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Buying Friends to Break Rivals: A Legal and Economic Case Against Anticompetitive Loyalty Rebates

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Loyalty rebates incentivize customers to buy from a particular seller by offering a lump sum payment when the customer's purchase share is above a given share threshold.¹ The share threshold is a critical feature of a loyalty rebate. It is calculated by adding together a customer's purchases from the entrant (or, more generally, any rivals) and the dominant firm, and asking what share of that expenditure goes to the dominant firm. A share-based rebate penalizes customers who buy a large enough *percentage* of their needs from the entrant or rival. What this type of pricing structure does is move away from our normal conception of price (a certain amount per unit purchased) to instead create a "cliff" in the total amount paid by the buyer to the dominant firm. This large payment can only be obtained by customers when they reach a pre-specified threshold level of share. It is important to note that loyalty rebates need not lower prices. The dominant firm not only controls the threshold and the size of the rebate, but also the list price. It is straightforward to make any rebate cost-neutral to the seller by adjusting the list price upwards so that it compensates for the rebate. An anticompetitive loyalty rebate is designed so that any customer who falls short of the threshold by buying from the entrant pays *more* for every unit it purchases from the dominant firm than the customer would if it remained loyal and reduced purchases from the entrant.

Loyalty rebates need not always be anti-competitive. Where head-to-head competition is the mode of competition, loyalty rebates may help firms compete or enter the market and ultimately lower prices to consumers. However, there is cause for concern where dominant firms use loyalty rebates to leverage market power in order to push rivals out of the market. We explain why the competitive impact of a prototypical loyalty rebate makes that contract illegal under the antitrust laws. Courts have come to this conclusion also. But there are varieties of loyalty rebate contracts and not all are anticompetitive. We therefore argue that the contract is best evaluated under the rule of reason, because in some settings and under some parameters, there may be no anticompetitive harm.

This paper proposes a legal framework for the rule of reason analysis. In particular, we argue that loyalty rebates are best understood within the significant jurisprudence on exclusive dealing. We identify certain characteristics of loyalty rebates as red flags signaling a real competitive threat warranting further investigation. By applying frameworks from the exclusive dealing jurisprudence and the rule of reason, harmful contracts can be identified and regulated accordingly.

I. Loyalty Rebates: A Brief Primer

As with exclusive dealing, in some contexts, loyalty rebates can stifle competition. Anticompetitive loyalty rebates are prevalent within U.S. markets, especially healthcare markets.²

¹ Fiona M. Scott Morton & Zachary Abrahamson, *A Unifying Analytical Framework for Loyalty Rebates*, 81 Antitrust L.J. 777, 778 (2017); 1 STEVE CERNAK & D. DANIEL SOKOL, ANTITRUST IN DISTRIBUTION AND FRANCHISING § 6.03 (2023) (hereinafter "ANTITRUST DISTRIBUTION").

² See *Eisai Inc. v. Sanofi Aventis U.S., LLC*, 821 F.3d 894 (3d Cir. 2016); *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 271-72 (3d Cir. 2012), discussed *infra*. Other recent cases include the FTC's action against two pesticide manufacturers, Sygenta and Corteva (complaint available at

The terminology “rebate” or “discount” can be misleading for policy-makers. While the name suggests lower prices—and thus higher consumer welfare—the contract can be designed to have any effect on the prices of the dominant firm, including higher ones. Even if the impact on final net price is neutral as to the dominant firm’s prices, the contract raises rivals’ costs and thus excludes the rival, thereby lessening competition for the dominant firm in the longer run. The dominant seller can then wield market power to increase prices in both the short and long run, ultimately harming consumers, through a loyalty rebate.

To understand how such monopolization via rebates might work, consider a hypothetical case in the market for medical syringes where Firm A is dominant. In particular, this manufacturer has held almost all of the market for many years. Hospitals across the region depend on Firm A to supply a variety of syringes to meet the demands of their customers. Developing each variety requires R&D, while producing it requires capacity and trained workers. Firm A therefore owns intellectual property and manufacturing equipment for all its products. Now, suppose Firm B wants to challenge Firm A’s dominance with an innovative syringe, offering higher quality or perhaps lower prices with this one special technology. Firm B does not make most types of syringes. Hospitals want to buy the innovative new syringe from Firm B, but they cannot abandon Firm A entirely because Firm B is too small to meet all their needs. This setup lets us define a key concept needed in loyalty rebates: the difference between contestable products (the syringes made by both A and B) and non-contestable products (the remaining syringes made by A).

If Firm B is able to supply 15% of syringe demand, then 15% of the market is “contestable” because hospitals have a choice of supplier, while the other 85% is “non-contestable” because it is supplied by a monopolist. In a competitive market, and assuming Firm B entered because its new syringe was an innovative idea and a superior option, we might expect hospitals to purchase 85% of their syringes from Firm A and 15% from Firm B. It is important to acknowledge the market reality that Firm B cannot enter with all the types of syringes at once. It is usual for entrepreneurs and entrants to enter with a leading type of product and grow in terms of reputation, capacity, distribution, etc. over time. Critically, there is non-contestable share because Firm B does not make every product (in a perfectly competitive market contestable share would be 100%).

With its new product, the entrant has proven it can execute on its business model and make sales. It now wants to expand sales of its syringe and launch a second type that is a bit different, but also innovative. If this occurs, Firm A will lose sales to Firm B’s new products. To protect its bottom line, Firm A decides to implement a loyalty rebate scheme.

The scheme is set up as follows. If a hospital buys at least 90% of its syringe supply from Firm A, it will receive a 10% discount on all units purchased. However, Firm A does not want the discount to eat away at its profit, and so it will raise the list price so that the discount only brings the price down to its pre-rebate level. Let’s say Firm A raises its price from \$45 to \$50 per syringe,

https://www.ftc.gov/system/files/ftc_gov/pdf/SygentaComplaint.pdf) and litigation between Pfizer and Johnson & Johnson about loyalty discounts for the immunosuppressant Remicade, which settled in March 2023. See Kate Arcieri, *Johnson & Johnson’s \$25 Million Remicade Antitrust Deal Approved*, BLOOMBERG L. (Mar. 16, 2023), <https://news.bloomberglaw.com/antitrust/johnson-johnsons-25-million-remicade-antitrust-deal-approved>.

while Firm B continues to charge \$45 per syringe. A hospital that needs 100 syringes has to buy at least 85 from Firm A, paying \$4250, but can then choose to buy 15 from Firm B, paying \$675 for a total of \$4,925. But if that hospital buys another five syringes from Firm A to reach the 90% threshold, it will receive the rebate. This will lower its total payment to Firm A to only \$4,050 for 90 syringes and Firm B \$450 for the remaining ten. The new total for the hospital will be \$4,500 which is lower than the total cost of its preferred product mix. The rational firm will thus buy more syringes from Firm A to save \$425. Note, however, that without the loyalty rebate, the hospital would still be paying \$4,500 for 100 syringes at the old price of \$45. So the hospital is not better off in terms of its costs.

How is the consumer harmed if the price remains the same? In the short run, the hospital suffers from a lack of choice. Before the rebate, the hospital could purchase 85 syringes from Firm A and then 15 different syringes from Firm B if they preferred Firm B's product. The loyalty rebate scheme raises the price of that choice such that many hospitals can no longer afford to buy more than 10% of their need from Firm B. Moreover, in the long run, consumers suffer as the dominant firm's rivals are pushed to the fringes of the market, allowing the dominant firm to exercise market power and raise prices, lower quality, and dampen innovation. Of course, the entrant can lower its own prices to compete with the dominant firm by effectively swallowing the rebate—but only if the new firm can afford it. In the syringe example, Firm B could make the customers indifferent to the rebate by lowering its price to around \$16.67 per syringe so that the cost of buying 15 syringes from Firm B is \$250 and the total cost of buying 100 is \$4,500. But a 60% price cut may prove too big for Firm B to absorb and keep its business afloat. If Firm B fails to invest to keep up with technology or fails to invest, or even exits, this allows Firm A to expand its market share through loyalty rebates.³

The initial inequality in market power can be leveraged in the not-infrequent case where a new firm enters with a single product, but the dominant firm has an entire line of products that customers often buy together. For example, the dominant syringe supplier may have market power in many kinds of syringes, and perhaps vials also. If so, the dominant firm can bundle rebates on them to leverage its market power in all types of syringes and also in vials to dissuade customers from buying the new firm's latest syringe product. Thus, the entrant cannot grow to offer variants of other products in the line, as the buyer has already committed financially to purchase everything else from the monopolist. As a result, end consumers are deprived of the quality and innovation that a successful new entrant may have been able to offer for other products across the line and the lower prices that would emerge from fierce competition.

II. Exclusive Dealing: A Useful Framework for Understanding Loyalty Rebates

The potential harm from loyalty rebates can be appreciated by analogy to a long-familiar practice: exclusive dealing. Exclusive dealing contracts between manufacturers and retailers require retailers to refrain from selling products created by the manufacturer's rivals or the

³ See Scott Morton & Abrahamson, *supra* note 1, at 780; Michael A. Salinger, *All-Units Discounts by a Dominant Producer Threatened by Partial Entry*, 81 ANTITRUST L.J. 507 (2017).

manufacturer to refrain from selling its products to the retailer's rivals.⁴ In either case, exclusive dealing contracts are not *per se* illegal.⁵ When customers can easily buy their bundle of needs from many different suppliers, those suppliers compete head to head and consumers have the freedom to leave for a rival that offers a better combination of low prices and high quality. An exclusive dealing arrangement in this setting can be efficient and benefit consumers.⁶

For example, exclusive dealing can be pro-competitive where it incentivizes manufacturers to advertise its products.⁷ Suppose a manufacturer's advertising successfully brings a customer into a retailer's brick and mortar store. Absent an exclusive dealing contract, the retailer may convince the customer to purchase another product that offers the retailer a higher margin, undercutting the manufacturer's investment. This possibility weakens the manufacturer's incentive to advertise or, similarly, provide training or other user support.⁸ In such cases, exclusive dealing contracts would be pro-competitive and pro-consumer.

In some cases, however, exclusive dealing may have an anticompetitive effect. If the manufacturer has market power, it can use exclusive dealing contracts to raise barriers to entry by, for example, cutting off access to a significant distribution channel such as an important retailer. If the entrant cannot make enough sales through alternative retailers, it cannot compete with the incumbent.⁹ Likewise, if the retailer has market power, it can use exclusive dealing contracts to lock up low-cost suppliers, forcing rivals to pay higher costs and then charge customers higher prices.¹⁰

Exclusive dealing, like loyalty rebates, can have a different impact in different settings, and courts must consider the full market context to understand how the practice is operating for the benefit or the detriment of consumers.

III. *Sanofi-Aventis v. Mylan*: Case Study in Anti-Competitive Loyalty Rebates

To illustrate how loyalty rebates can be understood as anticompetitive exclusive dealing, consider *Sanofi-Aventis U.S., LLC v. Mylan, Inc.*, where the Tenth Circuit had to consider how loyalty rebates and exclusive dealings could work to the consumer's disadvantage in the epinephrine auto-injector market.¹¹ Plaintiff Sanofi had brought a monopolization claim against Mylan under Section 2 of the Sherman Act. To win, Sanofi had to show that Mylan (1) had monopoly power and (2) willfully acquired or maintained that power through exclusionary

⁴ *Exclusive Dealing or Requirements Contracts*, FED. TRADE COMMISSION (last visited May 24, 2023), <https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/dealings-supply-chain/exclusive-dealing-or-requirements-contracts>.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ Howard P. Marvel, *Exclusive Dealing*, 25 J. L. & ECON. 1 (1982).

⁹ See Complaint, *FTC v. Star Pipe Products, Ltd.*, Case No. 1:16-cv-00755 (D.D.C. Apr. 25, 2016), <https://www.ftc.gov/system/files/documents/cases/1604starpipemcpt.pdf>.

¹⁰ See *FTC v. Mylan Laboratories, Inc.*, 62 F. Supp. 2d 25 (D.D.C. 1999).

¹¹ 44 F.4th 959 (10th Cir. 2022).

conduct. As to the first, Mylan, the maker of EpiPen, filled 90% of U.S. epinephrine auto-injector prescriptions when Sanofi entered the market in 2013 with its innovative product Auvi-Q. That market share was entrenched by the realities of the pharmaceutical market, where patients become accustomed to certain drugs, are familiar with the delivery mechanism, see a physician who is accustomed to prescribing them, and perhaps attend a school that also stocks the product in case of emergencies. Such patients expect an insurance plan to cover the incumbent drug because they cannot access medications without a prescription and pay substantial out-of-pocket costs for drugs not covered by their health plan. Health plans, in turn, rely on pharmacy benefits managers (PBMs) to negotiate prices with drug manufacturers and compile a “formulary,” which determines the price members pay for various medications.

One of the roles of a PBM is to stimulate price competition between brands. For this reason, a PBM has an interest in the entry of Auvi-Q; it could create price competition that would bring down the price of EpiPen and rival autoinjectors. A PBM might offer a position on the best tier of its formulary in exchange for a lower price from one of these providers of substitute products. But such a PBM might be reluctant to completely exclude EpiPen because many patients prefer the drug they know best, and its exclusion would make the PBM’s plan of lower quality in the eyes of those customers. If the PBM is reluctant to abandon a drug as ubiquitous as EpiPen, while at the same time creating some price competition, it could include both EpiPen and a rival product on the formulary. Once the PBM is thinking along these lines, it has created fertile ground for the operation of a loyalty rebate. The incumbent creates a loyalty rebate that makes it very expensive for the PBM to second-source from a rival. Thus the consumer behavior above creates what is effectively the “non-contestable share, and the incumbent then devises a contract to leverage the non-contestable into the contestable share.

Mylan exploited its dominance to exclude Sanofi in this way by offering loyalty rebates tied to share as well as most-favored-nation provisions. Several PBMs accepted Mylan’s offer, making EpiPen the exclusive or preferred epinephrine auto-injector on their formularies. Sanofi claimed these deals made it difficult for the entrant to get a foothold in the market. As in exclusive dealing, the argument is that a substantial share of the market is foreclosed. Applying the logic of loyalty rebates described above, it is not hard to see why this might work. PBMs were likely loathe to walk away from EpiPen entirely given the product’s high market penetration and entrenched share. As a result, PBMs were bound to buy a significant portion of their needs from Mylan with or without Sanofi’s entry. Let’s assume, as Sanofi argued, this non-contestable share hovered around 60% of the market. Mylan could then push Sanofi out of the contestable share of the market by offering a substantial rebate to any PBMs who purchased 80%, 90%, or even 100% of their auto-injectors from Mylan. The lump sum offered to the PBM who reached 90% would need to be matched by Sanofi before any PBM would consider continuing to dual-source. But if Sanofi expected a share of only half of the contestable share, perhaps 20%, it would need to match a discount applied to 90% of the market with one applied to only 20%. Obviously the Sanofi discount would have to be several times larger just to come close to making the consumer whole. Such a burden might discourage entry or expansion by a rival.

Nonetheless, upon summary judgment, the trial court found that no reasonable jury could rule such conduct exclusionary, and thus the plaintiff's claim failed. The Tenth Circuit reviewed the case *de novo* and affirmed. The Tenth Circuit dismissed both the exclusive dealing and loyalty rebate theories of consumer harm, expressing a deep skepticism of any antitrust claims against practices that, like loyalty rebates, ostensibly lowered prices. While recognizing that the burden on plaintiffs to prove such practices anticompetitive was "onerous," the court believed any alternative standard would actually harm consumers by propping up failing businesses. The court proceeded to evaluate the exclusive dealings claim under the general principles laid out by the Third Circuit in *ZF Meritor LLC v. Eaton Corp.*, ultimately finding insufficient evidence of market foreclosure to support Sanofi's claim of exclusionary conduct.¹² The court then summarily dismissed the loyalty rebate claim because Sanofi had not briefed the court on which legal standard to use.

The remainder of this paper steps into that void by evaluating the legal and economic tests the Tenth Circuit and other courts might rely upon in future cases like *Sanofi*. We suggest that courts should consider loyalty rebates a form of exclusive dealing, rather than predatory pricing, subject to analysis under the rule of reason and using quantitative methods like the Discount Attribution Test and the Effective Entrant Burden.

IV. Predatory Pricing v. Exclusive Dealing: Picking a Legal Standard for Loyalty Rebates

As loyalty rebates garner attention from antitrust enforcers, courts are turning to a wide range of precedent to analyze their market impact. Generally, courts consider loyalty rebates either a form of predatory pricing or exclusive dealing.¹³ Both theories of harm can be challenged under Section 3 of the Clayton Act upon showing that the practice "substantially lessen[s] competition or tend[s] to create a monopoly in any line of commerce."¹⁴ However, as explained in the next section, only exclusive dealing presents a suitable analog to loyalty rebates because loyalty rebates, by their nature, do not feature the loss-recoupment cycle that defines predatory pricing.

Nonetheless, courts continue to rely on predatory pricing theories to assess loyalty rebates, subjecting the practice to a high—often impossible—burden of proof. In *Brooke Group*, the Supreme Court stated that plaintiffs alleging predatory pricing must show (1) pricing below cost; and (2) a reasonable prospect of recouping the loss after eliminating competition.¹⁵ Courts applying *Brooke Group* will often find loyalty rebates permissible,¹⁶ echoing the Supreme Court's belief that predatory pricing schemes are "generally implausible."¹⁷ This is the approach the *Sanofi* court

¹² 696 F.3d 254 (3rd Cir. 2012).

¹³ ANTITRUST DISTRIBUTION, *supra* note 1, at 6.03(3)(a).

¹⁴ 15 U.S.C. § 14.

¹⁵ *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223-24 (1993) (rejecting predatory pricing claim as a matter of law where plaintiff failed to show a reasonable likelihood of recouping losses from the below-cost price period).

¹⁶ ANTITRUST DISTRIBUTION, *supra* note 1, at 6.03(3)(a).

¹⁷ *Energy Conversion Devices Liquidation Trust v. Trina Solar Ltd.*, 833 F.3d 680, 685 (6th Cir. 2016) (quoting *Brooke Group*, 509 U.S. at 227). See also *Morgan v. Ponder*, 892 F.2d 1355 (8th Cir. 1989) (finding above-cost pricing legal *per se*); *Transamerica Computer Co. v. IBM Corp.*, 698 F.2d 1377 (9th Cir. 1983) (finding above-cost pricing presumptively legal).

found the most persuasive, even though the Tenth Circuit refused to officially adopt a legal standard for loyalty rebates.¹⁸

The second theory, exclusive dealing, is subject to a rule of reason analysis under Section 1 of the Sherman Act, where there is evidence of collusion, or else Section 2, where the defendant holds market power. The test is whether rebates foreclose a “substantial” share of the market.¹⁹ Courts may use either a quantitative or qualitative substantiality test. The former looks only at the market share affected by the deal, with courts finding market shares as low as 6.7% “substantial.”²⁰ The latter approach considers the market share affected alongside other factors, including the relative dominance of the seller in the industry, the relative strength of the parties, the sales structure of the industry, the use of such deals within the industry, and the duration of those deals.²¹ Courts are more likely to find the practice anticompetitive where the defendant has strong market power, offers rebates as long-term contracts, and coerces or penalizes buyers who want to take their business elsewhere.²² Courts will also consider such exclusive dealing arrangements less problematic where the industry as a whole offers similar deals.²³

There is scant appellate caselaw considering loyalty rebates as exclusive dealing, and the results have been mixed. In *Concord Boat v. Brunswick Corp.*, for example, the Eighth Circuit allowed a boat engine manufacturer, which held 75% of the market, to offer a volume-based loyalty rebate where buyers were not bound by long-term contracts and could take advantage of the rebate while still buying up to 40% of their engine needs from other suppliers.²⁴ In *ZF Meritor v. Eaton Corp.*, the Third Circuit found a similar rebate impermissible where the manufacturer controlled almost the entire market and conditioned the rebate on long-term contracts ensuring that the buyers purchased 65-95% of their needs from that manufacturer.²⁵ And in *Eisai Inc. v. Sanofi Aventis U.S., LLC*, the Third Circuit permitted a volume-based rebate even though the defendant had 81% of the market, because only a small percentage of customers might be prevented from switching to a rival’s product.²⁶ In general, the appellate courts seem hesitant to find loyalty rebates illegal where the rebate is relatively modest and buyers can still purchase an appreciable amount from other sellers.²⁷

Once the plaintiff has shown the exclusionary impact of the rebate, the burden shifts to the defendant to either undermine the plaintiff’s evidence of exclusion or else demonstrate the benefit to consumers outweighs the exclusionary potential of the rebate.²⁸ The Supreme Court has

¹⁸ *Sanofi-Aventis U.S., LLC v. Mylan, Inc.*, 44 F.4th 959, 1003 (10th Cir. 2022).

¹⁹ ANTITRUST DISTRIBUTION, *supra* note 1, at 6.03(3)(a).

²⁰ 1 JULIAN O. VON KALINOWSKI ET AL., ANTITRUST LAWS AND TRADE REGULATIONS § 2.04 (2d ed. 2023).

²¹ *Id.*

²² *ZF Meritor LLC v. Eaton Corp.*, 696 F.3d 254, 271-72 (3d Cir. 2012).

²³ *Id.* at 272.

²⁴ 207 F.3d 1039 (8th Cir. 2000).

²⁵ 696 F.3d at 254.

²⁶ *Eisai Inc. v. Sanofi Aventis U.S., LLC*, 821 F.3d 894, 894 (3d Cir. 2016).

²⁷ Jonathan M. Jacobson, *A Note on Loyalty Rebates*, ANTITRUST SOURCE (June 2010).

²⁸ Derek W. Moore & Joshua D. Wright, *Conditional Rebates and the Law of Exclusive Dealing*, 22 Geo. Mason L. Rev. 1205, 1225 (quoting Judge Posner in *Roland Machiner Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 394 (7th Cir. 1984)).

recognized many pro-competitive effects from exclusivity deals: protection against price increases, guaranteed supply for long-term planning, lower transaction costs,²⁹ and incentivizing promotion efforts by retailers.³⁰ Among the few loyalty rebate cases before the circuit courts, even fewer have made it to the second stage of the rule of reason test.³¹ The cases that have, however, have affirmed the same procompetitive justifications.³²

Finally, if the defendant shows that the deal is at least competitively neutral, the plaintiff reassumes the burden of proof to show that the business justification is pretext or that the overall competitive effect will be harmful to consumers.

V. Putting a Price on Loyalty: Picking an Economic Standard for Loyalty Rebates

As the *Sanofi* court considered its options, it listed three prevalent economic standards for assessing the competitive impact of loyalty rebates: the price-cost test, the discount-attribution test, and the effective entrant burden test. This section discusses the merits of each in turn before concluding that the last is the most intuitive and reliable.

A. *The Price-Cost Test*

The price-cost test is a part of the predatory pricing framework.³³ But circuit courts have sometimes applied the price-cost test to loyalty rebates despite its unfitness for that purpose.³⁴ The price-cost test assesses whether marginal cost exceeds the price of the product.³⁵ If the marginal cost exceeds the price, this means that the company is incurring losses simply to gain market share. The logic is that the below-cost price allows the dominant firm to force its rivals to accept losses and exit in “Phase One.” In “Phase Two,” the dominant firm can raise its price with no fear of competition and recoup the profits lost during Phase One.

However, predatory pricing is an inapt framework for analyzing loyalty rebates. When a firm uses loyalty rebates, there is no Phase One or Phase Two. As explained above, loyalty rebates do not require dominant firms to take any losses, because firms can adjust the list price and discount to offset any rebate they offer. When a seller engages in anticompetitive loyalty rebates, it leverages its entrenched demand to raise list prices, and brings down effective per unit prices through the rebate, provided the buyer remains loyal. A disloyal buyer pays the higher list price.

²⁹ KALINOWSKI ET AL., *supra* note 20, § 6.03.

³⁰ 2 JULIAN O. VON KALINOWSKI ET AL., ANTITRUST LAWS AND TRADE REGULATIONS § 25.04 (2d ed. 2023).

³¹ *E.g.*, *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1060 (2000) (plaintiffs failed to establish market share rebate program was an “unreasonable contractual arrangement, based on the amount of market foreclosure, exclusivity, and the erection of entry barriers.”).

³² *ZF Meritor LLC v. Eaton Corp.*, 696 F.3d 254, 270 (3d Cir. 2012); *Sanofi-Aventis U.S., LLC v. Mylan, Inc.*, 44 F.4th 959, 983-84 (10th Cir. 2022); *Eisai Inc. v. Sanofi Aventis U.S., LLC*, 821 F.3d 894, 405 n.35 (3d Cir. 2016).

³³ *See* *US v. AMR Corp.*, 335 F.3d 1109, 1115-16 (10th Cir. 2003).

³⁴ *See, e.g.* *US v. Microsoft Corp.*, 253 F.3d 34, 68 (D.C. Cir. 2001).

³⁵ Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

The rebate, then, is not really a rebate because the seller *simultaneously* inflates the entire pricing curve in the short run *and* keeps out entrants in the long run.

Loyalty rebates thus present a fundamentally different problem than predatory pricing, which requires a dominant firm to take losses today in order to inflate prices tomorrow. Predatory pricing therefore incurs risks not present in loyalty rebating, making the court's skepticism that firms would bet on predatory pricing inapposite to the loyalty rebate analysis.

Courts should realize that a smaller rival's desire to expand threatens the profits of the incumbents. Loyalty rebates contain entrants on the fringes of the market, making it difficult for those small companies to grow in the short term and realize the efficiencies enjoyed by the dominant firm. Loyalty rebates thereby fend off threats to the dominant firm's non-contestable share, preventing competition and thus harming consumer welfare for the market as a whole. The price-cost test, at least as it is applied today, fails to account for this dynamic of contestability, and so courts should look to other economic tests when assessing loyalty rebates.

B. *The Discount-Attribution Test*

The discount-attribution test can more accurately capture harm in situations involving loyalty rebates. The discount-attribution test is a version of the price-cost test for assessing bundled discounts.³⁶ Bundled discounts are discounts conditioned on the buyer buying two or more products (a "bundle"), from the seller.³⁷ Under the discount-attribution test, bundled discounts are considered anticompetitive when a product in the bundle, after the discount is applied, is priced below the cost of making that product.³⁸ Put another way, the price of an individual product at the full rebated price should always exceed the marginal cost.

Loyalty rebates can be seen as a kind of bundled discount, as some courts have recognized.³⁹ The purchases that buyers must meet to trigger the loyalty rebate forms the "bundle," while the resulting rebate is the relevant discount. The key is to define the product to which the discount is applied. In our context, this product is naturally going to be the contestable product made by the incumbent, rather than any of the remaining elements of the product line that are also in the bundle. To apply the discount attribution test, courts would compare the total rebate to the amount of the *incumbent's* contestable product sold. The court would find the rebate anticompetitive when the list price less the rebate per-contestable-unit is below cost. Returning to the syringes example, the rebate per-contestable-unit is 90% (total sales of Firm A's product) x 10% (rebate from Firm A) applied to the 5% of the market that is contestable sales of Firm A. This 5% comes from the fact that the contestable share is 15% but the loyalty rebate is set up for A to receive only 5%. If the .09 of revenue is larger than the incremental share obtained by the contract

³⁶ DEPT. OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 91-105.

³⁷ *Id.*

³⁸ *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 973 (9th Cir. 2008).

³⁹ *Sanofi-Aventis U.S., LLC v. Mylan, Inc.*, 44 F.4th 959, 1002 n.23 (10th Cir. 2022).

(.05), then clearly the rebate creates a net price that is below any accounting measure of cost.

The rebate is measured as Firm A's 10% lump sum rebate divided by its own quantity sold of the contestable syringe (5% if the customer is loyal). However, as the syringe example shows, the distribution-attribution test is sensitive to the incumbent firm's performance in a way that creates some confusion. The more that customers buy from Firm A, the lower the per unit rebate becomes. Ironically, the better Firm A is at excluding the sales of Firm B by driving its share to zero, the lower the chance of liability for Firm A under this test. At a threshold of 100%, the total rebate becomes .1 while the incremental units for Firm A become .15. The answer to the test appears much more favorable. Nonetheless, the discount-attribution test marks an improvement to the price-cost test by applying its intuition to bundled discounts. In particular, it illuminates the strength of the incumbent's strategy by measuring how much rebate it creates per additional sales unit obtained.

C. *Effective Entrant Burden Test*

The Effective Entrant Burden ("EEB") test is a helpful metric for understanding whether a seller's use of loyalty rebates is anticompetitive. The EEB is an update to the tying doctrine and a modification of the discount attribution test.⁴⁰ Because tying is about conditioning the sale of one good on the sale of another, effectively "tying" the products together, it centers non-contestable demand, while predatory pricing and bundling do not. The EEB was created specifically for loyalty rebates, and what makes it a useful metric is that it is holistic. The EEB encapsulates several elements of loyalty rebates: the non-entrenched market share, the required threshold for the buyer, and the rebate itself.⁴¹

To calculate the EEB, the threshold is multiplied by the rebate to obtain the total sum at stake, as is done in the discount attribution test. However, then the EEB divides that number by the whole contestable share, rather than the entrant's units.⁴² The result is the rebate that the entrant must offer relative to the incumbent's price in order to compete with the incumbent. We assume the entrant is competitive, but not sufficiently innovative to the extent that a customer would be willing to lose the incumbent's entire rebate in order to buy a small number of units from the entrant. Rather, the entrant is good enough to attract demand when the playing field is level, meaning that the entrant must lower its price to make the customer whole. This is the way in which the loyalty rebate raises rivals' costs. In other words, the EEB is the incremental burden on entrants necessary for them to succeed in the market.

The EEB is a relative number. The higher the EEB, the greater the rebate the entrant would need to provide, so the harder it would be for the entrant to compete.⁴³ A low enough contestable

⁴⁰ See Scott Morton & Abrahamson, *supra* note 1.

⁴¹ *Id.* at 816-19.

⁴² *Id.*

⁴³ *Id.* at 819.

share or a high enough rebate would make it “too hard for a rival to compete for the non-entrenched share,”⁴⁴ indicating that the incumbent is engaging in anticompetitive behavior.

Under the EEB framework, a syringe producer requiring an 80% threshold for a 30% rebate generates the same cash lump sum as a producer requiring 60% threshold for a 40% rebate, and so forth. The question is then: what is the contestable share to which this lump sum is applied? Suppose it is 20% of the market. A customer must weigh the loss of 24% of expenditure on the gain from purchasing the entrant’s product. In our example, these sums are close in size, so the entrant would need to effectively give away its product for free in order to make the customer as well off from disloyalty as from loyalty. EEB grows with the size of the discount and the size of the threshold. It shrinks with the size of the contestable share because those are the units over which the entrant can spread its discount. However, because the incumbent designs the loyalty rebate contract, it controls the definition of the market and therefore the fraction of that market comprised of contestable products. The infeasibility of an entrant providing steep rebates while continuing to compete effectively in the market creates the competition problem. And, because there is no reason for the rebate contract to ever cease operation, there is no “phase two” in which the entrant would be free of the contract and able to grow.

There are, however, shortcomings to the EEB. Whereas the price-cost test and the discount-attribution test require only knowledge of the discount and the sales of the incumbent, EEB requires a measure of the *potential of the entrant* which increases the difficulty of administering such a test.⁴⁵ However, the EEB will generally find a rebate to be less powerful than the discount attribution test would, so the government could choose to rely on the “easier” test, and the defendant may have an incentive to do the work to establish what the contestable share is. Alongside the discount-attribution test, the EEB is a helpful method to analyze the extent to which loyalty rebates are anticompetitive by integrating the components of loyalty rebates into a comparable formula.

VI. Conclusion

Returning to the *Sanofi* case, we might see how the Tenth Circuit would have decided the case differently if it had adopted an exclusive dealing theory of loyalty rebates and applied the EEB test. It would have calculated the EEB by multiplying the threshold (up to 100% in some cases) by the discount (up to ~40%) and dividing by the contestable share (30-50%). The result could be as high as 1.3. In other words, Sanofi would have to *pay* customers 30% of list price as well as *give* them Auvi-Q to make them indifferent to Mylan’s loyalty rebate. If the court had used the discount attribution test, this penalty would have been even higher because the per unit rebate would be calculated based on only EpiPen sales (and Auvi-Q had some share initially). The 40% in our example would be divided by 20% if Auvi-Q obtained 2/3 of the 30% contestable share. Would-be rivals would *run* from this worst-case scenario, cementing Mylan’s market dominance and cutting out competition for lower-priced, higher-quality, and more innovative injectors over

⁴⁴ *Id.* at 1003.

⁴⁵ *See id.* at 1002 n.25 (“The EEB test . . . relies upon the extent of entrenched share which is difficult to objectively derive.”).

the long run. Thus, properly conceived as a matter of exclusive dealing and properly assessed as raising rivals costs very significantly, the consumer harm is self-evident. We recommend that courts and regulators adopt this method to see past the label of loyalty “rebates” and recognize the potential for abuse by firms with entrenched power.