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## Loyalty-Discount Programs and the Antitrust Laws

by G. Gabriel Zorogastua

Loyalty discounts are price reductions by a supplier in return for a customer's commitment to purchase a certain percentage of its requirements from the supplier. Sellers also sometimes discount their prices if a customer purchases two or more of the seller's products. These discounts generally pose little threat to competition and are often considered procompetitive. **But certain discount programs could have an anticompetitive market effect by eliminating competitors, increasing prices, and reducing product quality, thus implicating antitrust concerns.**

### Discount Programs

Single-product loyalty discounts come in many forms. For example, assume a supplier sells widgets at \$100 per unit and that a customer needs 1,000 of those widgets. To incentivize the customer to purchase its widgets, the supplier offers a 10% discount on the total order if the customer purchases 80% of the widgets it needs from that supplier. Instead of paying \$100 per widget, the customer would pay \$90 per widget if it buys at least 800 widgets per month from that supplier. This loyalty discount would effectively save the customer \$10 per widget, which amounts to a saving of \$10,000 on its total order if it buys all 1,000 units from the supplier.

Similarly, the supplier could offer the manufacturer a 10% loyalty discount on all units in excess of 50% of the customer's requirements. In this second example, the customer would pay \$100 for the first 500 units and \$90 for every additional unit. If the customer buys all 1,000 units from the supplier, it would pay a total of \$95,000, saving \$5,000 for the total order.

In contrast, multi-product bundled discounts are price reductions offered by a supplier to a customer if the customer buys a bundle of products instead of purchasing each product individually. The price of the bundled products is less than what the supplier charges for the products individually. For example, assume that a supplier individually sells widget X at \$100 per unit and widget Y at \$200 per unit. To incentivize the customer to buy both widget X and widget Y, the supplier offers a bundled discount price of \$250

for purchasing both widgets. This bundled discount would save the customer \$50 per bundle.

While often procompetitive, these discount programs sometimes raise antitrust risks.

## Legal Standards

Courts use different approaches when evaluating single-product loyalty discounts under the antitrust laws. Some use the rule of reason approach. See *Insight Equity A.P. X, LP*, No. CV 10-635-RGA, 2016 WL 3610155, at \*5 (D. Del. July 1, 2016). Under this method, courts analyze whether the loyalty discount forecloses competition “in such a substantial share of the relevant market as to adversely affect competition.” *Id.* “Foreclosure occurs when ‘the opportunities for other traders to enter into or remain in [the] market [are] significantly limited’” by the discount. *McWane, Inc. v. FTC*, 783 F.3d 814, 837 (11th Cir. 2015). Market foreclosures lower than thirty or forty percent are typically permissible. *Sterling Merch., Inc. v. Nestle, S.A.*, 656 F.3d 112, 123–24 (1st Cir. 2011). But if the loyalty discount forecloses more than forty percent, the loyalty discount likely resembles exclusive dealing and may be illegal. See *id.*

Other courts use the price-cost test to evaluate single-product loyalty discounts. *Eisai, Inc. v. Sanofi Aventis*, 821 F.3d 394, 408 (3d Cir. 2016). This approach tests whether the loyalty discount drives the product’s price below its costs and effectively eliminates competitors or creates a monopoly. *Id.* If it does, the loyalty discount could be considered predatory pricing and may be unlawful. See *id.*

Courts also use different antitrust standards when analyzing multi-product bundled discounts. Some courts hold that a monopolist pricing its bundled goods above the products’ costs does not automatically make the discount permissible. *LePage’s Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003). A monopolist still faces potential antitrust liability for an above-cost bundled discount if it offers bundled discounts “that may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a

comparable offer.” *Id.*

Other courts use the discount-attribution standard, which allocates the full amount of the bundled discount to the specific products facing competition. *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 906 (9th Cir. 2008). If the price of the competitive products is above the supplier’s production costs, the bundle is generally lawful. *Id.* However, if the price of the competitive products is below the supplier’s production costs, the discount could violate the antitrust laws. *Id.*

## Case Examples

In a recent case, the court ruled that a loyalty-discount arrangement was lawful and did not harm competition. *Eisai, Inc.*, 821 F.3d at 407–08. Customers participating in the loyalty-discount program received price discounts based on the volume and market share of purchased product, and agreed to not give competing suppliers priority status on their approved product lists. *Id.* at 400. Customers not participating in the loyalty-discount agreement were still free to purchase the supplier’s products at wholesale price. *Id.* The court held the loyalty-discount arrangement did not violate antitrust law because (1) buyers did not face penalties or risk product shortages by not partaking in the arrangement, (2) buyers could still purchase the company’s products absent any arrangement, and (3) no substantial market foreclosure occurred as only a few dozen customers out of 6,000 were prevented from purchasing competing products. *Id.* at 404–07. Accordingly, the supplier was free to continue offering its loyalty discount arrangement without violating antitrust laws. *Id.*

In another case, the court ruled a loyalty-discount agreement was legal because (1) the agreement was not exclusive, (2) buyers were free to purchase products from the company’s competitors, (3) buyers could terminate the agreement at any time, (4) a substantial share of the market was not foreclosed, and (5) product prices remained above marginal costs. See *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1058–63 (8th Cir. 2000).





In contrast, a supplier's rebate was found to be unlawful by another court because (1) the rebate was conditioned on customers buying their entire product need from the supplier, and (2) customers who bought from other suppliers could not purchase the supplier's product for twelve weeks. *McWane, Inc.*, 783 F.3d at 819. The court found that this type of exclusive dealing arrangement enabled the supplier to maintain an impermissible monopoly within the supplier's industry. *Id.* at 834–35.

A court also found an unlawful loyalty-discount program in a case where eighty-five percent of the market was foreclosed for five years. This substantial market foreclosure amounted to exclusive dealing, even if the product's prices remained above marginal costs. See *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 287–89 (3d Cir. 2012).

In yet another case, a loyalty discount arrangement violated the antitrust laws because the discount excluded competitors from essential distribution channels. The arrangement harmed competition by preventing competitors from gaining market power, thus preserving the company's monopoly. See *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 191 (3d Cir. 2005).

## Guidelines for Discount Programs

The standards and cases above are instructive and suggest that companies should consider the following before implementing a discount program:

- **Market Share:** Typically, discount programs are safe if the supplier lacks market power.
- **Market Foreclosure:** Businesses should ensure they are not foreclosing more than thirty to forty percent of the market through their discount programs.
- **Product Costs:** Discount programs can raise legal concerns if the price of any product (including all discounts) falls below its marginal cost (usually measured by short-term variable cost).

- **All-or-nothing Programs:** Discounts that require a customer to purchase a certain percentage of its needs before any units are discounted often face more antitrust scrutiny than those that apply to units in excess of a threshold number.
- **Exclusivity:** Discount programs that prevent customers from purchasing from other suppliers increase antitrust risk.
- **Procompetitive Justifications:** A company creating a discount program should document the program's procompetitive justifications. This documentation could later serve as a safeguard for the supplier in the event of an antitrust challenge.

**A company participating in a discount program lessens its risk of violating the antitrust laws by structuring its program based on the above guidelines. However, these general guidelines do not guarantee antitrust compliance. As a result, companies considering discount programs should engage antitrust counsel.** Polsinelli's antitrust experts can help minimize the litigation and regulatory risk of these programs.

The author appreciates the contributions to this e-alert by Kelsey Hauserman, a law student at Washburn University School of Law and summer associate at Polsinelli PC. Additional sources for this alert include: Joshua D. Wright, Comm'r, Fed. Trade Comm'n, Remarks at Bates White 10th Annual Antitrust Conference: *Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts* (June 3, 2013), available at [https://www.ftc.gov/sites/default/files/documents/public\\_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf](https://www.ftc.gov/sites/default/files/documents/public_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf); *Insight Equity A.P. X, LP v. Transitions Optical, Inc.*, No. CV 10-635-RGA, 2016 WL 3610155 (D. Del. July 1, 2016); and *Retractable Tech., Inc. v. Becton Dickinson & Co.*, 842 F.3d 883 (5th Cir. 2016).



### For More Information

For questions regarding this alert or to learn more about how it may impact your business, please contact one of the authors, a member of our **Antitrust** practice, or your Polsinelli attorney.

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