DE FACTO EXCLUSIVE DEALING, FORECLOSURE, AND MARKET SHARE DISCOUNTS

by

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Abstract

In recent years a number of cases have come before the courts in which market share discounts – arrangements in which a seller offers a buyer a lower price for its goods on the condition that the buyer purchases a specified minimum share of its requirements from the seller – have been alleged to have operated as unlawful de facto exclusive dealing arrangements. Almost all of these challenges have failed at the first hurdle of persuading the court that the discount arrangement forecloses competition. This paper identifies shortcomings in the courts’ foreclosure analysis and, adopting the appropriate inquiry into foreclosure established in other de facto exclusive dealing cases, shows that market share discounts are capable of foreclosing competition. This paper also advocates for the use of a discount attribution test – similar to that employed in bundled discount cases – to determine whether a given market share discount forecloses competition.
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# Table of Contents

Acknowledgments........................................................................................................... iii

Table of Contents ............................................................................................................ iv

Introduction ....................................................................................................................... 1

1 Exclusive Dealing: A Primer .......................................................................................... 4

2 Judicial Attitudes Toward Market Share Discounts and Foreclosure ......................... 13

3 The Proper Inquiry Into Foreclosure for De Facto Exclusive Dealing Arrangements ........................................................................................................... 20

4 How Market Share Discounts Foreclose Competition ............................................... 29

4.1 Nature of the Incentive ............................................................................................... 30

4.2 Can a Rival Profitably Meet or Beat the Discount? ................................................... 40

5 From Theory to Enforcement: Policy Considerations for the Test of Foreclosure for Market Share Discounts ................................................................................... 45

Conclusion ...................................................................................................................... 52

References ...................................................................................................................... 53
Introduction

Exclusive dealing arrangements can take many different forms, but at their core they involve a buyer agreeing (or being induced) to purchase certain goods only from a particular seller for a certain period of time. These arrangements are common throughout the economy and explain why one can buy Coke at McDonald’s but not Pepsi, or why car dealerships usually sell cars from only one manufacturer. There is a broad consensus that exclusive dealing generally poses little threat to competition – indeed, most believe exclusive dealing arrangements are generally procompetitive and highly efficient. However, exclusive dealing can also be employed for anticompetitive reasons. If, for example, a firm and its rival both need a particular input for use in production of their competing goods, one of them may deliberately exclude the other from the market by signing exclusive contracts with all suppliers of that input. The potential competition problem with exclusive dealing is one of exclusion of rivals through foreclosure to inputs or customers.

Exclusive dealing is traditionally conceived of as involving a contract between a buyer and seller containing an express commitment to exclusivity. The contract forecloses competition because, even if a rival can offer a better deal to the buyer, the buyer is precluded from accepting competing offers due to the contractual obligation. However, exclusive dealing can also be achieved through arrangements which use economic incentives

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1 ZF Meritor LLC v Eaton Corp, 696 F (3d) 254 at 270 (3rd Cir 2012) [Meritor].
2 See United States v Microsoft Corp, 254 F (3d) 34 at 69 (DC Cir 2001) [Microsoft], describing exclusive dealing as a “presumptively legitimate business practice”. See also Omega Environmental Inc v Gilbarco Inc, 127 F (3d) 1157 at 1162 (9th Cir 1997) [Omega]: “There are, however, well-recognized economic benefits to exclusive dealing arrangements, including the enhancement of interbrand competition”; Eastern Food Services Inc v Pontifical Catholic University Services Association Inc, 357 F (3d) 1 at 8 (1st Cir 2004): “[I]t is widely recognized that in many circumstances [exclusive dealing arrangements] may be highly efficient – to assure supply, price stability, outlets, investment, best efforts or the like – and pose no competitive threat at all”. See generally Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application, 3 ed (New York: Aspen Law & Business, 2006) at ¶ 1810 [Hovenkamp, “Antitrust Law”].
5 Meritor, supra note 1 at 340.
that are as effective at compelling a buyer to purchase exclusively from the seller as a contractual obligation. This type of arrangement is known as de facto exclusive dealing. In recent years an increasing number of cases have come before the courts in which it has been alleged that a market share discount has operated as an unlawful de facto exclusive dealing arrangement. Market share discounts are arrangements in which a seller offers a buyer a lower price for its goods on the condition that the buyer purchases a specified minimum share of its requirements from the seller. Plaintiffs have generally not fared well in these cases, with a large majority of challenges being rejected by the courts. As has often been the case with other de facto exclusive dealing arrangements, the courts have been sceptical of the capability of market share discounts to foreclose competition. Courts have reasoned that competition for buyers is not foreclosed because buyers can switch purchases to rivals simply by foregoing the lower price offered for meeting the market share requirement. To attract a buyer in these circumstances a rival need only to offer a superior discount to that offered by the seller. Courts have therefore typically viewed market share discounts as competition on price, a practice that is the “very essence of competition”.

The central motivation of this paper is to assess whether the scepticism of the capability of market share discounts to foreclose competition is justified. This is an important issue as businesses are increasingly adopting sophisticated pricing strategies which aim to induce loyalty from their customers. And, perhaps as a result of this trend, the number of antitrust

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6 United States v Dentsply International Inc, 399 F (3d) 181 at 193 (3rd Cir 2005) [Dentsply].
8 See Concord Boat Corp v Brunswick Corp, 207 F (3d) 1039 (8th Cir 2000) [Concord Boat]; Allied Orthopedic Appliances Inc v Tyco Health Care Group LP, 592 F (3d) 991 (9th Cir 2010) [Allied Orthopedic]; Southeast Missouri Hospital v CR Bard Inc, 642 F Supp (2d) 876 (ND Cal 2012) [Church & Dwight Co Inc v Mayer Laboratories Inc, 868 F Supp (2d) 876 (ND Cal 2012) [Church & Dwight]; Eisai Inc v Sanofi-Aventis US LLC, 2014 WL 1343254 (D NJ 2014) [Eisai].
9 Concord Boat, supra note 8 at 1061.
challenges to market share discounts appears to be rising quickly.\textsuperscript{11} Adopting the inquiry into foreclosure for de facto exclusive dealing arrangements established in the \textit{Dentsply} case – that is, asking whether a rival can plausibly provide an incentive to buyers to switch that is comparable to that offered under the de facto arrangement – this paper shows that market share discounts are capable of foreclosure, and that the courts which have had the opportunity to assess antitrust challenges to market share discounts have failed to properly understand the logic of how this discount practice forecloses competition.\textsuperscript{12} As such, the courts must resist dismissing challenges to market share discounts on the basis that they cannot foreclose competition. It is also argued in this paper that the requirement to assess whether a rival can provide a comparable economic incentive makes applying a discount attribution test similar to that used in bundled discount cases necessary, as it is only this test that flushes out whether a rival can meet or beat the market share discount offered by the seller.\textsuperscript{13}

The first part of this paper provides an overview of exclusive dealing, highlighting the relevant economics and law and further defining the concept of de facto exclusive dealing. The paper then turns to a discussion of judicial attitudes toward market share discounts. This part assesses the reasoning in those cases in which challenges to market share discounts have been rejected and shows that it is the scepticism of the capability of market share discount arrangements to foreclose competition that underpins the courts’ decisions. Next this paper analyzes how courts have assessed foreclosure under de facto exclusive dealing arrangements other than market share discounts. This exercise establishes the proper inquiry into foreclosure to be used in assessing challenges to market share discounts. The following part of the paper applies that inquiry to market share discount arrangements and shows how

\textsuperscript{11} A search of the Westlaw antitrust cases database shows that market share discounts have been the subject of complaints in at least eight cases in the last seven years. Prior to that period, there appears to have been only three cases in which market share discounts have been challenged.

\textsuperscript{12} \textit{Dentsply}, \textit{supra} note 6.

\textsuperscript{13} A discount attribution test takes the cumulative value of the seller’s discount offered over sales that are both incontestable and contestable, and attributes the discount to only those sales that are contestable. The price for the contestable sales is then compared to the incremental cost of producing the good to determine whether the price is below-cost. If the price is below-cost an equally efficient rival will be unable to profitably meet or beat the discount offered by the seller and the rival will be foreclosed from competing for the contestable sales. This test is further explored later in this paper.
these arrangements can foreclose competition. This part also advocates for the application of a discount attribution test. Finally, this paper considers the error costs that may arise from the application of the discount attribution test and, recognizing the potentially large costs of false positives, recommends a test which reduces the likelihood of an errant finding of foreclosure.

1 Exclusive Dealing: A Primer

While the practice of exclusive dealing is almost always procompetitive (or at least competitively benign), the history of antitrust shows that exclusive dealing arrangements can be and have been employed by firms as a method of excluding rivals from the market. The mechanism of exclusion is by foreclosing competition for sales to buyers which have committed to (or have been induced into) dealing exclusively with a seller. For example, suppose a seller has contracts with 90% of buyers in a market and under those contracts buyers have agreed to purchase exclusively from the seller for a period of five years. In this situation, competition for sales to 90% of buyers in the market will have been foreclosed for five years, and rivals will have an opportunity to compete for only 10% of the buyers in the market. However, while foreclosure is a necessary condition for competitive harm, it is not sufficient. Krattenmaker and Salop show that competitive harm will result only where foreclosure raises rivals’ costs (RRC). Foreclosure can RRC by either increasing the price of remaining available inputs (where distribution or retailing is an ‘input’ into the sale of the seller’s product) or by denying scale to rivals. The deprivation of minimum efficient scale drives rivals’ production costs upwards, making them less competitive; if rivals are denied minimum viable scale, they may exit the market altogether. Krattenmaker and Salop note that, while RRC hurts rivals, competition may not necessarily be harmed if some rivals

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14 See Standard Fashion Co v Magrane-Houston Co, 258 US 346, 42 S Ct 360 (1922); United Shoe Machinery Corp v United States, 258 US 451, 42 S Ct 363 (1922) [United Shoe cited to US]; Standard Oil Co of California v United States, 337 US 293, 69 S Ct 1051 (1949); Lorain Journal Co v United States, 342 US 143, 72 S Ct 181 (1951); Microsoft, supra note 2; Dentsply, supra note 6.

15 See generally Krattenmaker & Salop, “Raising Rivals’ Costs”, supra note 3.


17 Ibid at 667.
remain able to compete effectively.\textsuperscript{18} The firm implementing the exclusive dealing arrangements must therefore be shown to have gained “power over price” by having raised its rivals’ costs. If, for example, the increase in rivals’ costs is so trivial that it has little effect on rivals’ overall production costs, rivals are likely to remain an effective constraint on the firm’s power to raise prices.\textsuperscript{19}

When the economics of exclusive dealing was in a relatively primitive stage, the Chicago School of antitrust raised the obvious but penetrating question of why a buyer would ever agree to an exclusive dealing arrangement if the outcome was a reduction in competition and an increase in the price facing the buyer.\textsuperscript{20} Of course, downstream buyers ordinarily benefit from rigorous upstream competition between sellers.\textsuperscript{21} This consideration led Bork to conclude that exclusive dealing contracts will only be entered into if they are efficient, maximizing surplus for both the seller and buyer.\textsuperscript{22} Beginning with work by Aghion and Bolton a number of economic models have now shown that, while entry into an exclusive dealing arrangement may be profit maximizing for the seller and buyer (under conditions where buyers cannot coordinate), the arrangement can also impose an externality on parties outside the contract.\textsuperscript{23} For example, under one of these models, the seller exploits externalities among buyers by offering each buyer a small price reduction in return for their entry into an exclusive dealing contract.\textsuperscript{24} Acceptance of this offer by buyers is a Nash equilibrium, as each knows that the other buyers will accept the offer and that its decision to

\textsuperscript{18} Krattenmaker & Salop, “Raising Rivals’ Costs”, \textit{supra} note 3 at 214.
\textsuperscript{19} \textit{Ibid} at 243.
\textsuperscript{24} Rasmusen, Ramseyer & Wiley, “RRW”, \textit{supra} note 23.
remain a ‘free agent’ in the market would not be sufficient to induce new entry by a seller.\textsuperscript{25} New entrants are therefore excluded from the market because all buyers are locked into an exclusive contract with the incumbent seller.

Enforcement against anticompetitive exclusive dealing arrangements can be undertaken under sections 1 and 2 of the Sherman Act and also under section 3 of the Clayton Act, with claims subject to the rule of reason.\textsuperscript{26} Though the elements which need to be satisfied under each of these statutory provisions are articulated slightly differently, the essence of the claim is the same.\textsuperscript{27} Generally speaking, “modern antitrust law requires a showing of significant market power by the defendant, substantial foreclosure, contracts of sufficient duration to prevent meaningful competition from rivals, and an analysis of likely or actual anticompetitive effects considered in light of any procompetitive effects”.\textsuperscript{28} What constitutes “substantial foreclosure” should be answered in light of the economic emphasis on RRC,\textsuperscript{29} although Jacobson notes that decisions since the early 1980s have “routinely sustained the legality of exclusive dealing arrangements with foreclosure percentages of 40 percent or less”.\textsuperscript{30} Where the foreclosure achieved under an exclusive dealing arrangement is substantial, anticompetitive effects are possible.\textsuperscript{31}


\textsuperscript{26} Eisai, supra note 8 at 33.

\textsuperscript{27} Ibid.

\textsuperscript{28} Meritor, supra note 1 at 271.

\textsuperscript{29} In the Matter of McWane Inc and Star Pipe Products Ltd, 2014 WL 556261 at 49 (FTC 2014) [McWane], Commissioner Wright, dissenting: “Whereas earlier and now discredited formulations of foreclosure raised the concern that exclusive dealing contracts between an input supplier and a buyer foreclosed rival buyers from access to that input seller, the modern economics of raising rivals’ costs recognizes that determining a rate of foreclosure is not the end of the economic analysis, but rather is a starting point for a broader inquiry into whether the contracts raise a rival supplier’s costs sufficiently to impact the competitive process”.


\textsuperscript{31} Tampa Electric Co v Nashville Coal Co, 365 US 320 at 328-329, 81 S Ct 623 at 628-629 (1961) [Tampa Electric cited to US].
Critical to this paper is the distinction between the more traditional de jure exclusive dealing and de facto exclusive dealing. De jure exclusive dealing refers to a buyer’s contractual obligation to deal exclusively with a seller for a period of time.\textsuperscript{32} The contractual obligation can be framed as either a requirement for the buyer to take all of its requirements from the seller, or a prohibition on the buyer from dealing with other sellers.\textsuperscript{33} De facto exclusive dealing, on the other hand, involves the use of economic incentives to induce buyers to purchase exclusively from the seller.\textsuperscript{34} The “notion of de facto exclusive dealing has its roots in \textit{United Shoe Machinery Corp v United States}, a decision of the Supreme Court in 1922.\textsuperscript{35} In that case, the court held that a contract lacking an express agreement not to deal in the products of a rival can still be considered exclusive dealing if “the practical effect… is to prevent such use” of the rival’s products.\textsuperscript{36} The Supreme Court later confirmed the validity of the de facto exclusive dealing concept in \textit{Tampa Electric}.\textsuperscript{37}

De facto exclusive dealing is characterized by the absence of an explicit clause in a contract obligating the buyer to purchase exclusively from the seller for a significant period of time. The absence of such a clause makes an economic incentive necessary to sustain an exclusive purchasing relationship for a significant duration. De facto exclusive dealing arrangements have been found to exist in two circumstances. The first is where there is no express exclusivity clause (whether there is a contract between the parties or not). In \textit{Meritior}, for example, the defendant Eaton and buyers had entered into an agreement under which buyers received a discount on all purchases if they met a certain percentage of their requirements with Eaton products.\textsuperscript{38} The buyers were not contractually obligated to take any of their requirements from Eaton, but the court nonetheless found that the arrangements between

\footnotesize{\textsuperscript{32} International Competition Network, \textit{Unilateral Conduct Workbook – Chapter 5 Exclusive Dealing} (Presented at the 12\textsuperscript{th} Annual ICN Conference, Warsaw, Poland, April 2013) at para 34, online: ICN \texttt{<www.internationalcompetitionnetwork.org>} [ICN, “Exclusive Dealing”].

\textsuperscript{33} \textit{Ibid}.

\textsuperscript{34} Tom, Balto & Averitt, “Anticompetitive Aspects of Market-Share Discounts”, \textit{supra} note 4 at 615.

\textsuperscript{35} \textit{Meritior, supra} note 1 at 329.

\textsuperscript{36} \textit{United Shoe, supra} note 14 at 457.

\textsuperscript{37} See \textit{Tampa Electric, supra} note 31 at 326.

\textsuperscript{38} \textit{Meritior, supra} note 1 at 265.}
Eaton and the buyers amounted to “mandatory purchase requirements”.39 This was because there was evidence that Eaton had threatened to terminate its supply relationship with buyers if they did not meet the percentage targets that Eaton had set, and buyers could not afford to lose Eaton as a supplier.40 The second circumstance is where an explicit exclusivity clause exists, but the agreement is of short duration or can be terminated at will. In Dentsply, for example, the defendant Dentsply had made it a condition of supply to buyers that they not deal in the products of any of Dentsply’s rivals.41 Dentsply operated on an individual transaction basis and therefore the “relationship [was] essentially terminable at will”.42 Despite the easy terminability of the relationship, the court found that Dentsply could sustain buyers’ commitment to exclusivity for a sufficiently long period to foreclose competition.43 This was because Dentsply held such a large share of the market that it was commercially imperative for buyers to continue their relationship with Dentsply.

De facto exclusive dealing arrangements can be structured in a number of ways, but the forms that arise most commonly in cases – and which this paper is principally concerned with – are ‘all-or-nothing’ policies and market share discounts. An all-or-nothing policy refers to an arrangement whereby the seller conditions the supply of its goods on the buyer taking all its requirements (or in some cases, nearly all of its requirements) from the seller; if the buyer purchases some of its requirements from a rival of the seller, the seller will withdraw supply. Thus, the buyer must take ‘all’ or receive ‘nothing’. Market share discounts are arrangements where a seller gives a more favourable price to buyers who purchase more than a certain percentage of their requirements from the seller.44 This type of discount can take two forms. The first – called an incremental discount – provides a

39 Ibid at 282.

40 Ibid at 283: “Critically, due to Eaton's position as the dominant supplier, no OEM could satisfy customer demand without at least some Eaton products, and therefore no OEM could afford to lose Eaton as a supplier. Accordingly, we agree with the District Court that a jury could have concluded that, under the circumstances, the market penetration targets were as effective as express purchase requirements ‘because no risk averse business would jeopardize its relationship with the largest manufacturer of transmissions in the market’.”

41 Dentsply, supra note 6 at 185.

42 Ibid.

43 Ibid at 193.

44 Tom, Balto & Averitt, “Anticompetitive Aspects of Market-Share Discounts”, supra note 4 at 615.
discount on only those units purchased in excess of the target share threshold. For instance, a seller may offer a buyer a 10% discount on only those units purchased in excess of 70% of the buyer’s requirements.\(^{45}\) This type tends to attract little antitrust attention.\(^{46}\) The second type, and the one that typically raises greater antitrust concern, is the ‘retroactive’ or ‘all-units’ discount.\(^{47}\) Here, the seller provides a discount on all units purchased once the buyer meets its target share of requirements.\(^{48}\) For example, if the buyer’s total requirement is 100 units, the seller promises a 10% retroactive discount if the buyer meets a 70% target share, and the buyer purchases 75 units, the buyer will receive a 10% discount on all 75 units purchased. If the buyer purchases only 69 units, it will not receive a discount on any units.

The benefits of exclusive dealing referred to in the introduction to this paper relate mainly to the promotion of interbrand competition.\(^{49}\) Two well-accepted justifications for exclusive dealing are that it encourages distributor loyalty (“if the distributor carries only one brand, it will necessarily have a greater incentive to push that brand than if it carries others as well”)\(^{50}\) and prevents retailer free-riding,\(^{51}\) which encourages sellers to provide retailer-specific investments.\(^{52}\) As Jacobson notes, “exclusive dealing… involves significant complementary investments in which both supplier and customer devote time, energy, and money to their mutual success”.\(^{53}\) The courts have consistently recognized the potential benefits to interbrand competition of exclusive dealing and take these benefits into consideration under the rule of reason test for assessing exclusive dealing arrangements.\(^{54}\) The benefits are,

\(^{47}\) Ibid.  
\(^{48}\) Jacobson, “A Note on Loyalty Discounts”, supra note 45 at 1-2.  
\(^{50}\) Ibid at 357.  
\(^{51}\) In this context, free-riding refers to a retailer exploiting one seller’s investment in that retailer to help sell another seller’s goods.  
\(^{52}\) Jacobson, “Exclusive Dealing”, supra note 30 at 358.  
\(^{54}\) See e.g. Race Tires America Inc v Hoosier Racing Tire Corp, 614 F (3d) 57 at 76 (3rd Cir 2010); Meritor, supra note 1 at 270.
however, less well explored for market share discounts. Jacobson suggests that many loyalty discounts are generally associated with no complementary investments of the sort that would typically justify exclusive dealing arrangements: “Because some [purchases from rivals are] permitted, the supplier generally is not trying to get its dealer to provide an entirely dedicated focus to the distribution of its products”. On the other hand, Murphy et al. argue that there is “always a pro-competitive justification” for market share discounts.

This is because linear pricing – i.e., the form of pricing where the seller offers its product at a fixed price and the buyer can purchase whatever quantity at that amount – “leaves unrealized gains from trade”, while market share discounts – a form of non-linear pricing – unlock those gains. The intuition behind Murphy et al.’s work is that a market share discount motivates trading between buyer and seller at higher quantities than simple linear pricing, and (under the assumption that the price absent the market share discount is above marginal cost) both seller and buyer gain added surplus from the additional quantity. It is critical for the seller that the buyer commits to purchasing a minimum share of its requirements in order to receive the discounted price – otherwise, if free to do so, the buyer would purchase a lower quantity at the discounted price and the seller’s surplus would be less than what it would be absent the market share discount arrangement.

The motivation to trade at higher quantities characteristic of market share discounts can be achieved through other arrangements (including volume discounts), but there are additional reasons for preferring a market share discount. One is heterogeneity among buyers: specifying market share discount contracts “is especially useful when a seller supplies hundreds or even thousands of buyers of different sizes, and separately negotiated contracts

57 Ibid at 8.
59 Ibid at 10.
60 Ibid at 14-15.
A cost-effective approach of obtaining gains from trade in higher quantities in such circumstances would be to offer discounts from the list price in return for a buyer’s commitment to purchase a minimum share of its requirements. As Murphy et al. note, such contracts are independent of scale and allow small and large buyers to benefit from the share-based discounts. A second reason is that market share discounts may guarantee a seller a minimum volume of sales when demand in the market is relatively stable but individual buyer demand is unpredictable (due to a market share battle between buyers, for example). By entering into market share discount arrangements where all buyers agree to purchase at least 80% of their requirements, the seller can ensure that it trades 80% of the volume in the market, regardless of the actual quantities demanded by individual buyers. This can give the seller some certainty with respect to future sales volumes and allow it to optimize its production facilities.

Anticompetitive theories of market share discounts generally rely on the seller exploiting externalities among buyers, consistent with the economic models relating to more traditional exclusive dealing. Elhauge provides a helpful illustration of how a seller might profitably exclude rivals using market share discounts:

Suppose a monopolist charges $200 for a product that costs $100 to make. Other firms stand poised to enter the market, or to expand until they achieve sufficient scale to reduce their costs to $100, in which case competition will drive prices down to $100. To prevent this competitive outcome, the monopolist announces a loyalty program under which its price is $250 unless buyers agree to be loyal and buy 90% of their needs from the monopolist, in

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61 Ibid at 15.
62 Ibid.
63 Ibid. See also Crane, “Bargaining over Loyalty”, supra note 46 at 262.
64 Ibid at 261.
65 Ibid.
66 Ibid.
which case buyers get a nominal “discount” of $50. All the buyers agree to avoid the $50 price penalty, foreclosing 90% of the market. As a result, rivals cannot enter, or expand enough to achieve their minimum efficient scale, and the buyers all continue to pay the monopoly price of $200, which is double the $100 price they would have paid but for the loyalty program.68

The reason that this strategy works is that buyers face a coordination problem. Each would be better off not agreeing to be loyal, as new entry would drive prices down to $100, but agreeing to be loyal is a Nash equilibrium when buyers cannot coordinate.69 This outcome is, according to Elhauge, equally applicable to scenarios where small rivals are seeking to expand (in addition to the scenario of firms seeking to enter).70 The strategy is also costless for the seller – its price remains at the monopoly profit maximizing level of $200.71 It would also be a profitable strategy for the seller to offer an actual discount to its monopoly price (rather than the nominal one described in Elhauge’s example), given that the counterfactual is new entry driving prices down to $100. Thus, the seller could offer a discount to just above $100 and still be better off than the counterfactual scenario of new entry. The basic intuition in Elhauge’s example has been formally modelled in a number of papers.72

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68 Eisai Inc v Sanofi-Aventis US LLC, 2014 WL 1343254 (D NJ 2014) (Declaration of Professor Einer Elhauge on behalf of Eisai, 14 November 2008) [Eisai, “Elhauge Declaration”]. A important but undisclosed assumption in the example is that a new entrant cannot compete for the entire demand of a buyer, for if a new entrant could do so it would simply offer its product at the competitive price of $100 and capture the entire demand. This assumption is further explored later in this paper, but there are various reasons why a new entrant may not be able to compete for the entire demand of buyers. For example, the monopolist may have a strong brand reputation and its products may be considered a ‘must stock item’ by buyers because of final consumers’ preferences for the brand (see EC, Communication from the Commission – Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, [2009] OJ C 45/7 at para 36 [EC, “Guidance on Abusive Exclusionary Conduct”]). As discussed later, this means that the monopolist’s discount is actually concentrated on that part of the buyer’s demand that is contestable.


70 Eisai, “Elhauge Declaration”, supra note 68.

71 See also Economides, “Loyalty/Requirement Rebates”, supra note 67 at 132.

2 Judicial Attitudes Toward Market Share Discounts and Foreclosure

Despite the existence of anticompetitive theories for market share discounts, antitrust challenges to such practices have “generally met with failure”.\(^{73}\) As Crane observes, market share discounts “have received a generally hospitable welcome in US courts”.\(^{74}\) Actions against market share discounts typically allege that the arrangement constitutes unlawful de facto exclusive dealing. The core of the argument is that the discount – which is contingent on the buyer meeting a certain percentage of its requirements with the seller’s product – creates a powerful incentive to exclusivity (or more specifically, partial exclusivity, as it is in the case of market share discounts) which forecloses competition for sales to buyers subject to the discount arrangement.\(^{75}\) In rejecting challenges to market share discounts, the courts have focussed their inquiry on the question of whether the discount has resulted in foreclosure and have answered that question in the negative. In the analysis of market share discount cases that follows, this paper concentrates on the reasons the courts have given for finding that the discounts have not resulted in foreclosure.

The first important case addressing market share discounts was *Concord Boat*.\(^{76}\) The defendant Brunswick was the market leading manufacturer of stern drive engines for boats with a market share of between 75% and 80%.\(^{77}\) Brunswick had implemented a discount program with its customers (boat builders) under which a customer received a 3% discount if it purchased 70% of its requirements from Brunswick, a 2% discount for 65% of its requirements and a 1% discount for 60%.\(^{78}\) The plaintiffs (a group of 21 boat builders) alleged that the market share discounts amounted to unlawful de facto exclusive dealing in breach of sections 1 and 2 of the Sherman Act. There was no suggestion that the discounts resulted in a price that was predatory. The District Court held that Brunswick’s market

\(^{73}\) Crane, “Bargaining over Loyalty”, supra note 46 at 264-265.
\(^{74}\) Ibid at 264.
\(^{75}\) See e.g. *Church & Dwight*, supra note 8 at 904-905.
\(^{76}\) *Concord Boat*, supra note 8.
\(^{77}\) *Concord Boat Corp v Brunswick Corp*, 21 F Supp (2d) 923 at 931 (ED Ark 1998) [Concord Boat, District Court].
\(^{78}\) *Concord Boat*, supra note 8 at 1044.
share discount arrangements had “effectively required Plaintiffs and other boat manufacturers to purchase extremely high percentages of their total engine purchases from Brunswick for terms as long as three to five years, and that the manufacturers in fact risked their economic survival by dealing with alternative suppliers”. 79 It was clear to the District Court that the arrangements had resulted in foreclosure: “Although Plaintiffs ostensibly retained the ability to deal with Brunswick’s competitors, the overwhelming evidence was that this ability was tremendously restrained by the agreements, and that this restraint produced anticompetitive effects”. 80

The Court of Appeals for the 8th circuit reversed the District Court’s decision, finding that the plaintiffs “had failed to produce sufficient evidence to demonstrate that Brunswick had foreclosed a substantial share of the stern drive engine market through anticompetitive conduct”. 81 The court noted that the market share discount arrangements “did not require the boat builders to commit to Brunswick for any specified period of time” and reasoned that the boat builders were therefore “free to walk away from the discounts at any time”. 82 There was evidence that the boat builders had “in fact switched to [a competing manufacturer’s] engines at various points when that manufacturer offered superior discounts”. 83 It was important to the court’s finding of no foreclosure that Brunswick’s discounts did not result in prices that were below-cost: “Brunswick’s discounts, because they were significantly above cost, left ample room for new competitors such as Toyota to enter the engine manufacturing market and to lure customers away by offering superior discounts”. 84 As such, while the District Court was persuaded that the discounts had effectively made meeting the market share targets an economic imperative for the boat builders, the Court of Appeals believed that Brunswick’s arrangements did not lock boat builders into a partially exclusive relationship and there was, therefore, no foreclosure. The court ultimately

79 Concord Boat, District Court, supra note 77 at 932-933.
80 Ibid at 933.
81 Concord Boat, supra note 8 at 1059.
82 Ibid.
83 Ibid.
84 Ibid.
accepted Brunswick’s explanation that the market share discounts were simply an attempt to sell more of its product by cutting its prices.85

The decision in Concord Boat set the tone for subsequent cases involving challenges to market share discounts, with courts focusing on the perceived ability of buyers to walk away from the arrangement to take up deeper discounts offered by rivals. In Allied Orthopedic the defendant Tyco was a manufacturer of pulse oximetry products.86 Tyco had entered into agreements with its hospital customers under which the customers could “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. The greater the percentage of the customer’s requirements purchased from Tyco, the greater the discount Tyco gave”.87 The plaintiffs (a group of hospitals and other health care providers that purchased pulse oximetry products from Tyco) alleged that the market share discount agreements were an exclusive dealing arrangement in breach of section 1 of the Sherman Act. As was the case in Concord Boat, the plaintiff’s challenge floundered once the court found that the market share discounts did not result in foreclosure. The court reasoned that:

[i]t is significant that the market-share discount… agreements in this case did not contractually obligate Tyco’s customers to purchase anything from Tyco… Any customer subject to one of Tyco’s market-share discount agreements could choose at any time to forego the discount offered by Tyco and purchase from a generic competitor.88

The court concluded that “[t]he market-share discount agreements at issue here did not foreclose Tyco’s customers from competition because a competing manufacturer needed only offer a better product or a better deal to acquire their business”.89 There was no

85 Ibid at 1061.
86 Pulse oximetry provides a non-invasive method to measure a patient’s pulse and blood oxygenation. The principal components involved in a pulse oximetry system are a monitor (which is a relatively large initial expense) and sensors (which are relatively inexpensive, but need to be replaced regularly): see Allied Orthopedic Appliances Inc v Tyco Health Care Group LP, 2008 WL 7346921 at 1 (CD Cal 2008).
87 Allied Orthopedic, supra note 8 at 995.
88 Ibid at 996-997.
89 Ibid at 997.
analysis in the decision as to whether a rival could realistically offer a better deal to customers which would compensate them for the loss of a discount from not meeting the market share targets.

*Southeast Missouri Hospital* had similar facts to those in *Allied Orthopedic* and essentially the same outcome. The defendant was a manufacturer of medical supplies – in this case, the relevant product was catheters – and the plaintiff challenged the defendant’s use of market share discounts under a theory that they were “de facto exclusionary because the discount prices [were] so attractive that hospitals [could not] afford to forgo them”. The court dismissed the challenge in quick fashion, holding that the plaintiff’s “challenge to the share-based discounts is precluded by this court’s decision in *Concord Boat*. The court explained why:

Here, as in *Concord Boat*, [the defendant] offered share-based discounts. Share-based discounts gave hospitals discounts for committing to purchase specified percentages of their catheter needs from [the defendant]. The greater the percentage, the greater the discount. In order to receive these discounts, hospitals were not required to purchase 100 percent of their catheter needs from [the defendant], or to refrain from purchasing from competitors. Nor did the… discount agreements contractually obligate hospitals to purchase anything from [the defendant]. If a hospital purchased less than the agreed upon percent, it simply lost its negotiated discount. Contrary to [the plaintiff’s] position, the share-based discounts here parallel those in *Concord Boat*.

*Church & Dwight* was a case where the defendant, a condom manufacturer with a 75% share of the market, had offered retailers a percentage rebate off its wholesale price in exchange for a retailer’s commitment to devote a certain percentage of shelf space to the defendant’s products. The plaintiff, a rival of the defendant, argued that the defendant’s rebate

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90 *Southeast Missouri Hospital*, supra note 8.
91 *Ibid* at 612.
92 *Ibid*.
94 *Church & Dwight*, supra note 8 at 884. For a similar case with essentially the same outcome, see *RJ Reynolds Tobacco Co v Philip Morris Inc*, 199 F Supp (2d) 362 (MD NC 2002).
structure – where discounts were lost if the retailer did not allocate the specified percentage of its shelf space to the defendant’s products – meant retailers faced a “harsh” penalty for not allocating the specified space.\(^{95}\) According to the plaintiff, the discount was “coercive and results in golden handcuffs, whereby retailers cannot afford to forgo the rebate and thus are forced to devote unjustified display space to [the defendant]”.\(^{96}\) The discount program was alleged to have constituted an exclusive dealing arrangement resulting in substantial foreclosure.\(^{97}\) The court rejected the plaintiff’s arguments, comparing the facts of the case to those in *Allied Orthopedic*:

… like Tyco’s program in *Allied Orthopedic*, here [the defendant] does not force retailers to purchase anything, much less a certain percentage, of condom products from [the defendant]. Nor do the agreements force retailers to give any specified amount of shelf space to [the defendant] over its rivals. Rather, retailers are free to give [the defendant] as much or as little shelf space as they want. The only consequence is that retailers may not receive a rebate based on those decisions. Thus, the distinction drawn in *Allied Orthopedic* – between contracts that obligated customers to purchase a set percentage of their products from a supplier and those which merely conditioned a discount on such a purchase – applies here.\(^{98}\)

The plaintiff attempted to distinguish its case from *Allied Orthopedic* by arguing that the defendant’s discount program coerced retailers into giving the defendant greater shelf space than the retailers would have preferred.\(^{99}\) However, the court found no evidence that the discounts had been coercive, pointing to the fact that shelf space provided for the defendant’s products at retailers subject to the discount program was “roughly on par” with its share of sales at retailers not in the program.\(^{100}\)

In *Meritor* the defendant’s market share discount arrangements were condemned by the court, but only because the defendant’s threats to withdraw supply if buyers did not meet the

\(^{95}\) *Church & Dwight*, *supra* note 8 at 905.

\(^{96}\) *Ibid*.

\(^{97}\) *Ibid* at 901-912.

\(^{98}\) *Ibid* at 903.

\(^{99}\) *Ibid* at 904-905.

\(^{100}\) *Ibid* at 908.
target share requirements transformed the arrangements into something akin to an all-or-nothing policy.\(^\text{101}\) Notably, the court affirmed the decision in *Concord Boat*, holding that market share discounts without the plus factor of a threat to withdraw supply could be condemned only where the price with the discount was predatory.\(^\text{102}\) The court thus joined its “sister circuits in holding that the price-cost test applies to market-share [discounts]… offered by suppliers within a single-product market”.\(^\text{103}\)

*Eisai* followed shortly after the decision in *Meritor* and largely followed its reasoning, emphasizing that market share discounts without the plus factor of termination of supply for not meeting the target share requirement generally do not foreclose competition.\(^\text{104}\) The case concerned the market for a type of pharmaceutical primarily used to treat patients with deep vein thrombosis (*DVT*). The defendant Sanofi had offered its hospital customers discounts off the wholesale price of its drug Lovenox, with the discounts calculated based both on the customer’s volume of Lovenox purchases and on the share of its requirements met with Lovenox.\(^\text{105}\) The discount arrangements featured the same aspects as those challenged in the cases discussed above (*Meritor* excepted): a more favourable price for meeting a market share target, no contractual obligation to purchase anything from the seller, and only the loss of a discount as the consequence for not meeting the market share target.\(^\text{106}\) The plaintiff *Eisai* alleged that the “market-share condition operated as a de facto exclusive dealing arrangement”, under which a customer would need to purchase 90% of its requirements from Sanofi to obtain the maximum discount, “thereby capping the potential market share of competitors at 10%”.\(^\text{107}\)

\(^{101}\) *Meritor*, supra note 1 at 277-278.

\(^{102}\) Ibid at 275.

\(^{103}\) Ibid at 275, footnote 11. The price-cost test is the test applied to determine whether a price is predatory. It involves a comparison of the price of a product against the cost to produce that product to determine whether the price is below-cost and, therefore, predatory.

\(^{104}\) *Eisai*, supra note 8 at 3-4. The discounts ranged from 9% for a market share between 75%-79% on volume of $0 to $99,000 to a 30% discount for a market share above 90% on volume of $1.2 million or more.

\(^{105}\) Ibid at 3.

\(^{106}\) Ibid at 34.

\(^{107}\) Ibid at 12.
The court’s departure point for its analysis was the principle from *Meritor* that “market-share or volume rebates in a single-product market are evaluated under the price-cost test unless, essentially, something more is happening”. Therefore, the court noted, “the market-share and volume discounts offered by Sanofi are not, in-and-of themselves, problematic for antitrust purposes”. The court proceeded to assess whether there was ‘something more’ present in Sanofi’s discount arrangements but found nothing, instead emphasizing that what was present in *Meritor* – the threat of termination of supply – was absent in this case. After further reviewing precedent on market share discounts, the court confirmed the principle from *Meritor* and its application to the facts of the present case:

These cases from other courts demonstrate that market-share discounting practices generally do not foreclose a plaintiff from competing. These antitrust plaintiffs could have offered greater discounts or improved their products in order to maintain and increase their market shares. The fact that they did not and suffered a loss in profits is of no concern to the antitrust laws. These cases show that, in general, antitrust claims fail if customers are able to walk away from the defendant's discounts and still use the defendant as a supplier.

Judicial attitudes toward claims that market share discounts are de facto exclusive dealing arrangements resulting in foreclosure are, on the basis of recent cases, conservatively described as sceptical. The key element in each of the decisions is a view that the prospective loss of a discount is not sufficient to make it mandatory for a buyer to meet its market share target – buyers subject to market share discount arrangements are ‘free agents’ who can shift purchases between competitors depending on their economic incentives to do so. The core ground supporting this viewpoint is an assertion that rivals can simply offer a better price or product to attract buyers, and because buyers have no contractual obligation to purchase from the seller, they are free to switch purchases to rivals. The assertion that rivals can attract buyers by offering a better deal is critical to the conclusion that a market share discount does not foreclose competition, for if it were found that rivals could not

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109 *Ibid*.
110 *Ibid* at 36.
realistically counter the market share discount, foreclosure would seem a real possibility. Ultimately, the conclusion that market share discounts do not foreclose competition leads the courts to view such arrangements as simply competition on price – something that is the essence of competition and which antitrust law should therefore encourage.\(^{111}\) While the assertion that a rival can attract buyers subject to a market share discount by offering a better deal is critical to the conclusion that the discount arrangement does not foreclose competition, the assertion is often not based on a robust analysis of whether rivals are, in fact, capable of offering a better deal. For example, in \textit{Allied Orthopedic} the court simply posits that rivals “remained able to compete for Tyco’s customers by offering their products at better prices”.\(^{112}\) The likely basis for this assertion is the fact that the challenged market share discounts are conceded to have resulted in prices that remain above-cost, and therefore the discounts supposedly leave “ample room” for rivals to “lure customers away by offering superior discounts”.\(^{113}\) The failure to properly inquire into whether a rival can plausibly offer a better deal is a significant shortcoming of the courts’ approach, as this paper will later show.

\section{3 The Proper Inquiry Into Foreclosure for De Facto Exclusive Dealing Arrangements}

The history of de facto exclusive dealing cases shows that courts have previously been sceptical of the capability of other de facto arrangements to foreclose competition. In particular, challenges to exclusive dealing arrangements have been rejected on the basis that the contracts requiring exclusivity were of short duration or were terminable on short notice. The reasoning in these cases shows a close parallel with the reasoning in the market share discount cases, focussing on the perceived ability of buyers to walk away from the arrangement to take up a better deal. In \textit{Roland Machinery} the plaintiff (a distributor of construction equipment) alleged that the defendant (a manufacturer of construction equipment) had entered into contracts with dealers that contained an implicit exclu

\footnotesize{111} See e.g. \textit{ibid} at 28; \textit{Concord Boat, supra} note 8 at 1062.

\footnotesize{112} \textit{Allied Orthopedic, supra} note 8 at 998.

\footnotesize{113} \textit{Concord Boat, supra} note 8 at 1059.
clause, and that these contracts constituted unlawful exclusive dealing.\textsuperscript{114} The court rejected the plaintiff’s case, finding that the contracts did not foreclose competition because the contracts were terminable by either party on short notice.\textsuperscript{115} According to the court, this meant that the defendant’s rivals had “only to offer a better deal” to induce one of the defendant’s dealers to switch, and the dealer could take up the offer by giving the defendant 90 days’ notice of termination.\textsuperscript{116} This conclusion was reached despite there being evidence (discussed in the dissent to the court’s decision) that a dealer could not survive without stocking the defendant’s products, meaning that it would be unlikely in practice for a dealer to choose to terminate the exclusive dealing contract with the defendant.\textsuperscript{117} If termination was unlikely in practice, the exclusive relationship could have been sustained for as long as the defendant’s products were necessary for a dealer to survive.

\textit{Omega} was, in many key respects, a repeat of \textit{Roland Machinery}. The defendant was the market leader in the manufacture of petroleum dispensing equipment and had entered into exclusive dealing agreements with distributors of its products. The agreements were terminable by either party on 60 days’ notice. The plaintiff was a distributor who wished to stock multiple brands of dispensing equipment, and alleged that the exclusive dealing agreements were in breach of section 3 of the Clayton Act. The court dismissed the plaintiff’s challenge, holding that the “easy terminability” of the agreements “negate substantially their potential to foreclose competition”.\textsuperscript{118} In a nod to the reasoning in \textit{Roland Machinery}, the court found that because of the easy terminability of the arrangements “a competing manufacturer need only offer a better product or a better deal to acquire” the services of distributors.\textsuperscript{119} Again, however, there was evidence that distributors could not realistically abandon the defendant’s line of products for an alternative supplier’s products.

\textsuperscript{114} \textit{Roland Machinery Co v Dresser Industries Inc}, 749 F (2d) 380 at 382 (7th Cir 1984) [\textit{Roland Machinery}].

\textsuperscript{115} There was a question in the case as to whether the agreements did in fact contain an implicit exclusivity condition: see \textit{ibid} at 392-393. However, for the purposes of the foreclosure analysis the court assumed that there was an implicit exclusivity condition.

\textsuperscript{116} \textit{Ibid} at 394.

\textsuperscript{117} \textit{Ibid} at 404.

\textsuperscript{118} \textit{Omega}, supra note 2 at 1163.

\textsuperscript{119} \textit{Ibid} at 1164.
This was because end consumers would lose trust in the distributor if it switched completely from a brand it had long been associated with to a new brand.\textsuperscript{120} This evidence was central to Pregerson’s J dissent, in which he argued that the easy terminability of the exclusive agreements was “irrelevant” because “[n]o distributor would ever terminate voluntarily for fear of losing its customers and ultimately its business”.\textsuperscript{121}

The likely driver of the decisions in \textit{Roland Machinery} and \textit{Omega} is that the courts viewed the rivalry in the relevant markets as ‘competition for the contract’ – that is, competition to enter into exclusive contracts with distributors. So long as exclusive contracts are short in duration, competition for the contract can be a valuable “form of competition that antitrust laws protect rather than proscribe”.\textsuperscript{122} While the courts took the view that the exclusive contracts were terminable on short notice and therefore regular competition for the contract was possible, there was evidence in each case suggesting that termination may not have been possible in practice. Clearly, however, neither court was convinced by that evidence, believing that rivals could successfully induce distributors to terminate their existing contracts and switch by offering a better deal.

\textit{Dentsply} was a turning point in the analysis of de facto exclusive dealing arrangements. Its key contribution to exclusive dealing jurisprudence was to show that it is necessary to properly inquire into whether a rival can plausibly offer the “better deal” to induce buyers to switch that the courts in \textit{Roland Machinery} and \textit{Omega} had essentially assumed. This inquiry needs to be undertaken with reference to the economic realities of the relevant market, including the market position of the firm implementing the exclusive dealing arrangement.\textsuperscript{123} The implications for antitrust challenges to market share discounts arising from \textit{Dentsply} are significant.

\textsuperscript{120} \textit{Ibid} at 1177.
\textsuperscript{121} \textit{Ibid}.
\textsuperscript{122} \textit{Paddock Publications Inc v Chicago Tribune Co}, 103 F (3d) 42 at 45 (7th Cir 1997).
\textsuperscript{123} \textit{Dentsply}, supra note 6 at 189.
Dentsply was a manufacturer of artificial teeth for use in dentures, which it sold to dental products dealers. The dealers then supplied Dentsply’s artificial teeth and other materials to dental laboratories which fabricated the dentures for sale to dentists. Dentsply had “long dominated the industry” and enjoyed a 75%-80% market share.\footnote{Ibid at 184.} For 15 years Dentsply had supplied its products under a policy called “Dealer Criterion 6” which provided that dealers of Dentsply products “may not add further tooth lines to their product offering”.\footnote{Ibid at 185.} As noted earlier, the relationship between Dentsply and its dealers was essentially terminable at will. The Department of Justice alleged that Dealer Criterion 6 was an exclusive dealing arrangement employed to unlawfully maintain Dentsply’s monopoly power in the market for the sale of prefabricated artificial teeth.\footnote{Ibid at 184.} The District Court had sided with Dentsply, holding that “nothing contractually obligates a dealer to continue with [the exclusive dealing arrangement]” and that “dealers are free to leave Dentsply whenever they choose”.\footnote{United States v Dentsply International Inc, 277 F Supp (2d) 387 at 450 (D Del 2003) [Dentsply, District Court].} In reasoning that closely resembles the decisions in Roland Machinery and Omega, the District Court held that there could be no foreclosure as “any new or existing tooth manufacturer may ‘steal’ a Dentsply dealer by offering a superior product at a lower price”.\footnote{Ibid at 452.}

The Court of Appeals rejected the lower court’s theory that a rival could “steal” a customer by offering a superior product at a lower price:

[The theory] simply has not proved to be realistic… The paltry penetration in the market by competitors over the years has been a refutation of theory by tangible and measurable results in the real world… Dealer Criterion 6 created a strong economic incentive for dealers to reject competing lines in favor of Dentsply’s teeth. As in LePage’s, the rivals simply could not provide dealers with a comparable economic incentive to switch… The fact that dealers
have chosen not to drop Dentsply teeth in favor of a rival’s brand demonstrates that they have acceded to heavy economic pressure.\textsuperscript{129}

What was the strong economic incentive that Dentsply had created which rivals simply could not match? The key to the answer lies in Dentsply’s market position. Dentsply’s dominant market share meant that the “levels of sales that competitors could project in wooing dealers were minuscule compared to Dentsply’s”.\textsuperscript{130} For example, in attempting to lure a dealer away from Dentsply, one rival could project sales of only $1.2 million compared to the $8 million in sales of Dentsply’s products that the dealer had recently achieved.\textsuperscript{131} Because of Dentsply’s market position, dealers could not afford to lose Dentsply as a supplier – they needed to stock the “popular” Dentsply products to meet consumer demand.\textsuperscript{132} Confronted with an all-or-nothing policy, the only economically rational decision was to deal exclusively in Dentsply’s products. For a rival to have provided a “comparable economic incentive” for dealers to switch, it would have needed to have altered end consumer demand such that it could project sales volumes that were in the same ballpark as what Dentsply could generate. If a rival could achieve this, then a dealer might switch its entire demand to the rival because Dentsply would no longer be a ‘must have’ supplier. The District Court attributed rivals’ failure to generate greater demand for their products to their “failure to compete”, noting a lack of product promotion compared to Dentsply’s efforts.\textsuperscript{133} The Court of Appeals took a different view:

It has not been so much the competitors’ less than enthusiastic efforts at competition that produced paltry results, as it is the blocking of access to the key dealers… The apparent lack of aggressiveness by competitors is not a matter of apathy, but a reflection of the effectiveness of Dentsply’s exclusionary policy.\textsuperscript{134}

\textsuperscript{129} \textit{Dentsply}, supra note 6 at 194-96.
\textsuperscript{130} \textit{Ibid} at 194.
\textsuperscript{131} \textit{Ibid}.
\textsuperscript{132} \textit{Ibid} at 185.
\textsuperscript{133} \textit{Dentsply}, District Court, supra note 127 at 450.
\textsuperscript{134} \textit{Dentsply}, supra note 6 at 189.
Dentsply establishes the appropriate inquiry to determine whether an alleged de facto exclusive dealing arrangement produces foreclosure – that is, can a rival plausibly provide a comparable economic incentive for a buyer to switch? If the answer to that inquiry is ‘yes’ then access to that buyer has not been foreclosed; if the answer is ‘no’ then access to the buyer is foreclosed. Dentsply also shows that the theoretical possibility of providing a comparable incentive is not sufficient to dismiss a claim that a de facto arrangement forecloses competition.\textsuperscript{135} Rather, the court must look to market realities and the capabilities of existing and likely rivals, and determine whether there is a plausible case that a rival can provide a comparable incentive. The emphasis on whether a rival can provide a comparable economic incentive can be contrasted to the focus in a case such as Allied Orthopedic, where the court was preoccupied with the question of whether the buyer could walk away from the contract and simply forgo the discount offered by the seller.\textsuperscript{136} In a limited sense, the answer to such a line of questioning is, of course, ‘yes’ – there will be no breach of contract if the buyer walks away and any buyer can forgo a discount. But a buyer will only ever walk away if there is something better to walk to. Accordingly, the proper inquiry is whether a rival can provide just that something better.

One critical element of the inquiry is to understand the nature of the incentive that is being employed to induce exclusivity. The incentive in Dentsply was effective because it was generated by Dentsply leveraging its market position as a ‘must have’ supplier. Knowing that dealers could not afford to lose it as a supplier – essentially, knowing that a substantial portion of buyers’ demand was inelastic for its products – Dentsply made it an economic imperative for dealers to choose an exclusive relationship by refusing to supply if a dealer stocked rivals’ products. Without the base of inelastic demand for its products, Dentsply’s all-or-nothing policy would not have worked, as dealers would view rivals’ products as substitutes across their entire demand and could therefore switch all of their requirements to one or more of the rivals. This feature – the leveraging of a portion of inelastic demand to generate an incentive to exclusivity – was also a central aspect of the case in Meritor. As

\textsuperscript{135} The court noted that “[a]lthough its rivals could theoretically convince a dealer to buy their products and drop Dentsply’s line, that has not occurred”: see \textit{ibid}.

\textsuperscript{136} \textit{Allied Orthopedic}, \textit{supra} note 8 at 997.
discussed above, Eaton had threatened to terminate supply if OEMs (original equipment manufacturers) did not meet their market share targets. This threat was effective in inducing the OEMs into near-exclusive relationships because Eaton was the dominant supplier in the market and “no OEM could satisfy customer demand without at least some Eaton products, and therefore no OEM could afford to lose Eaton as a supplier”. The court found that the Eaton had “leveraged its position as a supplier of necessary products to coerce the OEMs into entering into the [exclusive arrangements]”.

Other cases have recognized the importance of this leveraging action. In Appleton the court was asked to rule on a motion for summary judgment for the defendant Appleton. Appleton argued that because its exclusive dealing agreements were terminable at will there could be no foreclosure of competition. The court rejected Appleton’s argument, finding that the plaintiff had produced sufficient evidence to create a fact question whether the agreements were truly terminable at will. Key to this finding was the plaintiff’s contention that “Appleton’s high market share and the deeply rooted customer preference for [Appleton’s] brand of paper prevent merchants from surrendering Appleton as a supplier, which they must do under these agreements if they desire to distribute non-Appleton brands”.

In McWane, a decision of the Federal Trade Commission (FTC), the defendant McWane argued that its Full Support Program – essentially an all-or-nothing policy – “could not have foreclosed access to distributors because it did not require distributors to commit to purchasing McWane’s fittings exclusively for a lengthy period of time”. The FTC did not agree:

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137 Meritor, supra note 1 at 283.
138 Ibid at 285.
139 Minnesota Mining and Manufacturing Co v Appleton Papers Inc, 35 F Supp (2d) 1138 (D Minn 1999) [Appleton].
140 Ibid at 1144.
141 Ibid.
142 McWane, supra note 29 at 24.
McWane’s Full Support Program required exclusive dealing for as long as McWane desired. The overwhelming evidence shows the practical effect of McWane’s program was to make it economically infeasible for distributors to drop McWane’s full line of domestic fittings and switch to a rival.\footnote{Ibid.}

As in Dentsply and Meritor, it was McWane’s market position that underpinned the effectiveness of its all-or-nothing policy. It was “economically infeasible” for distributors to abandon McWane’s products because McWane was the only full-line supplier of domestic iron piping fittings and distributors needed access to that full-line: “McWane knew very well that an exclusive dealing requirement would prevent distributors from purchasing from suppliers without full lines”\footnote{Ibid at 20.}.

Finally, although only an administrative complaint,\footnote{Later settled by Consent Order: see In the Matter of Intel Corp, 2010 WL 3180281 (FTC 2010).} the FTC’s allegations against Intel highlight how a dominant seller might leverage the portion of inelastic demand for its products to induce buyers into exclusive relationships.\footnote{In the Matter of Intel Corp, 2009 WL 4999728 (FTC 2009).} Intel was accused of making threats against buyers if they purchased too many non-Intel products, such as threatening to stop supply, increase prices or withdraw technical support.\footnote{Intel was also alleged to have implemented market share discount programs which foreclosed competition: see ibid at para 53.} The FTC explained that buyers were susceptible to these threats because Intel was a “must have or essential supplier for [OEMs]”.\footnote{Ibid at para 50.} It continued:

Intel is the only firm with the… product breadth to meet all the requirements and be the sole supplier to [OEMs]. Intel is also the only… supplier with the current capability to supply all or nearly all of the requirements of the largest OEMs. As a result, the… OEMs could not credibly threaten to shift all or even a majority of their… purchases away from Intel; to the contrary… OEMs needed Intel as a primary supplier.\footnote{Ibid.}
These cases show that a necessary condition of foreclosure through de facto exclusive dealing is that the incentive to exclusivity must be generated by the seller leveraging the inelastic demand for its product. In each case, the seller’s goods were a ‘must have’ for at least some of buyers’ requirements, and this inelastic demand was used to incentivize buyers to take their requirements exclusively from the seller. This was because the all-or-nothing policy adopted by the sellers, combined with the must have nature of their products, meant that the only economically rational choice for buyers was to purchase their requirements exclusively from the sellers. The key to understanding why this element is essential is to understand how the competitive process might have played out if, instead of there being a portion of buyers’ demand that was inelastic for the seller’s product, rivals’ products were viewed as substitutes for that demand. In this counterfactual, buyers would have the economically rational option available to them to drop the seller’s product and meet their entire demand with a rival’s product, which they would do if the rival’s product was cheaper or of superior quality. It is this competitive dynamic that the courts in Roland Machinery and Omega likely had in mind when they asserted that rivals could lure buyers away simply by offering a better deal. However, when a substantial portion of buyers’ demand is inelastic for the seller’s product (because of a need to meet consumer demand, for example), buyers will not be prepared to switch their entire demand to a rival. In this circumstance, if a buyer is confronted by the seller with an all-or-nothing choice it will choose exclusivity because it needs the seller’s products to meet the bulk of consumer demand. The alternative – buying from rivals but nothing from the seller – would mean that the buyer might meet only a fraction of consumer demand, risking economic survival as a result. Rivals who do not enjoy a substantial inelastic demand for their products simply cannot offer a competing incentive to compensate buyers who forgo the seller’s supply of products with a substantial inelastic demand.

In sum, there are two key implications for the approach to assessing foreclosure under market share discount arrangements arising from Dentsply and other recent de facto exclusive dealing cases. First, the inquiry into foreclosure must be focussed on whether a rival can plausibly provide a comparable economic incentive to that offered under the de
facto exclusive dealing arrangement. It is not sufficient to note that a buyer is free to walk away from a relationship and assert that a rival need only to offer a better deal to induce the buyer to switch without inquiring into whether rivals could, in fact, offer a better deal. Furthermore, there must be more than a theoretical possibility that a rival can provide a comparable economic incentive to dismiss a claim that a de facto arrangement forecloses competition. The court must assess whether rivals can realistically provide a comparable incentive, having regard to market realities (including the market position of the seller implementing the de facto arrangement) and the capabilities of existing and potential rivals. Second, a critical part of the inquiry is to determine whether the incentive to exclusivity provided by the seller is generated by leveraging the inelastic demand for the seller’s product. A positive finding on this part of the inquiry is a necessary condition for a finding of foreclosure.

4 How Market Share Discounts Foreclose Competition

Employing the inquiry into foreclosure established in *Dentsply*, this section shows how market share discounts can in certain circumstances foreclose competition. The section begins with an analysis of the nature of the incentive produced by market share discount arrangements, demonstrating that the incentive to partial exclusivity characteristic of such arrangements can be generated by leveraging the inelastic demand for the seller’s product. Market share discounts can, therefore, satisfy the necessary condition for a finding of foreclosure. The section then sets out a test to determine whether a rival can provide a comparable economic incentive which, in the context of market share discounts, requires asking whether a rival can profitably meet or beat the discount offered under the market share discount arrangement. The analysis in this section illustrates that market share discounts can be structured such that rivals are unable to meet or beat the discount, in which case the market share discount arrangement forecloses competition.
4.1 Nature of the Incentive

The leveraging action involved with market share discounts is analogous to that involved with bundled discounts. Courts have found firms to have leveraged the inelastic demand for a product in bundled discount cases where a seller links a product on which it faces no competition with a product on which it faces competition.\textsuperscript{150} In \textit{SmithKline}, for example, the defendant Eli Lilly marketed five pharmaceuticals known as cephalosporins, four of which were covered by patents.\textsuperscript{151} Two of those pharmaceuticals, Keflin and Keflex, dominated the cephalosporin market while Eli Lilly’s fifth cephalosporin, Kefzol, was not under patent and faced competition from SmithKline’s therapeutically equivalent Ancef. In response to increased competition from SmithKline’s Ancef, Eli Lilly offered hospital customers a 3\% rebate based on purchases of minimum quantities of any three of Eli Lilly’s cephalosporins which, in practice, meant combining purchases of the dominant Keflin and Keflex with the unpatented Kefzol. Eli Lilly’s bundled discount created a situation where, if a buyer wanted to purchase SmithKline’s Ancef instead of Kefzol, it would need to forgo discounts on Keflin and Keflex. Thus, it would not be enough for SmithKline to induce a buyer to switch to Ancef simply by pricing it lower than Kefzol. To meet the aggregate value of Eli Lilly’s bundled discount, SmithKline would need to offer a rebate on Ancef which matched Eli Lilly’s rebate across its three cephalosporins. Because SmithKline was unlikely to be able to match the bundled discount – it would need to offer a rebate on Ancef of between 16\% and 35\% to do so – it was foreclosed from competing. The court found Eli Lilly’s bundled rebate program unlawful because it linked products on which Eli Lilly faced no competition – Keflin and Keflex – with a competitive product, Kefzol. “The result was to sell all three products on a non-competitive basis in what would have otherwise been a competitive market for Ancef and Kefzol”.\textsuperscript{152}

\textsuperscript{150} \textit{SmithKline Corp v Eli Lilly & Co}, 575 F (2d) 1056 (3\textsuperscript{rd} Cir 1978) [SmithKline]; \textit{Ortho Diagnostic Systems Inc v Abbott Laboratories Inc}, 920 F Supp 455 (SD NY 1996) [Ortho]; \textit{LePage’s Inc v 3M}, 324 F (3d) 141 (3\textsuperscript{rd} Cir 2003) [LePage’s]; \textit{Cascade Health Solutions v PeaceHealth}, 515 F (3d) 883 (9\textsuperscript{th} Cir 2008) [Cascade Health].

\textsuperscript{151} \textit{SmithKline}, supra note 150 at 1059-1062.

\textsuperscript{152} \textit{Ibid} at 1065.
Like bundled discounts, market share discounts can link an area in which a seller faces no effective competition with an area in which it faces competition. However, rather than the linking of a non-competitive product with a competitive product, market share discounts link the inelastic portion of demand for the seller’s product with the elastic portion of demand in the same product market. It has become commonplace in commentary on market share discounts to refer to the inelastic portion of demand as the incontestable share, and the elastic portion of demand as the contestable share. Despite some problems with this choice of terminology (discussed later), for the purposes of consistency this paper adopts the terms incontestable and contestable share. A market share discount links the incontestable and contestable shares in a market when two features are present. First, the seller implementing the market share discount must have an incontestable share of the product market. Second, in order to establish the linking (or leveraging) of the incontestable share to the contestable share of the market, the discount must be retroactive – that is, the discount must apply to all units purchased once the market share threshold has been reached – and the market share threshold must be higher than the incontestable share.

When the above two features of the market share discount are present, then it may be concluded that the seller is leveraging its incontestable share by linking that share to the contestable share of the market. This is because the seller induces buyers to meet their market share targets by giving a discount on the incontestable share, rather than just on those incremental sales above the incontestable share. Essentially, the seller is leveraging the incontestable share to decrease the effective price of sales in the contestable share of the market. An example will help to illustrate. Assume a buyer, called BuyCo, has a total requirement for a type of product of 100 units. To meet end user demand, BuyCo must purchase 70% of its requirements from a particular seller, called SellCo, at the list price of $10/unit (for a total of $700). The remaining 30% of BuyCo’s requirements is contestable. SellCo offers BuyCo a discount of $1/unit across all units if BuyCo purchases 80% of its

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requirements from SellCo. Under this offer, the marginal price BuyCo pays for the additional 10 units to meet the market share requirement is $20 (i.e. BuyCo pays $720 for 80 units minus $700 for 70 units = $20). This equates to a marginal price (or the ‘effective price’) of $2/unit for the incremental units to reach the market share requirement. SellCo can be seen as funding the discount on the incremental purchases largely through discounts on the incontestable share (the cumulative value of the discounts on the incontestable share is $70 versus $10 on the incremental units). This example can also be used to illustrate that the larger the incontestable share, the greater the leveraging power. For example, if BuyCo must meet only 10% of its requirements with SellCo’s products and SellCo offers a $1/unit all-units discount if BuyCo purchases 20% of its requirements from SellCo, the marginal price for the incremental units would be $8/unit. This is clearly not as compelling an offer as the $2/unit that was possible where SellCo was leveraging a 70% incontestable share to induce BuyCo to purchase 80% of its requirements from SellCo.

Contrast the example of the retroactive discount above with an incremental discount. Assume again that BuyCo has a total requirement of 100 units and it must purchase 70% of its requirements from SellCo which offers its product at $10/unit. This time, however, SellCo offers a discount of $1/unit on only those units above 70 if BuyCo purchases a minimum of 80% of its requirements from SellCo. The marginal price for the additional 10 units is $90 (10 units x $9/unit). Here, only discounts on the incremental units have been used to induce BuyCo to take more of its requirements from SellCo, whereas in the earlier example discounts on the incontestable share are also used to induce BuyCo to purchase more. The difference between the two types of discount highlights how a seller leverages the incontestable share to reduce the effective price for contestable units under a retroactive discount.

The existence of an incontestable share is critical to the logic of foreclosure under market share discounts.155 If the entire demand of buyers is contestable, a rival could respond to the

155 See EC, “Guidance on Abusive Exclusionary Conduct”, supra note 68 at para 36: “If competitors can compete on equal terms for each individual customer’s entire demand, exclusive purchasing obligations are
market share discount by offering a better deal to steal market share from the seller. This might be achieved, for example, by a rival offering its product at a price which is cheaper than the seller’s price absent the market share discount. If the seller’s market share can realistically be competed away, the seller will have no secure market share from which to leverage.

The courts have had at least two opportunities to assess the contention that the incentive under market share discounts is generated by leveraging an incontestable market share, and on both occasions the contention has been rejected. In *Meritor* the court was confronted with an argument from amicus curiae American Antitrust Institute (AAI) which was essentially based on the logic above – that is, a dominant seller with an incontestable share of a product market leveraged that share to decrease the effective price it offered for sales in the contestable share of the market.¹⁵⁶ Both the majority and dissenting opinions rejected AAI’s argument, declining to adopt the leveraging theory applied in *LePage’s* for bundled discounts to single-product market share discounts.¹⁵⁷ The danger of bundled discounts, according to Greenberg J (dissenting), is that they “may exclude an equally efficient but less diversified rival even if the bundled [discount] resulted in above-cost prices”.¹⁵⁸ However, “[a]bove-cost single-product market-share discounts… do not present the same putative danger of excluding an equally efficient but less diversified rival by virtue of that rival’s limited production alone”.

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¹⁵⁶ *ZF Meritor LLC v Eaton Corp*, 696 F (3d) 254 (3rd Cir 2012) (Brief of Amicus Curiae American Antitrust Institute) at 13-14.

¹⁵⁷ *Meritor, supra* note 1 at 275, footnote 11: “The reasoning of LePage’s is limited to cases in which a single-product producer is excluded through a bundled rebate program offered by a producer of multiple products, which conditions the rebates on purchases across multiple different product lines. Accordingly, we join our sister circuits in holding that the price-cost test applies to market-share or volume rebates offered by suppliers within a single-product market”.

¹⁵⁸ *Ibid* at 320, footnote 18.
In *Eisai* a central part of the plaintiff’s case was that Sanofi had “bundled contestable and incontestable demand” for its pharmaceutical Lovenox. The court explained:

Eisai does not claim that Sanofi bundled separate products in separate markets but rather that Sanofi bundled the demand for Lovenox that could be satisfied by other [DVT] drugs with the demand for Lovenox that could not be satisfied by the other [DVT] drugs. Boiled down, Eisai’s argument is that Lovenox had a Unique Cardiology Indication that the other [DVT] drugs did not have. Even if hospitals wanted to use a rival drug or to conduct a therapeutic interchange to a rival [DVT] drug, hospitals would continue to have some demand for Lovenox because of this unique indication.

Again, the court rejected the plaintiff’s case. Barely grappling with the substance of the plaintiff’s argument, the court simply replied that “[t]he incontestable demand relating to these unique indications is attributable to the inherent properties of the product at issue, and thus competition on the merits. Therefore, Eisai was not excluded and could have competed for business by offering a superior product at a lower price.” The court’s rejection of the leveraging theory led it to find that Sanofi’s market share discounts were merely competition on price, and therefore should be assessed under a standard predatory pricing analysis.

Assuming that courts accept the logic of the leveraging theory as it applies to bundled discounts – which does not seem to seriously be in dispute (see *SmithKline, LePage’s, Cascade Health, Ortho*) – the genesis of courts’ rejection of the theory in relation to market share discounts must lie either in the belief that there is no such incontestable share to be leveraged or that, if there was an incontestable share, there was no leveraging of the share into the contestable share of the market. Neither is necessarily true.

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159 *Eisai*, *supra* note 8 at 26.
160 Lovenox also had a Federal Drug Administration-approved use in treating myocardial infarction: see ibid at 2.
161 Ibid at 27.
162 Ibid.
163 Ibid at 30.
164 *Supra* note 150.
The belief that there is no incontestable share is probably the central barrier to courts accepting the leveraging theory as it applies to market share discounts. It is therefore necessary to dig deeper into the concept to understand its validity. As mentioned above, the term ‘incontestable’ has somewhat unfortunately become an established part of the lexicon of commentary on market share discounts. It is unfortunate because the term is too strong to describe the actual concept we are concerned with, suggesting as it does a market share which is immune to competitive forces – such as might be the result of a patent or statutory monopoly. Despite the common usage of the term, definitions of incontestable share are vague and do not greatly assist in fleshing out the concept. For example, the European Commission defines incontestable share as “the amount that would be purchased by the customer from the dominant undertaking in any event” (in contrast to the contestable share which is defined as “the amount for which the customer may prefer and be able to find substitutes”).

Economides defines the concept similarly as the “part that is always purchased from the dominant firm”. As the earlier discussion of Dentsply and other de facto exclusive dealing cases suggests, the correct way to think about the concept is to understand it in terms of demand elasticity. Incontestable share can be defined as that portion of buyers’ demand for which there are no proper substitutes for the seller’s product, i.e., the portion of buyers’ demand for the seller’s product which is insensitive to changes in the price and quality of rivals’ products. Thus, the incontestable share is that portion of buyers’ demand that is highly inelastic. Or, borrowing from the language used in bundling cases, the incontestable share could be described as that share of the market for which the seller faces no effective competition – a substantively similar concept to that of inelastic demand. These descriptions do leave open the theoretical possibility that a rival might be able to successfully compete for the incontestable share. For example, assuming that the portion of demand is not perfectly inelastic, a rival could offer very deep discounts which

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168 See e.g. SmithKline, supra note 150 at 1065, where the court noted that the defendant’s product was “subject to no serious price competition from other sellers”.

might yet induce a customer to switch. Or, a rival could make large investments in promoting its product which may undermine a firm’s market power attributable to brand reputation.\textsuperscript{169} It is difficult to specify the precise inelasticity at which point it can be confidently asserted that an incontestable share exists which can be leveraged by the seller. An appropriate measure could be the degree of inelasticity where realistic improvements in the price and quality of rivals’ products are insufficient to induce customers to switch.

There may also be some difficulty with estimating the durability of demand inelasticity, for elasticity is measured at a point in time and conditions in the market can change. If, for example, the seller’s market power can be eroded within less than a year of implementing the market share discount, the period during which the seller can leverage its incontestable share will be limited and any potential foreclosure short-lived. The durability of the demand inelasticity will depend to a large extent on the source of the market power over that portion of demand. Market power can be achieved for a variety of reasons, including product differentiation, brand reputation, capacity constraints, or the presence of switching costs.\textsuperscript{170} Some of these sources of market power – which are essentially barriers to entry – may be surmounted by rivals, in which case the inelastic portion of demand will be undermined. However, it is difficult to know ex ante whether and when a rival will overcome such barriers to entry. The exercise is not dissimilar to that carried out by competition authorities and courts in assessing whether a firm possesses durable market power for the purposes of assessing monopolization cases – that assessment, of course, takes into account the presence of barriers to entry and will always be fact-specific.\textsuperscript{171}


\textsuperscript{170} J Padilla & G Slater “Rebates as an Abuse of Dominance under Article 82 EC” in Damien Geradin, ed, \textit{Global Competition Law Centre Research Papers on Article 82 EC} (Belgium: Global Competition Law Centre, 2005) at 101; Brannon, “Conditional Pricing Practices”, \textit{supra} note 169; Faella, “Antitrust Assessment of Loyalty Discounts”, \textit{supra} note 167 at 402.

In any event, basic economic theory using the concepts of market power, barriers to entry and demand elasticity suggests that the concept of an incontestable market share is a viable one. Some courts have intuitively grasped the validity of the concept, most notably in the decisions upholding challenges to all-or-nothing policies. Recall in *Meritor* the court held that “due to Eaton’s position as the dominant supplier, no OEM could satisfy customer demand without at least some Eaton products, and therefore no OEM could afford to lose Eaton as a supplier”\(^{172}\). The court did not specify why Eaton’s products were “necessary” for at least some demand, other than attributing it to Eaton’s dominance in the market.\(^{173}\) However, Eaton was a long-established incumbent in the market and there was evidence of “greater customer preference and brand recognition for the Eaton product”.\(^{174}\) The same was true in *Dentsply* and *McWane* – in those cases no buyer could afford to lose the defendant as a supplier because buyers needed at least some of the defendant’s products to meet customer demand. In fact, all decisions upholding challenges to all-or-nothing policies must implicitly recognize that the defendant has an incontestable market share – otherwise, the threat of refusing supply would not be compelling as a buyer could simply switch all of its purchases to a rival.

The decision in *Masimo* – the only case in which a claim for unlawful exclusive dealing via a market share discount was upheld – may be explicable by the fact that the incontestable share was so definitive and easily identifiable.\(^{175}\) Like *Allied Orthopedic*, *Masimo* concerned the market for oximetry products.\(^{176}\) The defendant Tyco had offered each of its hospital customers a discount on oximetry products if the hospital purchased a minimum specified share of its sensors from Tyco.\(^{177}\) Tyco was the incumbent and had an installed base of monitors that had previously been sold to the hospitals. Those monitors were

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\(^{172}\) *Meritor*, *supra* note 1 at 283.

\(^{173}\) Eaton’s monopoly power was not contested before the Court of Appeals and there was, therefore, no discussion of why Eaton was dominant.

\(^{174}\) *Meritor*, *supra* note 1 at 307.

\(^{175}\) *Masimo Corp v Tyco Health Care Group LP*, 2009 WL 3451725 (9th Cir 2009) [*Masimo*].

\(^{176}\) See footnote 86 above for a description of pulse oximetry and the principal components of a pulse oximetry system.

\(^{177}\) *Masimo Corp v Tyco Health Care Group LP*, 2006 WL 1236666 at 5 (CD Cal 2006).
compatible only with Tyco’s sensors, and so hospitals “were financially locked into purchasing a fixed amount of Tyco sensors to support their installed Tyco monitors”.\textsuperscript{178} According to the court this fixed demand for Tyco sensors, when combined with the market share discounts, “effectively prevented the hospitals from purchasing sensors” outside of its arrangement with Tyco.\textsuperscript{179} This was because the plaintiff Masimo, with its smaller base of sales, “could not price its sensors low enough to compensate hospitals” for the loss of Tyco’s discounts that would result from a hospital failing to meet its market share target.\textsuperscript{180} In a counterfactual where there was no fixed demand for Tyco’s sensors, hospitals could have switched their entire demand to Masimo and avoided the loss of the discount on those sensors that they were, in the factual, financially locked into purchasing because of the installed base of monitors. The incontestable share in this case – i.e., the sensors that hospitals had to purchase from Tyco to support their installed base of Tyco monitors – was therefore critical to the court’s finding that the market share discount compelled hospitals to purchase most of its sensor requirements from Tyco.

Hovenkamp suggests that the fixed demand in \textit{Masimo} makes that case distinguishable from other market share discount cases, arguing that “[t]his fact had given Tyco additional tying-like leverage and served to justify the lower court’s conclusion of illegality”.\textsuperscript{181} What Hovenkamp is suggesting here is that the leveraging of the incontestable share into the contestable share of the market is only really possible where the incontestable share is strongly fixed, as it was in \textit{Masimo}. Hovenkamp’s intuition that the incontestable share must be robustly incontestable makes sense: if buyers may switch their supposedly incontestable purchases to a rival in response to that rival offering a better price/quality combination, then the rival can compete for the entire demand of buyers and there can be no leveraging action. The incontestable share in \textit{Masimo} was a function of the switching costs involved in replacing Tyco’s monitors with a rival’s. However, because an incontestable share is essentially market power over a portion of demand, such a share may arise in ways

\begin{itemize}
\item \textsuperscript{178} \textit{Ibid} at 6.
\item \textsuperscript{179} \textit{Ibid}.
\item \textsuperscript{180} \textit{Ibid} at 5.
\item \textsuperscript{181} Hovenkamp, “Antitrust Law”, supra note 2 at ¶1807b2.
\end{itemize}
other than through the presence of switching costs (which is just one possible barrier to entry). In *LePage’s*, where the court found that 3M had linked the non-competitive branded Scotch tape with the competitive private label tape, the demand for the branded Scotch tape was incontestable because of the strong brand reputation that 3M enjoyed in respect of the product. One could have argued that a rival needed only to build its brand reputation in order to contest sales of Scotch tape. However, a new entrant would need to make substantial marketing investments to develop a comparable reputation and this process may take a long time.\(^{182}\) Accordingly, while an entrant may have eventually undermined 3M’s monopoly over its branded Scotch tape, that market power lasted sufficiently long to be leveraged into the contestable private label tape market in order to foreclose competition.\(^ {183}\)

The decision in *Eisai* represents a rare instance where the court was prepared to accept the existence of an incontestable market share. As explained above, this was because Sanofi’s drug Lovenox had a Unique Cardiology Indication that rivals’ drugs did not have, meaning hospitals needed Lovenox for at least some of their requirements. However, the court failed to see how Sanofi’s market share discount arrangements leveraged its incontestable share, instead focussing on the fact that Sanofi had achieved its incontestable share through “competition on the merits”\(^ {184}\). The problem with the court’s decision is that it confused the attack on the market share discount as an attack on the success of Lovenox. There was no suggestion from Eisai that the incontestable demand for Lovenox was anything other than the result of the success of the product; rather, the substance of the complaint was that Sanofi had leveraged that lawfully obtained incontestable demand to gain sales in the contestable share of the market in order to exclude its rivals. It did this by offering discounts of up to 30% on all purchases of Lovenox if a hospital met at least 90% of its requirements with Lovenox. Because hospitals would have purchased the incontestable share at the non-discounted price in any event, the value of the total discount was concentrated on those

\(^ {182}\) ICN, “Assessment of Dominance”, *supra* note 171 at 77.

\(^ {183}\) It is also difficult to reconcile Hovenkamp’s remarks with the decision in *Meritor*. If buyers needed at least some Eaton products to satisfy consumer demand, could not that demand also be used for “additional tying-like leverage”, such was the case in *Masimo*?

\(^ {184}\) *Eisai*, *supra* note 8 at 27.
incremental purchases above the incontestable share. There was evidence that Eisai could have responded to Sanofi’s market share discounts with a comparable economic incentive, but this was moot given the court had rejected the leveraging theory. \(^ {185}\)

The reasons for rejecting the logic that market share discounts can leverage a seller’s incontestable share to induce purchases in the contestable share of the market are unconvincing. Economic theory supports the notion that a firm may possess an incontestable share of a market, and previous decisions of the courts have implicitly recognized as much. And, contrary to the decision in Eisai, when a seller with an incontestable market share implements an all-units discount conditioned on buyers purchasing a specified minimum share of their requirements from the seller, the incontestable share is being leveraged to induce buyers into a near-exclusive relationship.

4.2 Can a Rival Profitably Meet or Beat the Discount?

While the leveraging of an incontestable share to induce purchases in the contestable share of the market is a necessary condition for foreclosure, the determinative question is whether rivals are able to offer buyers a comparable economic incentive to switch. In relation to market share discounts, a rival will be able to provide a comparable incentive if it can profitably meet or beat the seller’s cumulative discount for those incremental sales above the incontestable share targeted by the market share discount. \(^ {186}\) This can be contrasted with the cases concerning all-or-nothing policies, where rivals would need to offer a package that compensated the buyer for losing supply of a must stock product. Whereas providing a comparable incentive in the context of an all-or-nothing policy seems generally implausible where the seller is dominant in the market – a rival would need to supply a product which is also a must stock item capable of meeting a similar level of demand as the seller’s product – meeting or beating a discount appears more plausible, at least in the abstract.

\(^ {185}\) Ibid at 27-28.

Asking whether a rival can meet or beat the discount is consistent with the approach taken in bundled discount cases. As Greenberg J explained in LePage’s, the key to the plaintiff’s success in SmithKline was showing that it could not plausibly provide a comparable economic incentive to switch:

SmithKline showed that it could not compete by explaining how much it would have had to lower prices for both small and big customers to do so. SmithKline ascertained the rebates that Lilly was giving to customers on all three products and calculated how much it would have had to lower the price of its product if the rebates were all attributed to the one competitive product.\(^{187}\)

While Greenberg’s J emphasis on the need for a plaintiff to show that it could not provide a comparable incentive did not form part of the majority’s decision in LePage’s, the 9th circuit in Cascade Health was more receptive to the approach. In that case, the court adopted a price-cost test – discussed further below – intended to flush out whether a rival could meet or beat the competitor’s bundled discount.\(^{188}\)

Some academics have argued that market share discounts should only be condemned where the price across all units is below-cost after all discounts have been taken into account – in other words, a standard predatory pricing analysis should apply to market share discounts.\(^{189}\) Hovenkamp reasons that an equally efficient rival should be able to meet or beat a seller’s above-cost discount, as the above-cost discount leaves room for rivals to offer deeper discounts. Therefore, no rival who is as-efficient as the seller can be foreclosed.\(^{190}\) However, this reasoning misses the significance of the incontestable share. An equally efficient rival may be able to offer a deeper discount per unit of the product, but may still be unable to beat the cumulative discount because of its smaller base of sales. If the rival could

\(^{187}\) LePage’s, supra note 150 at 175.

\(^{188}\) Cascade Health, supra note 150 at 906.


\(^{190}\) Hovenkamp, “Antitrust Law”, supra note 2 at ¶1807.
contest the seller’s market share and grow its sales base, it might be able to match the seller’s discount, but this assumes that the seller does not have an incontestable share of the market. However, as this paper has shown, it is only those cases where a seller has an incontestable share where concerns arise.  

To determine whether a rival can provide a comparable incentive, a test in which the total discount under the arrangement is attributed to those incremental sales above the incontestable share which the seller is targeting with its market share discount seems unavoidable. In fact, the emphasis in the case law on assessing whether a rival can provide a comparable incentive – in cases of market share discounts, to profitably meet or beat the seller’s cumulative discount – suggests that such a test is imperative. Attributing the discount to the incremental sales in the contestable share of the market makes sense because the discount is being used to induce those sales, rather than sales in the incontestable share of the market which are already assured for the seller. The discount attribution test applied in Cascade Health for bundled discounts could be usefully adapted to cases involving market share discounts:

191 Nor should the length of time over which the market share target is to be met necessarily matter in the determination of whether the discount has a foreclosure effect (c/f ibid). If a customer perceives that it will obtain a higher cumulative discount from meeting a target share requirement, it will renew its commitment to meeting the target share in subsequent periods. This will be the case where the customer knows that it must buy a substantial amount of its requirements in the forthcoming period from the seller on which it can obtain a discount only if it meets the market share requirement.

192 This type of test is employed by the European Commission to test for foreclosure for market share discounts: see EC, “Guidance on Abusive Exclusionary Conduct”, supra note 68 at para 39-45. Others have also advocated for the use of this type of test or something similar: see Faella, “Antitrust Assessment of Loyalty Discounts”, supra note 167; Tom, Balto & Averitt, “Anticompetitive Aspects of Market-Share Discounts”, supra note 4 at 638. Finally, the DOJ applied such a test in its complaint against United Regional Health Care System: see United States v United Regional Health Care System, 7:11–cv–00030 (ND Tex 2011) (Competitive Impact Statement).

193 See SmithKline, supra note 150 at 1062: “To meet the bonus discounts offered by Lilly, a competitor was forced to more than meet the competition on the one product, cefazolin; it had to match the bonus rebate awarded to the hospital purchaser based on total purchases of three cephalosporins, including the leading sellers, Keflin and Keflex. In SmithKline’s case, this meant it had to compete “three-on-one”; LePage’s, supra note 150 at 161: “The jury was capable of calculating from the evidence the amount of rebate a customer of 3M would lose if it failed to meet 3M’s quota of sales in even one of the bundled products. The discount that LePage’s would have had to provide to match the discounts offered by 3M through its bundled rebates can be measured by the discounts 3M gave or offered”; Cascade Health, supra note 150 at 907; Dentsply, supra note 6 at 195.
Under this standard, the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products. 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… This standard makes the defendant’s bundled discounts legal unless the discounts have the potential to exclude a hypothetical equally efficient producer of the competitive product.194

Under the *Cascade Health* test, if the price (with the total discount attributed) for the incremental sales targeted by the market share discount is less than the seller’s cost to produce the product, then an equally efficient rival is foreclosed from competing for those incremental sales. Using the example given earlier, assume BuyCo’s total requirements are 100 units, BuyCo must purchase 70% of its requirements from SellCo at a price of $10/unit, and the remaining 30% of BuyCo’s requirements are contestable. SellCo offers BuyCo a discount of $1/unit across all units if BuyCo purchases 80% of its requirements from SellCo. The total discount under this offer would be $80 ($1/unit discount across 80 units) which would be attributed to the contestable share – in this example, the incremental 10% that SellCo is targeting. The effective price for the incremental units is $20 or $2/unit. If SellCo’s cost to produce the incremental units is $5/unit, the market share discount results in a below-cost effective price. In this circumstance, an equally efficient rival would be unable to profitably provide a comparable economic incentive to switch because that would require the rival to price below its cost. The rival would therefore be foreclosed from competing for the contestable share targeted by the market share discount.

Some criticisms have been levelled against adopting the test in *Cascade Health* for market share discounts. The main flaw, according to critics, is that the test would allow for the exclusion of a less than equally efficient rival.195 This is argued to be problematic because the principal anticompetitive effect of exclusionary market share discounts is to deny scale to rivals, thereby preventing them from becoming as efficient as the competitor implementing the discounting scheme. Critics also argue that less efficient rivals can still

194 *Cascade Health*, supra note 150 at 906.
exert a competitive constraint on dominant firms. The discount attribution test is unlikely to be a flawless approach to distinguishing whether market share discounts foreclose competition or not, and technical criticisms of its application to market share discounts exist from both sides – that is, some argue that it may tend to produce false positives while others contend that it may tend to generate false negatives. However, antitrust standards need to be administrable and also to provide at least some certainty to businesses engaged in practices which tread the line between anticompetitive and competitively benign. A test which asks whether an equally efficient rival would be foreclosed gives guidance to businesses, as it is their costs that provide the benchmark and they will have knowledge of those costs. Conversely, a test which asked whether a particular rival would be foreclosed would require a business to have knowledge of its rival’s costs – not to mention risking protection of a rival which is not as efficient as the firm and may never achieve such efficiency. For these reasons, the discount attribution test is preferable to other tests which

196 Economides, “Loyalty/Requirement Rebates”, supra note 67 at 140.
197 See Economides, “Loyalty Rebates and the AMC”, supra note 166 at 267-275; Murphy, Snyder & Topel, “Competitive Discounts”, supra note 56 at 32-33: For example, the authors argue that in a world without the market share discount the seller’s list price is likely to be lower than in a world with the market share discount. In such cases, the discount attribution test will be biased against the seller because it would attribute a greater discount to the contestable share than should be the case.
198 Barry Wright Corp v ITT Grinnell Corp, 724 F (2d) 227 at 234 (1st Cir 1983) [Barry Wright]: “… 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. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counterproductive, undercutting the very economic ends they seek to serve”. These are also the considerations that led the Antitrust Modernization Commission to approve an equally efficient competitor test for bundled discounts – see Antitrust Modernization Commission, Report and Recommendations (April 2007) at 100, online: Antitrust Modernization Commission <www.govinfo.library.unt.edu/amc>.
199 Cascade Health, supra note 150 at 905-907: “The discount attribution standard provides clear guidance for sellers that engage in bundled discounting practices. A seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the rule we have outlined… Requiring the defendant’s pricing policies to protect the trade of higher cost rivals is overly solicitous of small firms and denies customers the benefits of the defendant’s lower costs”. Furthermore, in a recent workshop held by the FTC and DOJ on conditional pricing practices, one legal advisor described price-cost tests (such as the discount attribution test) as “extremely useful” in the context of counselling clients seeking to implement market share discount programs. She explained: “The companies can figure out what their costs are. And for counseling purposes, they can figure out if they’re anywhere close to their costs. A risk averse company might want to avoid anything that’s even questionably below cost. So I think even if the economists can debate about precisely how you measure cost, for practical purposes for companies, I think it’s quite useful to have that type of a test for counseling purposes”: see FTC-DOJ Condition Pricing Practices Workshop, “Transcript: Segment 7” (23 June 2014) online: FTC <www.ftc.gov> [FTC-DOJ, “Conditional Pricing Practices Workshop Transcript”].
may overly complicate enforcement by seeking to take into account “every economic complexity and qualification”.200

5 From Theory to Enforcement: Policy Considerations for the Test of Foreclosure for Market Share Discounts

Applying the inquiry into foreclosure established in Dentsply to market share discounts yields a plausible theory of foreclosure, which can ultimately be tested for by employing a discount attribution test similar to that used in Cascade Health. The discount attribution test ensures that only market share discounts which are found to foreclose an equally efficient rival may be condemned as anticompetitive. A finding of foreclosure does not, however, lead inexorably to a finding of antitrust liability. After establishing foreclosure, a court will need to assess whether that foreclosure is sufficiently substantial to produce anticompetitive effects in the market, and must also balance those effects against any procompetitive effects.201 Nonetheless, the discount attribution test is likely to be the central part of the assessment of antitrust liability for market share discounts: if the test shows that there has been no foreclosure, the plaintiff’s case fails; if the test finds competition has been foreclosed, liability potentially follows. For this reason, the design of the test needs to be sensitive to potential error costs arising from its use.

According to Evans & Padilla, the design of any antitrust rule should seek to “minimize the expected cost of errors resulting from condoning harmful practices or condemning beneficial ones, while maintaining a degree of predictability for businesses and administrative ease for the courts”.202 There are sound economic reasons for believing that that the error costs arising from false positives – that is, condemnation of competitive practices – are likely to

200 Barry Wright, supra note 198 at 234.
201 Dentsply, supra note 6 at 187. As discussed earlier, foreclosure is likely to produce anticompetitive effects if it RRC and enables the firm implementing the exclusive dealing arrangements to gain power over price.
be higher than the costs arising from false negatives (condoning anticompetitive practices).\textsuperscript{203} This is because the monopoly prices that flow from mistakenly condoned anticompetitive practices attract new entry which, in the long run, should erode the monopolist’s position.\textsuperscript{204} Conversely, Easterbrook notes that there is no such equivalent mechanism to expunge incorrect decisions condemning competitive practices.\textsuperscript{205} Concerns about false positives are particularly relevant to the antitrust approach to market share discounts. As Hovenkamp observes in relation to discounting practices, “[t]he social costs of an overly aggressive rule is not simply the damages paid by one unlucky defendant, but also the billions of dollars that consumers will subsequently lose when firms are warned away from aggressive but competitive price cutting”.\textsuperscript{206} However, it should be recalled that the relevant rule here – the discount attribution test – does not ultimately determine liability (although liability may flow from a finding of foreclosure). Thus the costs of a false positive here – that is, a mistaken finding that there has been foreclosure – are not as certain and can therefore be expected to be lower than false positives arising from a rule which does determine liability.

Even assuming that the costs of a false positive are not as high as they would be for rules which determine antitrust liability, there are sound reasons to avoid an overly aggressive rule for assessing foreclosure. Applying a Bayesian probability framework to the discount attribution test shows that the likelihood of a false positive is likely to be significant. The basic intuition of a Bayesian framework is that the probability of an event – such as a finding of foreclosure – is a function of prior beliefs about the practice in question and the likelihood that the test producing the finding is correct.\textsuperscript{207} In relation to market share discounts, the key is to understand that the probability that a finding of foreclosure is correct is not solely determined by the accuracy of the test for foreclosure, but also by prior beliefs about the general incidence of market share discounts that foreclose competition. Economic

\textsuperscript{203} Evans & Padilla, “Designing Antitrust Rules”, supra note 202 at 83-84.
\textsuperscript{204} Ibid at 84.
\textsuperscript{205} Easterbrook, “The Limits of Antitrust”, supra note 202 at 15.
\textsuperscript{206} Herbert Hovenkamp, “Discounts and Exclusion” (2006) 2 Utah L Rev 841 at 861.
theory provides sound reasons to believe that market share discounts are generally used for procompetitive reasons and observation suggests that market share discounts are a “ubiquitous practice across a wide range of highly competitive markets”. While this evidence does not speak directly to the general incidence of market share discounts that foreclose competition, the fact that most market share discounts are likely to be procompetitive does suggest that they are unlikely to foreclose competition. Therefore, a reasonable prior belief about market share discounts is that the general incidence of such discounts that foreclose competition is low.

In relation to the accuracy of the discount attribution test, two factors suggest that the results of the test are subject to some uncertainty. First, the central difficulty with implementing the discount attribution test is likely to be in estimating the incontestable share of the seller. A reasonably accurate estimation of the incontestable share is pivotal to the accuracy of the test. If the incontestable share is overestimated, for example, the contestable share to which the discount is attributed will be smaller than should be the case and the likelihood of the price being below-cost will be unjustifiably greater. However, compared to the exercise for bundled discounts – where the area of incontestability is a separate product – identifying the incontestable share in a single-product market will likely be more

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210 It is possible that procompetitive market share discounts do foreclose competition but in such a small share of the market that the practice is not considered to be anticompetitive.

211 Lande queries whether the general proposition that most discounting arrangements are procompetitive holds true in circumstances where the discount is given by a dominant firm: see Robert H Lande, “Should Predatory Pricing Rules Immunize Exclusionary Discounts?” (2006) 3 Utah L Rev 863 at 865. If fresh empirical evidence came to light concerning the use of market share discounts by dominant firms, the prior belief employed here may need to be revised.


complex. In particular, it may be difficult to discern the boundary at which demand becomes sufficiently elastic such that it is no longer considered incontestable. This will be the case particularly where the market share discount is offered to a large number of end user customers, in which case the data needed to understand customers’ demand elasticity will be extensive. However, competitive concerns with market share discounts have generally arisen only in relation to intermediate customers such as distributors. And, as Faella observes, intermediate buyers:

…should be able to say, with an acceptable degree of approximation, whether, and how large, a portion of their requirements must be satisfied by a particular product or producer, for instance because of final consumers’ preferences, the specific characteristics of certain products, significant switching costs, or capacity constraints faced by other suppliers.

Accordingly, while there will be difficulty in estimating the incontestable share and some degree of error may be expected, the difficulty should not be overstated. The second factor creating uncertainty is the definition of the relevant cost benchmark to estimate the defendant’s costs. Defining the relevant cost benchmark is “one of the most controversial issues in the application of any price-cost test”, and “[s]cholars have taken a variety of positions about the proper cost measure”. Some cost benchmarks are likely to be overly favourable to defendants in some circumstances, while in other circumstances those same benchmarks may be appropriate. The selection of an inappropriate cost benchmark in any

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216 This is likely because it would be difficult to foreclose a substantial part of the market consisting of smaller end user customers. The market share discount cases discussed in this paper mostly involve alleged foreclosure of intermediate customers. Where the alleged foreclosure relates to end customers, typically the cases involve hospital customers which are large and constitute a substantial part of demand in the market: see ibid at 402-403.
217 Ibid at 403.
218 Ibid.
219 Ibid.
221 Ibid at 703-7.
The uncertainty in the results of the discount attribution test, combined with the prior belief that the general incidence of market share discounts that foreclose competition is low, point towards a discount attribution test which is conservative in nature. However, it must be remembered that there is already a degree of conservatism built into the test in that it would permit the exclusion of a less than equally efficient competitor – one who might nonetheless provide some competitive constraint. It is also important to note that it is the plaintiff which carries the burden of proving foreclosure.\textsuperscript{222} A test which is too conservatively skewed may largely eliminate false positives but substantially increase the costs arising from false negatives. With this balancing task in mind, this paper suggests the following features of the discount attribution test. First, where there is a range of plausible estimates for the incontestable share, the lower bound of that range should be used. Second, a conservative cost benchmark should be adopted. Consistent with predatory pricing decisions in several of the Court of Appeals circuits, the appropriate benchmark should be average variable cost as a surrogate for marginal cost (unless the cost structure of the market requires a different benchmark e.g. markets with high fixed and low variable costs).\textsuperscript{223} And third, only where price is significantly below cost should foreclosure be concluded – that is, if price is only just below cost, a court should refrain from finding that the market share discount has foreclosed competition. A discount attribution test which includes these features strikes the right balance between legitimate concerns about the costs of false positives and a test which is tilted too far in favour of defendants. The conservative nature of the test means that false negatives may be more likely than a test which is more neutral, but this is appropriate given the generally lower costs of false negatives. In this relatively early stage of understanding the competitive effects of market share discounts it also makes sense for courts to adopt a cautious approach.

\textsuperscript{222} If the plaintiff is unable to present sufficient evidence to support an estimation of the incontestable share of the defendant, for example, a conclusion of foreclosure would be unlikely.

\textsuperscript{223} \textit{Cascade Health, supra} note 150 at 909.
The discount attribution test should be part of a broader legal framework for assessing foreclosure under market share discounts. The legal framework should follow the inquiry established in *Dentsply* – that is, discern the nature of the incentive provided by the market share discount and then ask whether a rival can provide a comparable incentive to induce a buyer to switch. It is in that latter step of the inquiry that the discount attribution test can be applied. In relation to the requirement of discerning the nature of the incentive, a plaintiff will need to first establish that the defendant has substantial market power.\(^224\) The next step will be to identify the defendant’s incontestable share of the market. The defendant’s market share should not be treated as a proxy for the incontestable share, as the demand at the margins of its market share could be sufficiently elastic to be considered contestable. It may be helpful here to give at least a rough indicator of the size of the incontestable share necessary to sustain a market share discount that is capable of foreclosure. It is generally only when rivals’ share of the market is small that they will be unlikely to be able to meet or beat the seller’s discount, as the cumulative discount on a small market share is unlikely to reach the size of the cumulative discount offered by the seller. It seems unlikely that a seller could successfully leverage a 30% incontestable share to foreclose competition, as rivals could utilize the remaining 70% share of the market to meet or beat the seller’s market share discount. A conservative suggestion of the minimum incontestable share to sustain a market share discount which forecloses competition is 30%. If it has been established that the defendant has a sufficiently substantial incontestable share, the next step will be to determine whether the market share discount is structured as a retroactive or incremental discount, and whether the market share target is higher than the incontestable share. This is necessary to establish whether the incontestable share is being leveraged to induce sales in the contestable share of the market.

After determining the nature of the incentive, the court will then need to assess whether a rival can provide a comparable incentive. The court should first look for evidence of buyers switching purchases from the defendant to its rivals. If there is evidence of significant levels of switching, then it might be concluded that the market share discount does not foreclose

\(^{224}\) Faella, “Antitrust Assessment of Loyalty Discounts”, *supra* note 167 at 379.
competition as rivals have been able to successfully lure buyers away from the defendant. This evidence was central to the decision in *Concord Boat*, for example, where two buyers had testified that they had switched substantial amounts of their purchases to a rival when the rival offered better prices.\(^{225}\) The discount attribution test may also be pre-empted if there is evidence that rivals have room to cut prices but have not done so to meet the competition.\(^{226}\) This type of evidence was key to the decision in *Eisai*, where there was evidence that the plaintiff enjoyed an 85% profit margin on its product but did not cut its prices further to meet the defendant’s market share discount.\(^{227}\) If such evidence on switching or on the ability of rivals to further cut prices is unavailable or inconclusive, the discount attribution test will need to be applied.

The specification of safe harbours will be important for market share discounts. A safe harbour can be defined in the current context as criteria which, if met, preclude a finding of foreclosure. Specifying safe harbours is important because market share discounts will generally be procompetitive and it is important to avoid chilling such arrangements which typically benefit consumers.\(^{228}\) It is also important for businesses and their advisers to have clear guidance on which to structure their business activities and advice. This paper suggests two safe harbours – one for firms without substantial market power and another for firms with an incontestable share of 30% or less.\(^{229}\) These two safe harbours cover situations where it is highly unlikely that the firm would possess the capability to implement a market share discount that is capable of foreclosure. The suggestion of a safe harbour for firms with an incontestable share of 30% or less is, however, tentative given the absence of case law or economic theory addressing this specific issue.

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\(^{225}\) *Concord Boat*, supra note 8 at 1059.


\(^{227}\) *Eisai*, supra note 8 at 27-28.

\(^{228}\) Gregory J Werden, “Identifying Exclusionary Conduct Under Section 2: The ‘No Economic Sense’ Test” (2006) 73 Antitrust LJ 413 at 418, footnote 21: “Prudential safe harbors are an important adjunct to any test for exclusionary conduct, as the per se rule is a critically important tool in the evaluation of the reasonableness of restraints of trade under Section 1 of the Sherman Act”.

\(^{229}\) There is some obvious overlap between these two safe harbors, but there is some utility in their separate specification. For example, it might be concluded that a firm has substantial market power on the basis of a high market share (as well as other factors) but the demand for some of that market share may not be sufficiently inelastic to be considered incontestable.
Conclusion

Many plaintiffs have challenged market share discounts as an unlawful de facto exclusive dealing arrangement but almost all have failed at the first hurdle of persuading the court that the discount arrangement forecloses competition. What the courts have seen in these cases is essentially an arrangement where buyers get a lower price for purchasing a minimum share of their requirements from the seller, but which they are free to walk away from if a rival offers a better deal. Based on this perception, it is not difficult to see why the courts generally reject the allegation that market share discounts foreclose competition, instead viewing such a practice as simply robust competition. This paper urges the courts to apply the lessons of Dentsply and other de facto exclusive dealing cases by seeking to properly understand whether rivals can plausibly offer the better deal that lures buyers away from the discount arrangement, and to take into account the economic realities of the market (especially the market position of the seller implementing the market share discount) when conducting this inquiry. Doing so may reveal that, for some of the market share discounts the courts are called upon to assess, rivals cannot realistically offer a better deal to buyers to switch and that competition for sales to those buyers will therefore be foreclosed.

Market share discounts are, without doubt, one of the hard problems of antitrust. They have the look and feel of legitimate competition on the merits, and in most cases this is what they are. However, this paper has shown that market share discounts can also be used as a subtle yet effective method to foreclose competition, and that a test is available which can effectively distinguish between those market share discounts that foreclose competition and those that do not. It took some time before the scepticism of the capability of other de facto exclusive dealing arrangements to foreclose competition eroded in the face of compelling evidence that they could. Perhaps it is also only a matter of time before courts begin to see that market share discounts are also capable of foreclosing competition.
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