can then use its increased market power to raise its prices above what otherwise would be the competitive level.[32]

The most recent Supreme Court case to analyze predatory pricing was *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*[33] The plaintiff, a manufacturer of generic cigarettes, alleged that Brown & Williamson engaged in price predation by entering the market for generics and cutting its prices below cost while offering discriminatory volume rebates to wholesalers.[34] While the case was brought as a Robinson-Patman claim, the Court specifically found the legal standard for price predation to be essentially the same under section 2 of the Sherman Act: "A business rival has priced its products in an unfair manner with an object to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market."[35] The Court held that when a claim alleges predatory pricing under section 2, there are two prerequisites to recovery: (1) proof that a rival's prices are less than an "appropriate measure of [the] rival's costs", and (2) a demonstration that the competitor has a "dangerous probability[ ] of recouping its investment in below-cost prices."[36] The Court reaffirmed its previous stance, rejecting "the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws."[37]

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[28] 15 U.S.C. §§ 1–2 (2002).

[29] 15 U.S.C. § 13(a) (2002).

[30] 15 U.S.C. § 45 (2002).

[31] Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962) (finding antitrust laws were passed for "the protection of *competition*, not *competitors*").

[32] For a detailed explanation and economic analysis of predatory pricing, see generally Phillip E. Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

[33] 509 U.S. 209 (1993).

[34] *Id.* at 212–17.

[35] *Id.* at 222.

[36] *Id.* at 222–24.

[37] *Id.* at 223 (citing Atl. Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 340 (1990)).

However, the Supreme Court in *Brooke Group* declined to reach the question of the appropriate measurement of costs below which pricing is predatory. Some circuits have found prices above average variable cost[38] to be lawful.[39] Other circuits have adopted a hybrid test under which prices above average variable cost but below average total cost[40] are presumed lawful and prices below average variable cost are presumed predatory.[41] Regardless of the measure of cost applied, as the Supreme Court noted, the "prerequisites to recovery [in predatory pricing cases] are not easy to establish, but they are not artificial obstacles to recovery; rather, they are essential components of real market injury."[42]

B. *Exclusionary Conduct*

The classic predatory pricing model involves a price cut followed by a period of recoupment. However, there are many instances in which businesses engage in strategic pricing behavior that does not fit neatly into this model.[43] Section 2 claims also may be brought alleging exclusionary conduct apart from predatory pricing.[44]

Exclusionary conduct has been defined as "[c]onduct that intentionally, significantly, and without business justification excludes a potential competitor from outlets (even though not in the relevant market), where access to those outlets is a necessary though not sufficient condition to waging a challenge to a monopolist and fear of the challenge prompts the conduct."[45] Alternatively, it has been described as acts that "are reasonably capable of creating, enlarging or

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38 "Variable costs . . . are costs that vary with changes in output. . . . [A]verage variable cost is the sum of all variable costs divided by output." Areeda & Turner, *supra* note 32, at 700.

39 *See, e.g.*, Irvin Indus., Inc. v. Goodyear Aerospace Corp., 974 F.2d 241, 245 (2d Cir. 1992) (applying average variable cost measurement to predatory pricing claim); *but see* Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455, 467–68 (S.D.N.Y. 1996) (holding average variable cost not controlling standard where package pricing at issue).

40 "Average [total] cost is the sum of fixed cost and total variable cost, divided by output." Areeda & Turner, *supra* note 32, at 700.

41 *See, e.g.*, William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co., 668 F.2d 1014, 1035–36 (9th Cir. 1981); D.E. Rogers Assocs. v. Gardner-Denver Co., 718 F.2d 1431, 1436–37 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984).

42 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 226 (1993).

43 For a discussion of business practices involving strategic pricing behavior, see Davis, *supra* note 10, at 69–70; Charles E. Koob, *Whither Predatory Pricing? The Divergence Between Judicial Decisions and Economic Theory: The* American Airlines *and* Virgin Atlantic Airways *Cases*, 3 SEDONA CONF. J. 9, 21–22 (2002); Tom, Balto & Averitt, *supra* note 10.

44 *See* Wildfang & Madel, *supra* note 27, at 73–77 (giving historic overview of section 2 cases involving conduct other than predatory pricing).

45 Eleanor M. Fox, *What Is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 ANTITRUST L.J. 371, 390 (2002) (interpreting holding on exclu-

prolonging monopoly power by impairing the opportunities of rivals" and that either "do not benefit consumers at all," are "unnecessary for the particular consumer benefits that the acts produce," or "produce harms disproportionate to the resulting benefits."[46]

A court considering an exclusionary conduct claim necessarily must engage in a highly fact-specific analysis of the challenged conduct and its effects. In addressing the proper analysis of exclusionary conduct, the Supreme Court explained:

> The question whether . . . conduct may properly be characterized as exclusionary cannot be answered by simply considering its effect on [the plaintiff-competitor]. In addition, it is relevant to consider its impact on consumers and whether it has impaired competition in an unnecessarily restrictive way. If a firm has been "attempting to exclude rivals on some basis other than efficiency," it is fair to characterize its behavior as predatory.[47]

While a plaintiff bringing an exclusionary conduct claim against a monopolist must meet the general *Grinnell* standard (showing possession of monopoly power and willful acquisition or maintenance), courts have varied in their findings of what will or will not constitute exclusionary conduct in violation of section 2.[48] As always, the underlying tension for courts is trying to ban behavior that harms consumers without deterring pro-consumer competition on the merits.

In addition to predatory pricing, certain other types of conduct have been found to be generally exclusionary and illegal under section 2. Since *United States v. Aluminum Co. of America* announced the principle that illegal monopolization requires more than merely the existence of a monopoly,[49] courts have found violations of section 2 in behavior such as: refusals to deal in the absence of valid business justifications;[50] monopoly leveraging;[51] tying arrangements;[52] a monopo-

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sionary conduct in Microsoft litigation). This definition was used approvingly in the *LePage's* majority opinion. LePage's Inc. v. 3M, 324 F.3d 141, 159 (3d Cir. 2003).

46 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749, at 141 (Supp. 2003).

47 Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985) (quoting ROBERT H. BORK, THE ANTITRUST PARADOX 160 (1978)).

48 *See, e.g.*, SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056, 1065 (3d Cir. 1978) (noting that conduct is exclusionary when it so affects price, supply, and demand as to prevent competition when there otherwise would be competitive market); Concord Boat Corp. v. Brunswick Corp., 21 F. Supp. 2d 923, 933 (E.D. Ark. 1998) (finding that monopolist's conduct that results "in the obvious exclusion of any significant competition in the relevant market" violates section 2, even absent de facto "exclusive dealing"); Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455, 467–470 (S.D.N.Y. 1996).

49 148 F.2d 416, 429–30 (2d. Cir. 1945).

50 *See, e.g.*, *Aspen Skiing*, 472 U.S. at 586; Lorain Journal Co. v. United States, 342 U.S. 143, 143 (1951).

list's denial to competitors of access to essential facilities;[53] predatory advertising and promotions;[54] predatory product innovation;[55] and enforcement of a monopoly obtained by a patent procured through fraud.[56] As one court framed the scope of the issue, "'[a]nticompetitive conduct' can come in too many different forms, and is too dependent upon context, for any court or commentator ever to have enumerated all the varieties."[57]

II

In *LePage's Inc. v. 3M*, an en banc panel of the Court of Appeals for the Third Circuit vacated a judgment by a prior three-judge panel and affirmed a district court finding that 3M violated section 2 of the Sherman Act when it implemented a loyalty rebate pricing scheme.[58] The plaintiff argued that 3M's loyalty rebate scheme was an illegal exclusionary act in violation of section 2.[59] 3M responded by arguing that, after *Brooke Group*, its pricing structure was per se legal since it never priced any of its products below cost.[60] The court rejected this reading of *Brooke Group* and held that exclusionary conduct by a monopolist apart from below-cost predatory pricing could sustain a verdict under section 2.[61]

This Comment now turns to a closer examination of the *LePage's* case. A description of the loyalty rebate scheme implemented by 3M is followed by a discussion of the Third Circuit's en banc opinion.

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51 *See, e.g.*, United States v. Griffith, 334 U.S. 100, 100 (1948); Eastman Kodak Co. v. Image Technical Servs., 504 U.S. 451, 452 (1992).

52 *See Eastman Kodak*, 504 U.S. at 451.

53 *See, e.g.*, MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1132–33 (7th Cir. 1983).

54 *See, e.g.*, Int'l Travel Arrangers, Inc. v. W. Airlines, Inc., 623 F.2d 1255, 1266 (8th Cir. 1980).

55 *See, e.g.*, Transamerica Computer Co. v. IBM Corp., 481 F. Supp. 965, 1002–03 (N.D. Cal. 1979) (recognizing that product innovation with "no purpose and effect other than the preclusion of . . . competition" violates section 2, while holding for defendant), *aff'd*, 698 F.2d 1377 (9th Cir. 1983).

56 *See, e.g.*, Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172, 176–77 (1965).

57 Caribbean Broad. Sys., Ltd. v. Cable & Wireless PLC, 148 F.3d 1080, 1087 (D.C. Cir. 1998).

58 324 F.3d 141 (3d Cir. 2003).

59 *Id.* at 147.

60 *Id.*

61 *Id.*

A. *3M's Loyalty Rebate Programs*

3M, founded in 1902, introduced transparent tape to the home and office products markets over 70 years ago.[62] As the manufacturer of Scotch tape, the top-selling brand name tape in the United States, 3M held a monopoly in the overall domestic transparent tape market, with a market share above ninety percent until the early 1990s.[63] LePage's, founded in 1876, manufactured a variety of office products.[64] Around 1980, LePage's decided to enter the market for second-brand and private-label transparent tape, which sold at lower prices than brand name tape. While private-label tape represented a small portion of the total market for transparent tape, by 1992 LePage's had captured eighty-eight percent of this segment of the market. Due to the growth of office superstores like Staples and Office Depot and mass merchandisers like Wal-Mart and Kmart, demand for second-brand and private-label tape increased at the expense of brand-name tape. In the early 1990s, 3M entered the private-label market by introducing its own second brand called Highland.[65]

In 1993, 3M began to offer rebate programs that "bundled" discounts for various items.[66] Retailers could earn rebates by purchasing a variety of products in addition to transparent tape.[67] As Judge Greenberg recognized in his dissenting opinion, "There is no doubt but that these programs created incentives for retailers to purchase more 3M products."[68] This was due to the structure of the rebate scheme: 3M linked the size of the rebates to the number of product lines in which the retailers met individualized growth targets. If a retailer failed to meet a target in one product line, its rebate was reduced substantially.[69]

3M in fact engaged in three different types of rebates. Its "Executive Growth Fund" ran from 1993 to 1995 and was offered to a small number of retailers.[70] Under this program, volume and growth targets for six 3M consumer products divisions were negotiated with

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62 LePage's Inc. v. 3M, Nos. 00-1368 & 00-1473, 2002 WL 46961, at *1 (3d Cir. Jan 14, 2002), *vacated, withdrawn, and reh'g en banc granted*, 277 F.3d 365 (3d Cir. Feb. 25, 2002).

63 *LePage's*, 324 F.3d at 144. 3M conceded a monopoly in the transparent tape market for purposes of the appeal. *Id.*

64 *Id.*

65 *Id.*

66 *Id.* at 170 (Greenberg, J., dissenting); *see also id.* at 154.

67 Additional products included stationery, home care, and leisure products. *See id.* at 170.

68 *Id.* at 170.

69 *Id.*

70 *Id.* at 170–71.

retailers. Retailers meeting the target in three or more divisions earned volume rebates of between 0.20% and 1.25% of total sales.

In 1995, 3M started its "Partnership Growth Fund" for the same six consumer products divisions.[71] Uniform growth targets were established that were applicable to all participants. Customers increasing their purchases from at least two divisions by one dollar and increasing their total purchases by at least twelve percent qualified for a rebate ranging from 0.5% to 2.0% based on the number of divisions and total volume of purchases increased.

Between 1997 and 1998, 3M also offered "Brand Mix Rebates" to two customers, Office Depot and Staples.[72] A minimum purchase level for tape was set by adding a "growth" factor to the amount purchased the previous year. If a customer increased its percentage of Scotch purchases relative to certain lower-priced tape orders, it could obtain the higher rebate. In response to these programs, LePage's sued, alleging, inter alia, that 3M's use of multi-tiered bundled rebates violated section 2 of the Sherman Act.

B. *LePage's: The Third Circuit's Opinion*

LePage's claimed 3M used its monopoly over brand name transparent tape to gain a competitive advantage in the private-label segment of the market. It argued that 3M's behavior was targeted at preventing competitors from gaining or maintaining large volume sales, effectively restricting the availability of lower-priced transparent tape to consumers.[73]

In response, 3M relied on *Brooke Group* to argue "above-cost pricing cannot give rise to an antitrust offense as a matter of law, since it is the very conduct that the antitrust laws wish to promote in the interest of making consumers better off."[74] The Third Circuit rejected this argument. After an analysis of prior Supreme Court law on section 2, the court found:

> Assuming *arguendo* that *Brooke Group* should be read for the proposition that a company's pricing action is legal if its prices are not below its costs, nothing in the decision suggests that its discussion of the issue is applicable to a monopolist with its unconstrained market power. . . . 3M is a monopolist; a monopolist is not free to take certain actions that a company in a competitive (or even oligo-

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[71] *Id.*

[72] *Id.* at 171.

[73] *Id.* at 144.

[74] *Id.* at 147 (quoting Appellant's Brief at 30, *LePage's* (Nos. 00-1368, 00-1473)).

polistic) market may take, because there is no market constraint on a monopolist's behavior.[75]

It further distinguished *Brooke Group* as a case involving predatory pricing, a claim not made by LePage's, and found nothing to suggest the *Brooke Group* opinion overturned existing Supreme Court precedent, which called for evaluating a monopolist's liability under section 2 "by examining its exclusionary, i.e. predatory conduct."[76] The Third Circuit concluded: "[N]othing that the Supreme Court has written since *Brooke Group* dilutes the Court's consistent holdings that a monopolist will be found to violate section 2 of the Sherman Act if it engages in exclusionary or predatory conduct without a valid business justification."[77]

The court then determined that bundled rebates were analogized more appropriately to tying[78] than to predatory pricing.[79] The court quoted the treatise *Antitrust Law* to explain that "[t]he anticompetitive feature of package discounting is the strong incentive it gives buyers to take increasing amounts or even all of a product in order to take advantage of a discount aggregated across multiple products."[80] The customer purchases the defendant's product B in order to receive a greater discount on product A, which the plaintiff does not produce. In such a case, the plaintiff can compete in B only by giving the customer a price that compensates it for the lost discount on A. Given enough volume, an equally efficient rival may not be able to compensate for lost discounts on products it does not produce.[81] "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 manufacture an equally diverse group of products and who therefore cannot make a comparable offer."[82]

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[75] *Id.* at 151–52.

[76] *Id.* at 152.

[77] *Id.*

[78] Tying is an anticompetitive practice in which a seller agrees to sell one product only on the condition that the buyer also purchase a second "tied" product. 9 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1700a, at 2 (2d ed. 2004).

[79] *Id.* at 155 (citing PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 794, at 83 (Supp. 2002)). LePage's initially accused 3M of illegal tying, but dropped this allegation after 3M filed a motion to dismiss. *See* LePage's Inc. v. 3M, Nos. 00-1368 & 00-1473, 2002 WL 46961, at *1 (3d Cir. Jan 14, 2002), *vacated, withdrawn, and reh'g en banc granted*, 277 F.3d 365 (3d Cir. Feb. 25, 2002).

[80] *LePage's*, 324 F.3d at 155 (quoting AREEDA & HOVENKAMP, *supra* note 79, ¶ 794, at 83 (Supp. 2002)).

[81] *Id.* (citing AREEDA & HOVENKAMP, *supra* note 79, ¶ 794, at 83–84 (Supp. 2002)).

[82] *Id.* at 155.

The court applied its prior reasoning in *SmithKline Corp. v. Eli Lilly & Co.* to the case at hand.[83] In *SmithKline*, the court found a loyalty rebate scheme involving the sales of certain antibiotic drugs to be a violation of section 2, where the defendant possessed monopoly power in the market and provided rebates to hospitals based on minimum purchases across multiple products.[84] The defendant in the case, Eli Lilly (Lilly), sold five broad-spectrum antibiotics called cephalosporins to hospitals. The court found that these drugs were at the time indispensable to hospital pharmacies. Lilly possessed a monopoly on two of the antibiotics, Keflin and Keflex, because of its patents. However, it faced competition on a third product, Kefzol, from a generic drug produced by rival SmithKline. In response to this competition, Lilly instituted a rebate scheme providing rebates in the form of merchandise based on the total amount of cephalosporins purchased and an additional three percent bonus rebate for buyers who purchased established minimum quantities of any three of Lilly's five cephalosporins.[85]

In its panel decision, the Third Circuit recognized the relevant market as cephalosporin antibiotics.[86] The court found that "[a]lthough eligibility for the 3% bonus rebate was based on the purchase of specified quantities of any three of Lilly's cephalosporins, in reality it meant the combined purchases of Kefzol and the [still patented] leading sellers, Keflin and Keflex."[87] The court concluded that, in violation of section 2, an "act of willful acquisition and maintenance of monopoly power was brought about by linking products on which Lilly faced no competition . . . with a competitive product,"[88] resulting in the sale of all three products "on a non-competitive basis in what would have otherwise been a competitive market for [SmithKline's generic drug] Ancef and Kefzol."[89]

The *LePage's* court found that, in the same way Lilly linked a product on which it faced competition, Kefzol, with products on which it faced no competition, Keflin and Keflex, and insulated Kefzol from true price competition with its competitor, here Scotch tape was used to insulate 3M's private-label and second-brand tape.[90] The court

83 *Id.* at 156.

84 SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056, 1065 (3d Cir. 1978).

85 *Id.* at 1059–60.

86 *Id.* at 1064–65.

87 *Id.* at 1061.

88 *Id.* at 1065.

89 *Id.*

90 LePage's Inc. v. 3M, 324 F.3d 141, 156 (3d Cir. 2003). The court found evidence that Scotch tape is indispensable to any retailer in the transparent tape market. *Id.* The court did not discuss the fact that in *SmithKline* the bundled products were all within the same

determined that 3M's motive was not to compete with LePage's transparent tape but "to preserve the market position of Scotch-brand tape by discouraging widespread acceptance of the cheaper, but substantially similar, tape produced by LePage's."[91]

The court then examined the anticompetitive effect of 3M's rebate scheme. It began by recognizing that "even the foreclosure of one significant competitor from the market may lead to higher prices and reduced output."[92] It then found that a jury could have reasonably determined 3M's exclusionary conduct had the effect of cutting off LePage's from key retail pipelines necessary to permit it to compete profitably.[93] The effect of 3M's rebate scheme was to increase its private-label tape sales. "LePage's in turn lost a proportional amount of sales. . . . As a result, [its] manufacturing process became less efficient and its profit margins declined."[94] The court concluded that 3M's exclusionary conduct not only harmed LePage's ability to compete but also harmed competition itself.[95] Since there were substantial barriers to entry and 3M's interest in raising prices was well documented in the record, the court concluded that "the record amply reflects that 3M's rebate programs did not benefit the ultimate consumer."[96] Having found evidence of exclusionary conduct, the court determined that the conduct was not accompanied by an adequate business justification, finding no proof of economic efficiencies in having single invoices or single shipments.[97] It concluded that 3M violated section 2 of the Sherman Act by using its "market power over transparent tape, backed by its considerable catalog of products, to entrench its monopoly to the detriment of LePage's, its only serious competitor."[98]

market, while in *LePage's* the bundled products consisted of transparent tape products as well as other products outside of the tape market. *Compare SmithKline*, 575 F.2d at 1059-60, *with Lepage's*, 324 F.3d at 154.

91 *Id.*

92 *Id.* at 159 (citing Roland Mach. Co. v. Dresser Indus., Inc., 749 F.2d 380, 394 (7th Cir. 1984)).

93 *Id.* at 160.

94 *Id.* at 161. In 1997, LePage's closed one of its two plants. *Id.* at 162.

95 *Id.*

96 *Id.* at 163 (quoting Le Page's [sic] Inc. v. 3M, No. CIV.A.97-3983, 2000 WL 280350, at *7 (E.D. Pa. Mar. 14, 2000)).

97 *Id.* at 164.

98 *Id.* at 169.

C. *Analysis of the Third Circuit's Opinion in LePage's*

The *LePage's* decision has been criticized as "unreasoned" and lacking "a clear standard of what would constitute illegal conduct."[99] The court's "failure to articulate clearly the basis for its holding" has left the state of the law on loyalty rebates, as well as more general section 2 exclusionary conduct violations, unclear.[100] Several aspects of the *LePage's* opinion raise particular concerns for both courts and businesses in analyzing loyalty rebate schemes going forward.

The court in *LePage's* explicitly refused to find that *Brooke Group*'s predatory pricing test applied to a monopolist that was accused of exclusionary conduct, even where price levels were an integral part of the plaintiff's complaint. Instead, it read Supreme Court law on section 2 to require a two-step inquiry: (1) whether the monopolist engaged in exclusionary or predatory conduct, and if so, (2) whether it had a valid business justification for doing so.[101] In framing its analysis in this manner, the court clearly rejected a predatory pricing analysis of above-cost loyalty rebates. Rather, the court determined that a separate exclusionary conduct violation could exist which disallowed an affirmative defense of above-cost pricing.

In the opinion, however, the court engaged in essentially no economic analysis of pricing issues. It read the holding of *Brooke Group* narrowly, distinguishing it on its facts as a Robinson-Patman case involving an oligopolist.[102] Even if the court were correct in finding *Brooke Group* distinguishable as a particular type of predatory pricing case, it treated the economic analysis of pricing in *Brooke Group* with too little regard. The court spent no time discussing the economics of pricing or the concern expressed in *Brooke Group* 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."[103]

The court also expressed no concern that its application of the law might discourage legitimate price competition or protect inefficient competitors. Instead, it focused solely on the exclusionary aspects of the rebate scheme. In dissent, Judge Greenberg pointed out that, as of the time of trial, LePage's still had sixty-seven percent

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99 Gregory G. Wrobel, *New Clothes for the Emperor? Tailoring Section 2 Standards for Predatory and Exclusionary Conduct*, 18 ANTITRUST 26, 28 (2003).

100 W. Dennis Cross, *What's Up With Section 2?*, 18 ANTITRUST 8, 11–13 (2003).

101 *LePage's*, 324 F.3d at 159–64.

102 *Id.* at 151.

103 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

of the private-label business.[104] Yet the majority did not require LePage's to show that it could not actually compete by calculating the discount it would have to provide to match 3M's multi-product discounts.[105] Because the economist for LePage's conceded that LePage's was a less efficient tape producer than 3M, Judge Greenberg concluded that "section 2 of the Sherman Act is being used to protect an inefficient producer from a competitor not using predatory pricing but rather selling above cost."[106]

The particular aspects of the rebate scheme that the court found impermissibly exclusionary also remain unclear.[107] At the beginning of its opinion, the court describes the assertion by LePage's that "3M used its monopoly over its Scotch tape brand to gain a competitive advantage in the private-label portion of the transparent tape market."[108] However, it later focused not on 3M's Scotch tape monopoly but on the fact that the rebate bundle included products other than transparent tape, against which LePage's could not compete.[109] It is unclear going forward whether the elements of monopoly in one market and the maintenance of that monopoly through the use of loyalty rebates bundling the monopoly product with products not offered by competitors are both essential to a section 2 claim, or whether perhaps the second element alone might be enough.[110]

Finally, the court placed a high degree of reliance on evidence of intent by 3M to eliminate the private-label market, and it dismissed 3M's actions as having no valid business justification. Addressing this intent, the court held that "[m]aintaining a monopoly is not the type of valid business reason that will excuse exclusionary conduct."[111] Thus, the jury reasonably could determine that single invoices and single shipments were insufficient business justifications. In contrast, the dissent found adequate business justification in 3M's desire to sell more products and earn more revenue, and perceived 3M's rebate scheme to be in pursuit of the company's economic interests. Read in conjunction with the court's praise of *United States v. Aluminum Co. of America*[112] and the emphasis placed upon harm to LePage's, the ruling raises the concern that a monopolist may be found to violate section 2 "by pursuing normal commercial conduct that is generally

104 *LePage's*, 324 F.3d at 175 (Greenberg, J., dissenting).
105 *Id.*
106 *Id.* at 177.
107 *See* Cross, *supra* note 100, at 11–12.
108 *LePage's*, 324 F.3d at 145.
109 *Id.* at 154–55.
110 *See* Cross, *supra* note 100, at 11–12.
111 *LePage's*, 324 F.3d at 164.
112 148 F.2d 416 (2d. Cir. 1945).

considered procompetitive if the effect of such conduct is to enhance its market position."[113]

III

While the *LePage's* opinion arguably followed Third Circuit precedent set by *SmithKline*, it provoked a heated response from the legal and business communities.[114] According to one practitioner, "The standard applied by the Third Circuit sets an extremely low threshold for demonstrating exclusionary conduct by a monopolist. . . . *LePage's* is likely to increase the frequency of firms holding their competitive punches and not competing aggressively—particularly on price."[115] The court engaged in a detailed recitation of modern section 2 jurisprudence, but, this Comment proposes, it failed to apply a principled approach to analyzing the legality of loyalty rebate schemes under section 2 of the Sherman Act.

This Comment argues that a clearly articulated test based on the fundamental antitrust principle of protecting pro-competitive price cutting (even by monopolists) is called for. Part III.A begins by discussing the economic implications of loyalty rebates that an effective test must take into consideration. Part III.B presents a number of alternative tests that have been suggested by courts and commentators. Finally, Part III.C proposes a test that balances the exclusionary effects of loyalty rebates against issues of administrability and the likelihood of chilling legitimate pro-competitive conduct.

A. *The Economic Implications of Loyalty Rebates*

While 3M's case rests on the argument that *Brooke Group* requires a plaintiff to show below-cost pricing when complaining about any pricing scheme under section 2 of the Sherman Act, there seems to be a general consensus among commentators that loyalty rebates and similar pricing structures do not warrant traditional predatory pricing analysis.[116] Predatory pricing rests on the claim that a

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113 ABA Section of Antitrust Law, Antitrust Law Developments 247 (5th ed. 2002).

114 *See, e.g.*, Balto, *supra* note 11; Brief for Amici Curiae BellSouth Corp. et al. in Support of Petitioner, 3M Co. v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865); Brief for Amici Curiae Boeing Co. et al. in Support of Petitioner; Brief for Amicus Curiae The Business Roundtable in Support of Petitioner; Brief for Amici Curiae Morgan Stanley et al. in Support of Petition for Certiorari; Brief of Amici Curiae Washington Legal Foundation and National Association of Manufacturers in Support of Petitioner.

115 Balto, *supra* note 11.

116 *See, e.g.*, Areeda & Hovenkamp, *supra* note 46, ¶ 749, at 133 (Supp. 2003) (noting that not every allegedly exclusionary practice merits cost-based predatory pricing analysis); Einer Elhauge, *Why Above-Cost Price Cuts To Drive Out Entrants Are Not Predatory—*

competitor has priced its products below cost with the object of reducing competition in order to ultimately raise prices.[117] In contrast, plaintiffs bringing loyalty rebate claims are not complaining merely about low prices but about overall market foreclosure brought about by the rebate structure.[118] As one commentator describes, the concern in such situations "is not that prices are predatory or, if not predatory, that their general level is low enough to cause a competitive problem. Rather, the concern is that the particular *structure* of the prices is designed in such a manner that it amounts to a de facto exclusivity requirement."[119]

A loyalty rebate by a monopolist is structured in such a way as to encourage buyers to deal more or less exclusively with the monopolist across multiple product lines. To illustrate, consider the following hypothetical: Firm X offers products A, B, and C, and a smaller rival Firm Y sells only A'.[120] An above-cost volume or market-share discount by X on product A could be matched by Firm Y as long as Y was an equally efficient manufacturer. However, consider the effect when Firm X institutes a loyalty rebate scheme aggregated across its three products, targeting buyers who use all three products. Suppose Firm X offers a progressive discount that gives a one percent rebate for all three products for each additional 1000 units of A, B, and C that are purchased. A purchaser who took 20,000 units of each product would receive a twenty percent discount on all three. If that purchaser took only 10,000 units of A and 20,000 each of B and C, it would find its discount dropped to ten percent on each product line. A purchaser who chose to buy 10,000 units of product A' from Firm Y would be giving up ten percent discounts on B and C. Therefore, Firm Y would have to offset this loss with a thirty percent discount just to compensate the buyer for its total loss aggregated across all three products.[121]

The additional costs that such a scheme imposes on the single-product firm can be viewed as a "tax" or "penalty."[122] In effect, the

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and the Implications for Defining Costs and Market Power, 112 YALE L.J. 681, 698 n.53; Tom, Balto & Averitt, *supra* note 10, at 623–32.

117 *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222 (1993).

118 *See* AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 133 (Supp. 2003).

119 Tom, Balto & Averitt, *supra* note 10, at 637 (emphasis in original).

120 This hypothetical is taken from AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 136–37 (Supp. 2003).

121 This is a highly simplified example; the incentives of such a scheme can become even larger and more complex depending on the volume, number of product lines, size of the rebate offered, and market shares at issue.

122 *See* Tom, Balto & Averitt, *supra* note 10, at 627; Wildfang & Madel, *supra* note 27, at 78–79.

firm is "paying" this amount to compete in the market by offering an additional discount to compensate the buyer for the rebates it loses when it switches.[123] A single-product rival can compete against a loyalty rebate only by offering a significantly larger discount on its own single product.[124] This can be viewed as the creation of a barrier to entry, a cost that is incurred by firms trying to compete with the multiproduct monopolist.[125] While such an entry barrier may be surmountable, this would seem to be an effective means of handicapping new entry or expansion by existing rivals.[126]

Thus, the implication of a loyalty rebate scheme is that it has the potential to exclude an equally efficient single-product rival from the market, based on the exclusionary aspects of the pricing structure rather than on pro-consumer competition on the merits. As one commentator observes, "A key reason to treat such loyalty rebates differently [than predatory pricing claims] is that, by foreclosing the market share rivals need to reach the minimum efficient scale, loyalty rebates can raise rivals' costs or exclude them from the market altogether."[127] If loyalty rebates were judged to be illegal only upon a showing that price was below cost, a firm could evade liability by "inflating the price and then offering a rebate conditioned on exclusivity."[128] By engaging in de facto exclusive dealing, monopolists using loyalty rebates gain market power through raising rivals' costs rather than by improving their own efficiency.[129]

In their treatise *Antitrust Law*, Professors Areeda and Hovenkamp find the *LePage's* court to have assessed accurately the exclusionary aspect of loyalty rebate schemes.[130] They explain that, in *LePage's,* aggregating discounts across multiple products could have had significant effects on single-product rivals. Since the discounts were aggregated across multiple products over a lengthy time period and generated few proven economies, they were capable of excluding an equally efficient rival.[131] In response to the argument that an equally efficient rival would be one who could have entered all of 3M's product lines and matched its discounts, the authors find that

123 Wildfang & Madel, *supra* note 27, at 79.

124 *See* Areeda & Hovenkamp, *supra* note 46, ¶ 749, at 137 (Supp. 2003) (illustrating that single-product rival must compensate its customer for its lost rebate through significant discounting to compete effectively).

125 *See* Wildfang & Madel, *supra* note 27, at 78–80.

126 *See id.*

127 Elhauge, *supra* note 116, at 698 n.53.

128 *Id.*

129 *Id.*

130 Areeda & Hovenkamp, *supra* note 46, ¶ 749, at 132–33 (Supp. 2003).

131 *Id.* at 136.

defining "equally efficient rivals" in such a manner would result in giving multi-product monopolists many years of protection with little benefit to consumers.[132] Since the rebates were individually tailored to specific customers, a defendant-monopolist could repeatedly modify its rebate package in response to any new product line a competitor developed.[133]

B. *Possible Tests for Exclusionary Conduct Cases Involving Loyalty Rebates*

Given the potential exclusionary effects of loyalty rebate schemes, a variety of legal responses have been proposed to help courts determine when such schemes violate section 2 of the Sherman Act. In this Section, three general approaches are considered.

1. *Pricing Above Cost Is Presumptively Legal*

Having lost its case in the Third Circuit, 3M petitioned the Supreme Court for a writ of certiorari, on the question "[w]hether a dominant firm's discounted but above-cost prices for volume purchases, of either individual products or multiple products, may be condemned as unlawful under section 2 of the Sherman Act based on the incentive such low prices offer to shift purchases away from smaller rivals."[134] Numerous parties filed amici curiae briefs in support of 3M's petition, including, among others, Boeing, Caterpillar, Honeywell, Intel, Northwest Airlines, Staples, and Verizon.[135] 3M's petition urged the Court to adopt a rule that prices above an appropriate measure of cost are per se legal.[136] This has been described by one commentator as the "silver bullet defense."[137] Under an expan-

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132 *Id.* at 139–40.

133 *Id.* This argument, however, does not seem to consider adequately the realities of competition among modern business conglomerates. It might not be necessary for a competing firm to match each product line of a multi-product monopolist; rather, it could compete if it had multiple products of its own, only some of which competed directly. That is, a firm that had a monopoly in paper clips, for example, might compete with a tape monopolist in the private-label tape category by offering rebates over its own product lines. In theory, such competition could result in lower (but above cost) prices and ultimately benefit consumers. In contrast, the *LePage's* opinion protects the smaller, less efficient firms in the marketplace—protecting the competitor, not competition.

134 Petition for a Writ of Certiorari at i, 3M Co. v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865).

135 Brief for Amici Curiae BellSouth Corp. et al. in Support of Petitioner; Brief for Amici Curiae Boeing Co. et al. in Support of Petitioner; Brief for Amicus Curiae The Business Roundtable in Support of Petitioner; Brief for Amici Curiae Morgan Stanley et al. in Support of Petition for Certiorari; Brief of Amici Curiae Washington Legal Foundation and National Association of Manufacturers in Support of Petitioner.

136 *See* Petition for a Writ of Certiorari at 12–14.

137 Wildfang & Madel, *supra* note 27, at 85.

sive reading of *Brooke Group*, the rule would hold that monopolists engaged in marketing strategies such as market-share agreements, bundled discounts, and other forms of loyalty rebates are immune from section 2 liability so long as the prices of the products to which the strategies are attached are above cost.[138]

A more moderate version might be taken from the Eighth Circuit's opinion in *Concord Boat v. Brunswick Corp.*[139] In *Concord Boat*, Brunswick, the market leader in stern drive engine manufacturing, instituted a single-product discount program which rewarded buyers based both on volume and market share.[140] The plaintiff did not allege predatory pricing by Brunswick but rather pointed to a pattern of exclusionary conduct designed to strengthen Brunswick's monopoly power in the market.[141] Applying *Brooke Group* to overturn the section 2 judgment, the court found that the alleged monopolist's above-cost market share discount program did not qualify as exclusionary conduct.[142] The court recognized three key principles in the *Brooke Group* decision: (1) emphasis on a policy favoring vigorous price competition even by dominant firms, (2) distrust of claims alleging pricing low in the short run in order to monopolize in the long run, and (3) skepticism of the ability of a court to separate anticompetitive price-cutting from legitimate price competition.[143] With these principles in mind, the Eighth Circuit applied a balancing test to the exclusionary conduct claim, requiring the plaintiff to overcome a presumption of legality for discounts that leave price above average variable cost.[144]

Under this form of the test, a plaintiff complaining that a monopolist-competitor priced above its average variable cost would have to overcome "a strong presumption of legality by showing other factors indicating that the price charged is anticompetitive."[145] One commentator proposes considering the monopolist's business strategy as one factor.[146] He suggests it should be possible to determine whether the monopolist's plan either "is likely to be profitable even if the plaintiff does not exit the business, e.g., because the defendant is simply giving up margin on some sales in order to gain volume and market share" or

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[138] *Id.* Wildfang and Madel argue that such a rule would eliminate all section 2 causes of action except predatory pricing claims, an effect not intended by *Brooke Group*. *Id.*

[139] Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000).

[140] *Id.* at 1044.

[141] *Id.* at 1060, 1062.

[142] *Id.* at 1061–63.

[143] *Id.* at 1060–61. *See* Davis, *supra* note 10, at 71 (discussing *Concord Boat* opinion).

[144] *Concord Boat*, 207 F.3d at 1061.

[145] *Id.*

[146] Davis, *supra* note 10, at 72.

"depends for its profitability on the assumption that the defendant's competitors will exit, permitting it to raise its prices."[147] Such a test would keep the balance tilted toward protecting aggressive price competition while allowing a plaintiff to prevail in a clear case of anticompetitive effect.

Critics of such tests argue that they give too much leeway to firms to engage in anticompetitive exclusionary conduct to the ultimate detriment of consumers.[148] However, as the *Brooke Group* court emphasized, the argument in favor of such tests is not that all price cuts are good, but that a less rigorous standard for plaintiffs runs the risk of chilling too much good behavior.[149] In other words, given the difficulties courts face in distinguishing between good and bad pricing behavior and the high cost to consumers of judicial miscalculation, the harms of alternative rules outweigh the benefits.

2. *Pricing Above Cost Is Irrelevant to a Claim of Exclusionary Conduct*

At the other end of the spectrum from the "silver bullet defense" are the *SmithKline* and *LePage's* decisions. After *LePage's*, it can be argued that any loyalty rebate scheme in the Third Circuit could be subject to antitrust scrutiny and quite possibly found to violate section 2 of the Sherman Act.[150] Certainly, the opinions in both cases make clear that the exclusionary elements of loyalty rebates will not find a safe harbor merely because they can be shown to be above a level of cost.[151] Under the analysis applied by the *LePage's* court, section 2 claims that do not allege predatory pricing will be scrutinized under a two-step test: (1) Does the court find the monopolist to have engaged in exclusionary or predatory conduct (with no consideration given to level of pricing), and (2) does the monopolist have a valid business justification for its loyalty rebate scheme (apart from a desire to enhance its short-term profits)?[152]

While this test recognizes the harm that loyalty rebates potentially can inflict on equally competitive single-product competitors, it tips the balance too heavily in favor of plaintiffs. Under such a standard, inefficient competitors will undoubtedly be protected against competition that might be beneficial to consumers. Especially under a

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147 *Id.*

148 *See, e.g.*, AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 140 (Supp. 2003).

149 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

150 *See supra* Part II.C.

151 *LePage's*, 324 F.3d at 147; SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056, 1062–65 (3d Cir. 1978).

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

LePage's-type analysis that does not consider short-term gains and increases in sales to be an adequate business justification, such a standard effectively allows a violation to be shown based on evidence of anticompetitive intent plus harm to rivals.[153]

This test is essentially a judicial determination in opposition to the reasoning in *Brooke Group*. There, the Court determined that a price cut above an appropriate 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."[154] In other words, given the degree of difficulty in distinguishing good conduct from bad conduct, the least costly alternative is to allow such behavior. In contrast, the *LePage's* test considers the costs of monopolists' loyalty rebate schemes to be so high that the appropriate rule is one which protects less efficient competitors at the cost of higher prices for consumers. A *LePage's* rule might be justifiable under one of two conditions: Either (1) the particular situation of a monopolist offering a loyalty rebate is one in which a court is somehow more able to distinguish between good and bad behavior than in a price-cutting context, or (2) the cost of such behavior by a monopolist is so high that chilling legitimate price competition and protecting less efficient competitors is an acceptable price to pay on balance. Regarding the first condition, the *LePage's* decision can be characterized as holding that loyalty rebate schemes by their very nature violate section 2, and a fact-specific analysis as to whether the particular scheme actually resulted in significant harm to the plaintiff is unnecessary. As to the second condition, there seems to be no persuasive economic evidence to find it more than conclusory.

3. *Pricing Above Cost Might Be Legal*

Several tests have been proposed that attempt a more refined balancing of the potential harm to competition from exclusionary conduct against the concern with chilling pro-consumer price cuts. Professors Areeda and Hovenkamp propose a test in which "[t]he relevant question is not whether a particular plaintiff was equally efficient, but whether the challenged bundling practices would have excluded an equally efficient rival, without reasonable justifica-

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153 *See* Balto, *supra* note 11. For an argument distinguishing *LePage's* from *Aspen Skiing* on grounds that 3M likely *increased* short-term sales, see *LePage's*, 324 F.3d at 178 (Greenberg, J., dissenting); AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 139 (Supp. 2003).

154 *Brooke Group*, 509 U.S. at 223.

tion."[155] This would not require a showing that the actual plaintiff was equally efficient, thus lowering the bar for the plaintiff. They further argue that proving whether a hypothetical equally efficient rival is excluded by a multi-product discount should be manageable.[156] On the other hand, proving the actual plaintiff is equally efficient can be difficult, especially if the defendant produces a larger product line than the plaintiff does and joint costs are involved.[157] This test, they submit, strikes the right balance between "permitting aggressive pricing while prohibiting conduct that can only be characterized as anticompetitive."[158]

Another commentator proposes applying the Federal Trade Commission's slotting allowance analysis to loyalty rebates.[159] Under this test, the court would first consider "the extent that rival suppliers as a whole likely would be disadvantaged from a given marketing arrangement, including consideration of their ability to avoid or mitigate the disadvantage."[160] Second, in order to show harm to competition rather than competitors, the court should examine "the likely impact on competition in markets in which the disadvantaged suppliers seek to compete."[161] In the final step, the court should consider "whether the practice produces pro-competitive benefits that likely would offset the harm and whether similar benefits could be obtained by practical, significantly less restrictive means."[162] Under this step, some showing of harm to consumers would be required.[163]

A third "balancing" test can be found in *Ortho Diagnostics Systems, Inc. v. Abbott Laboratories, Inc.*,[164] a case involving the sale of products called blood assays, which are used to screen the blood supply for viruses. Abbott Laboratories provided a rebate scheme with different package options, with the result that the more assay types a buyer purchased, the greater a discount it received on each. In no instance, however, did prices for any individual product fall below

155 Areeda & Hovenkamp, *supra* note 46, ¶ 749, at 140 (Supp. 2003).

156 *Id.*

157 *Id.*

158 *Id.*

159 Balto, *supra* note 11. Slotting allowances are "lump-sum, up-front payments from a manufacturer or producer . . . to a retailer to have a new product carried by the retailer and placed on its shelves." Federal Trade Commission, Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry 1 (Feb. 2001), *available at* http://www.ftc.gov/opa/2001/02/slottingallowancesreportfinal.pdf.

160 Balto, *supra* note 11.

161 *Id.*

162 *Id.*

163 *Id.*

164 920 F. Supp. 455, 469 (S.D.N.Y. 1996).

cost. Recognizing that the pricing at issue involved "the bundled pricing of a package of complementary products, in some of which the defendant has market power, as well as the unbundled prices of the components of the package," the court found the crucial question to be "whether 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."[165] Finding an affirmative answer, the court determined that *Brooke Group* was not controlling in this case because it did not address package pricing. Rather, the court applied a two-prong test for determining the legality of loyalty rebate schemes.[166]

Under the *Ortho* test, a plaintiff could bring a claim against a monopolist-competitor if the monopolist faced competition on a portion of a complementary group of products, offered those products both individually and as a package, and had a rebate scheme that effectively forced the plaintiff to make up the difference between the bundled and unbundled prices of the product in which the monopolist had market power. The plaintiff would be required to show either that the monopolist priced below its average variable cost, or that the plaintiff was as efficient a producer of the competitive product as the monopolist, but the rebate scheme made it unprofitable for the plaintiff to continue to produce.[167]

The common strength of each of these tests is that they attempt to acknowledge the general legitimacy of above-cost pricing while recognizing that loyalty rebates have the potential to exclude equally efficient competitors and decrease competition. The *Ortho* test encounters the problem that Areeda and Hovenkamp's test tries to avoid, namely, that it might be difficult for a plaintiff to prove it is as efficient a producer as the monopolist. On the other hand, by not requiring a showing of equal efficiency in fact, Areeda and Hovenkamp's test might protect a less efficient competitor that is already in the market, a result that the antitrust laws should attempt to avoid. However, this is not necessarily the case. Consider a multiproduct monopolist that is not allowed to offer loyalty rebates but is still able to offer volume discounts. In theory, a more efficient monopolist should be able to offer an above-cost volume discount that a less efficient rival could not compete with—a display of on-the-

165 *Id.* at 466–67.
166 *Id.* at 467–68.
167 *Id.* at 469.

merits competition rather than illegal exclusionary conduct.[168] Another potential weakness of the test proposed by Professors Areeda and Hovenkamp is that, given a less demanding standard to meet, plaintiffs might be more likely to litigate relatively weaker exclusionary conduct claims against monopolists, diverting resources and reducing the overall level of consumer welfare.

C. *Balancing the Exclusionary Aspects of Loyalty Rebates Against "The Intolerable Risks of Chilling Legitimate Price Cutting"*[169]

A strong case can be made that *Brooke Group* does not necessarily hold that section 2 of the Sherman Act will never be violated when a monopolist offers a loyalty rebate scheme in which prices remain above an appropriate measure of cost.[170] In addition, it seems clear that loyalty rebates can be designed so as to have exclusionary effects to the extent of shutting out equally efficient rivals from the market.[171] The question remains how to craft a rule that allows as much vigorous competition on the merits as possible while catching as much anticompetitive exclusionary conduct as possible.[172]

The Supreme Court's concern in *Brooke Group* about setting a standard that would discourage beneficial price-cutting represents a persuasive argument against adopting a robust version of the *LePage's* test. In economic terms, the *LePage's* test provides an inefficiently high amount of deterrence to monopolists. It seems clear that such a test inevitably would protect smaller, less efficient firms against aggressive price competition by monopolists, thereby protecting competitors at the expense of competition. One only need look at *LePage's* itself: While the court found that LePage's was harmed by 3M's loyalty rebates—harm to the competitor—there was not a strong showing that competition itself was harmed.[173]

On the other hand, the test proposed by 3M insulates too much anticompetitive behavior by monopolists against potentially legitimate complaints. Loyalty rebate schemes with exclusionary effects should be subject to scrutiny under section 2 analysis. As previously discussed, loyalty rebates can be used to maintain a monopolist's monopoly in one or more product lines by foreclosing the market and

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168 *But cf.* Tom, Balto & Averitt, *supra* note 10 (discussing potential exclusionary effects of market-share discounts involving volume rebates).

169 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

170 *See supra* Parts II.C, III.B.

171 *See supra* Parts II, III.A.

172 AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 141 (Supp. 2003) (recognizing that "[t]he difficult question is the formulation of an administrable rule that does not overreach and condemn competitive conduct").

173 *See* LePage's Inc. v. 3M, 324 F.3d 141, 159–63 (2003).

raising rivals' costs.[174] A test that requires a showing of below-cost pricing before finding liability ignores these effects and might allow a monopolist ultimately to raise prices to consumers.

How can a test be crafted that encourages aggressive price competition by a monopolist while still protecting consumers against the possibility that the monopolist is, in fact, eliminating its competition with the intention of raising prices in the future? Two principles provide guidance: (1) The antitrust laws are intended to protect competition, not competitors,[175] and (2) above-cost price-cutting may reflect the lower cost structure of the price cutter.[176] This Comment argues that an effective test not only should protect equally efficient single-product rivals—who can compete by matching each other's above-cost price cuts—but also should allow the market to eliminate less efficient producers who cannot survive aggressive competition on the merits. Such a test would recognize that a given loyalty rebate scheme may or may not be legal, depending on its potential to exclude equally efficient competitors. The proper balance might be achieved through a combination of the test used in *Ortho* and that proposed by Professors Areeda and Hovenkamp.

Under such a rule, a plaintiff bringing a section 2 claim against a multi-product monopolist's use of a loyalty rebate scheme would be required to make one of two showings: Either (1) the monopolist has priced below its average variable cost,[177] or (2) an equally efficient producer of the competitive product would find it unprofitable to continue to produce.[178] If the plaintiff could show that an equally efficient producer would have been foreclosed from the market, the defendant would be allowed to rebut a presumption of illegality only by showing reasonable justification for its actions.[179]

A showing of below-cost pricing would provide a proxy for a clear violation of section 2, setting a low threshold that most defendants would be able to meet. That is, it is likely that most defendant-monopolists are careful to price above cost, lest they run afoul of *Brooke Group*'s predatory pricing law. On the other hand, the

174 *See supra* Part III.A.

175 *See* Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962).

176 *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

177 Because a determination of the appropriate measure of cost is beyond its scope, this Comment relies upon the *Ortho* court's endorsement of average variable cost as the most appropriate measure. *See* Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455, 466, 469 (S.D.N.Y. 1996).

178 *Id.*; AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 140 (Supp. 2003); *supra* Part III.B.

179 *See* AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 140 (Supp. 2003).

Brooke Group standard requires an additional showing by the plaintiff that the defendant has a reasonable chance of recoupment. For purposes of loyalty rebate law, the proposed test might allow the plaintiff to apply the below-cost predatory pricing test to the specific customers targeted in common by both the plaintiff and the defendant.[180] In other words, LePage's could have argued that the discounts on Scotch tape 3M gave to its key customers, like Staples and Office Depot, should be measured against the costs of the private-label tape 3M sold them. The test might allow a plaintiff to argue that the discounts on the monopoly product should be attributed to the sales on the competitive product, so long as it can show that the intent of the defendant was to incentivize sales on the competitive product.

In the more likely case of a monopolist who prices above cost, the plaintiff should be allowed to show that an equally efficient producer of the competitive product would find it unprofitable to continue producing. This requirement addresses the fundamental exclusionary aspect of loyalty rebates: foreclosure of equally efficient single-product rivals due to discounts aggregated across multiple products. Allowing the plaintiff to use a hypothetical equally efficient producer eliminates the concern that the burden of proving its own efficiency would be too high.[181] In response to the concern that such a test protects an inefficient competitor-plaintiff, consider that a monopolist-competitor likely would have legitimate means of eliminating such an inefficient rival ex ante, perhaps through the use of single-product volume rebates.

While courts' analyses of the legality of loyalty rebate plans will necessarily remain highly complex fact-specific inquiries, they can benefit from a test that protects competition on the merits while recognizing that

> [a]s a general rule, 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.[182]

A test that bases its analysis on a hypothetical equally efficient competitor recognizes the dangers of foreclosure while respecting the Supreme Court's concerns in *Brooke Group*.

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180 *See* Kenneth L. Glazer & Brian R. Henry, *Coercive vs. Incentivizing Conduct: A Way Out of the Section 2 Impasse?*, 18 ANTITRUST 45, 50 (2003) (noting that predatory pricing test can be applied to individual customer).

181 *See* AREEDA & HOVENKAMP, *supra* note 46, ¶ 749, at 140 (Supp. 2003).

182 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

Conclusion

At this time, the antitrust implications of loyalty rebates remain unclear. While the recent *LePage's* decision took an aggressive stance against what it found to be exclusionary conduct in violation of section 2 of the Sherman Act, the subsequent response by the legal and business communities highlights the uncertainty facing market leaders over when their pricing decisions will be subject to antitrust scrutiny. Further guidance from the courts will be beneficial in addressing the narrow question of how businesses should analyze loyalty rebate schemes as well as in providing much-needed clarification as to the boundaries of legitimate behavior under section 2. Now that the Supreme Court has denied certiorari in *LePage's*, lower courts have the opportunity to clarify the law by applying a principled test which balances a recognition of the exclusionary aspects of loyalty rebates with the desire to avoid chilling legitimate competition.