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Narrowing the Gap for the Price-Cost Test: Lessons From *Eisai v. Sanofi-Aventis*

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For companies that rely on price discounting as a sales and marketing tool, navigating antitrust risk can be difficult. Lower prices always benefit customers in the short run, but economic theory creates room for plaintiffs to argue that a subset of discounting practices have long-run anticompetitive effects. While the traditional discount specter is predatory pricing, a range of conditional pricing practices such as loyalty and bundled discounts have received increased antitrust scrutiny. Both FTC and DOJ recently have signaled an interest in examining the competitive impact of conditional discounts.[1]

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A significant open issue in the developing case law is when (if ever) the price-cost test provides defendants safe harbor from liability. The price-cost test treats as per se legal discounts for which the net effective price remains above some ''appropriate measure'' of cost. Although the test has received no detailed or rigid formulation, the main idea is clear enough: If a supplier's price net of the challenged discount remains at or above cost, the supplier is off the antitrust ''hook.'' While not without critics (one can debate, for example, which among the many possible cost measures is relevant), the test operates as a bright-line rule relative to an open-ended rule of reason analysis.

The Third Circuit's recent decision in *Eisai v. Sanofi-Aventis* is the latest in a series of cases limiting the circumstances in which the safe harbor may be applicable—and indeed, may herald its complete demise in the Third Circuit.[2] Though affirming the ruling below that Sanofi's loyalty discounts on its blood-thinning drug Lovenox did not constitute unlawful exclusive dealing, the Third Circuit diverged from the dis-

[1] *See Dept. of Justice & Fed. Trade Comm'n, June 23, 2014 Workshop Transcript: Conditional Pricing Practices: Economic Analysis and Policy Implications*, *available at* www.ftc.gov/system/files/documents/public_events/302251/cpp_workshop_transcript.pdf. Just-emerging press reports also state that the DOJ is analyzing the legality of an ''incentive program'' employed by leading global brewer AB InBev which may contain a pricing component. *See* Alex Wilts, *DOJ Looks Into AB InBev Incentive Programme*, GLOBAL COMPETITION REV., May 26, 2016, *available at* https://globalcompetitionreview.com/news/article/41132/doj-looks-ab-inbev-incentive-programme.

[2] *Eisai, Inc. v. Sanofi Aventis US*, 2016 BL 142023 (3d Cir. May 4, 2016). Eisai has petitioned for rehearing en banc.

trict court's approach. While the opinion does not explicitly do away with the price-cost safe harbor, it whittles its applicability down to what ultimately may be a null set.

Not Everyone Likes a Sale

Lower prices are generally accepted as good for consumers, but economic theory suggests that particular discounts may lead to anticompetitive harm. A dominant competitor may, for example, use its power in one product market to offer bundled discounts and drive out competition in a second market. Or a dominant competitor may use its market power to offer single-product loyalty discounts that make it difficult for smaller suppliers of the same product to compete. When these types of discounts are challenged, the question for the court becomes whether the alleged exclusionary conduct has resulted in harm to competition (not just competitors).

Rule of Reason & The Price-Cost Shortcut

Conditional pricing practices can reduce costs for sellers, ensure buyers' stable supply and pricing, and constitute a ''vital form of rivalry'' that antitrust law encourages.[3] As such, they fall outside the scope of per se illegality and are evaluated under the rule of reason.[4] Under the rule of reason, courts weigh anticompetitive effects against procompetitive efficiencies. Alleged exclusionary conduct is unlawful only if its ''probable effect'' is to lessen competition substantially in the relevant market.[5]

A rule of reason approach tends to be fact intensive and wide-ranging, making it difficult to predict whether its application to a specific pattern of business conduct will result ultimately (perhaps after years of litigation) in a finding of antitrust liability. As the Third Circuit explained in *ZF Meritor, LLC v. Eaton Corp.*, ''there is no set formula for determining the legality of an exclusive-dealing agreement.''[6] Relevant factors may include ''significant market power by the defendant; the duration of the agreements; any procompetitive/anticompetitive effects; whether the dominant firm engaged in behavior that was coercive; customers' ability to terminate the agreements; and whether the defendant's competitors also engaged in such arrangements.''[7]

In *Brooke Group*, the Supreme Court adopted a shortcut—the price-cost test, as one basic element of predatory pricing law. It treats as per se legal discounts for which the net effective price remains above some ''appropriate measure'' of cost (e.g., variable cost).[8] If, however, the discount is below cost *and* there is a likelihood of recouping the investment in below-cost pricing through the subsequent exercise of market power, then the discount may be found unlawful.[9] The Court explained the underlying logic as follows: ''[T]he exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting.''[10]

The Ninth Circuit embraced a form of the price-cost test in *Cascade Health Solutions v. PeaceHealth*[11] to evaluate bundled discounts—discounts of a sort that consumers know as extra-value meals, season tickets, and all-inclusive vacation deals. Defendant PeaceHealth, one of two providers of primary and secondary health care services and the sole provider of tertiary services in the relevant market, offered discounts for tertiary services only to insurers who made PeaceHealth the preferred provider for all three. The Ninth Circuit required a showing of below-cost pricing based on the ''discount attribution'' test, which aggregates discounts across all bundled products, then allocates the aggregate discount to the competitive products (primary and secondary services in that case), and precludes liability if the net price is still at or above cost.[12] One justification the Ninth Circuit gave for rejecting a default rule of reason approach is that the risk of false negatives is countered by the fact that the price-cost test allows sellers to determine the legality of their discounting practices by relying on information they have on their own prices and costs of production.[13]

Several other Circuits have adopted variations of the price-cost test.[14] The Third Circuit, however, has been less inclined to adopt the test for discounting cases. In *LePage's Inc. v. 3M*,[15] plaintiffs alleged that 3M used its branded Scotch tape monopoly to gain a competitive advantage in the private label transparent tape market by offering multi-tiered, bundled rebates. The court declined to evaluate the discount practices with the price-cost test, reasoning that the rebates' foreclosure effects were similar to anticompetitive tying, which is evaluated under the rule of reason. The court added that *Brooke Group* did not contemplate a blanket safe har-

[3] *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 270 (3d Cir. 2012) (citations omitted).

[4] *Id.* at 271.

[5] *Id.* at 268.

[6] *Id.* at 271.

[7] *Eisai, Inc. v. Sanofi-Aventis US*, 2014 BL 96331 at *34 (D.N.J. 2014) (*citing ZF Meritor*, 696 F.3d at 271-72).

[8] See *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1993) (*citing Cargill, Inc. v. Monfort of Co., Inc.*, 479 U.S. 104, 116 (1986). *See also* Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697 (1975) (proposing that prices below reasonably anticipated marginal cost (or its proxy, average variable cost) are predatory, while prices at or above either cost are not).

[9] *Brooke Group*, 509 U.S. at 223-24 (clarifying that liability for predation requires proof of below-cost pricing and, under both Sherman Act and Robinson-Patman Act standards, proof of a ''reasonable prospect'' of recoupment or a ''dangerous probability'' of recoupment for the offense of attempted monopolization under Sherman Act, Section 2).

[10] *Id.*

[11] *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir. 2007).

[12] *Id.* at 919-20.

[13] *Id.* at 919.

[14] *See, e.g., Bridges v. MacLean-Stevens Studios, Inc.*, 201 F.3d 6, 13 (1st Cir. 2000); *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917, 951-52 (6th Cir. 2005); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1061 (8th Cir. 2000); *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int'l*, 2009 BL 256644, *7 (D. Mass. Nov. 20, 2009); *Peoria Day Surgery Ctr. v. OSF Healthcare Sys.*, No. 1:06-cv-01236 (C.D. Ill. Dec. 30, 2009).

[15] *LePage's Inc. v. 3M*, 324 F.3d 141, 145 (3d Cir. 2003).

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bor for "a monopolist with unconstrained market power" or "exclusionary or predatory conduct without a valid business justification."[16]

The Third Circuit declined again to use the price-cost test in *ZF Meritor*. Eaton entered into long-term agreements with every direct purchaser of heavy-duty truck transmissions, offering rebates so long as the customers fulfilled a certain percentage of their needs with Eaton products. The contracts allowed Eaton to terminate the agreement or recoup the discounts if customers did not meet their market share targets.[17] While taking a rule of reason approach, the Third Circuit left room for the price-cost test, indicating that it "may be utilized as a specific application of the 'rule-of-reason' when the plaintiff alleges that price is the vehicle of exclusion,"[18] but, where "price itself [is] not the clearly predominant mechanism of exclusion," a complete rule of reason analysis is in order.[19]

Eisai Magnifies the *ZF Meritor* Shift Towards the Rule of Reason

Until the Third Circuit weighed in, the district court's decision in *Eisai* stood as an example of the type of discounting that *ZF Meritor* deemed fit for the price-cost test. Instead, the Third Circuit effectively recalibrated the qualifications for the applicable test once again.

Eisai alleged that market share and volume discounts offered by Sanofi on its anticoagulant drug Lovenox illegally excluded Eisai's competing drug Fragmin. Sanofi moved for summary judgment. The district court concluded that price was the predominant mechanism of alleged exclusion for the at-issue loyalty discounts.[20] Because the conduct at issue appeared to fall in the gap left by *ZF Meritor* for the price-cost test, the district court concluded that Eisai's antitrust claims could not succeed because Sanofi's prices were above cost.[21]

The Third Circuit affirmed summary judgment but took a very different path. Though the ultimate court opinion in *Eisai* may not formally remove the distinction between cases in which price is the predominant method of exclusion and those in which another means of exclusion predominates, it suggests that such a distinction is now without practical significance.

Eisai Takes the Scenic Route

In *Eisai*, the Third Circuit began with a full rule of reason analysis.[22] The Third Circuit agreed with the district court that summary judgment could be granted because "Eisai . . . has failed to demonstrate that the probable effect of Sanofi's conduct was to substantially lessen competition in the relevant market . . . ."[23] It reached this conclusion, therefore, before even asking predicate questions of whether the price-cost test applied and whether the conduct in question fell within the safe harbor. While it was "not persuaded that Eisai's claims fundamentally relate to pricing practices," the court said that it need not reach the question of whether the price-cost test applied, because the rule of reason favored granting summary judgment.[24]

Some critics have pointed out that the price-cost safe harbor is over-inclusive—blind to certain above-cost discounts with exclusionary effects.[25] Setting aside important policy questions about the efficacy of the test, its practical value is in bypassing the far more fact-intensive rule of reason. As the Ninth Circuit pointed out, a price-cost test gives potential discounters (and potential litigants) clarity about the likely outcome of an antitrust challenge, saving time and resources, and ultimately encouraging procompetitive discounting.[26] But instead of following the price-cost shortcut already traveled by the district court, the Third Circuit took the long way. Without officially declaring the price-cost test subordinate to a rule of reason analysis, *Eisai* signals a diminished significance for the test going forward.

After *Eisai* , Price May Never Be the Predominate Method of Exclusion

The Third Circuit takes a second step to shrink the space for the price-cost test in *Eisai*. It speculates that Sanofi's at-issue loyalty discounts may not be susceptible to evaluation under the price-cost test at all because the bundling—not the price—may have been the primary exclusionary tool.[27] The court ultimately saves the question for another day but states that the alleged bundling of "contestable" and "incontestable" demand presents "different factual circumstances" than a case in which a firm "uses a single product loyalty discount or rebate."[28] With this distinction, the court signals that the price-cost test may never apply to cases in which a loyalty discount applies to products for which a portion of demand is "incontestable."

Eisai alleged that Sanofi's single-product discounts effectively bundled contestable and incontestable demand for Lovenox.[29] Sanofi had obtained a unique FDA indication for Lovenox to treat severe forms of heart attack. Eisai's competing drug Fragmin was not indicated

[16] *Id.* at 151-52.
[17] *ZF Meritor*, 696 F.3d at 265.
[18] *Id.* at 273.
[19] *Id.* at 277.
[20] *Eisai v. Sanofi*, 2014 BL 96331 at *29-30.
[21] *Id.* at *30.
[22] 2016 BL 142023 at *5. Note, however, that the district court also concluded that even if the contracts were exclusionary through means other than price, Eisai's claims must fail, because Eisai could not prove an actual antitrust injury. The district court credited numerous alternative procompetitive explanations for Lovenox's success compared to Eisai's Fragmin, including better physician familiarity with the product, more marketing campaigns, and more FDA-approved indications. *Eisai v. Sanofi*, 2014 BL 96331 at *27-29.
[23] 2016 BL 142023 at *9.
[24] *Id.* at *9-10.
[25] Joshua D. Wright, Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts, Remarks at the Bates White 10th Annual Antitrust Conference (June 3, 2013) (transcript available at www.ftc.gov/sites/default/files/documents/public_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf); Steven C. Salop, *Exclusionary Conduct, Effect on Consumers and the Flawed Profit-Sacrifice Standard*, 73 Antitrust L.J. 311 (2006). *But see* Benjamin Klein & Andres V. Lerner, *Price-Cost Tests in Antitrust Analysis of Single Product Loyalty Contracts*, 80 Antitrust L.J. 631 (2016).
[26] *See PeaceHealth*, 502 F.3d at 912-15.
[27] *Eisai v. Sanofi*, 2016 BL 142023 at *10.
[28] *Id.* ("[W]e will not opine on when, if ever, the price-cost test applies to this type of claim.").
[29] *Id.* at *2-3.

for that use and therefore, according to Eisai, could not compete for a portion of Lovenox's demand. The loyalty discount applied once Lovenox constituted 75% of a hospital's purchases among four competing anticoagulant drugs. Eisai alleged that this arrangement leveraged Sanofi's market power for incontestable demand (resulting from the unique FDA indication) to exclude Eisai from making sales for the contestable portion of demand. While not dispositive to the ultimate outcome, the Third Circuit takes time to speculate that alleged bundling of contestable and incontestable demand for a single product may be enough to put the conduct outside the reach of the price-cost test.

Although the Third Circuit makes an effort to distinguish single-product loyalty discounts from single-product loyalty discounts that bundle contestable and incontestable demand, it is likely to be a distinction without meaning or impact. Plaintiff's expert's description of incontestable demand highlights why. Professor Einer Elhauge defined incontestable demand as ''the 'units that the customer is less willing to switch to rival products' because of 'unique indications, departmental preferences, and doctor habit.' ''[30]

Outside the realm of economic theory, however, this definition is universal to all products sold in quantities greater than one: In real-world markets, there will always be some units for which customers are relatively less willing to switch to rival products. Elhauge's definition of ''incontestable demand'' simply describes relatively inelastic demand. Yet demand varies from highly elastic to highly inelastic for essentially all products.[31] Other than in a literally perfectly competitive market, some portion of customers will have relatively inelastic demand for some quantity of the good in question.

Under the *Eisai* definition of incontestable demand, all real-world loyalty discounts inherently ''bundle'' contestable and incontestable sales. Thus, any plaintiff alleging that a single product loyalty discount bundles contestable and incontestable demand will, as a matter of math, be correct. In *Eisai*, the Third Circuit only signals that alleged single-product demand bundling *may* require a complete rule of reason analysis. However if subsequent cases follow this path, the portion of discounts appropriate for price-cost analysis will likely become a null set.

Refining the Rule of Reason in Absence of the Price-Cost Test

Ultimately, *Eisai* signals a narrower role for the price-cost shortcut. While critics of the price-cost test may rightly argue that this trend is justified given the test's imprecision, support for the more flexible rule of reason should not come without consideration of the potential costs. While the rule of reason may reach more discounts having anticompetitive effects, it also creates uncertainty and may ultimately deter procompetitive discounting.[32] As the space for bright-line rules like the price-cost test shrinks, it becomes increasingly important to inject clarity and predictability into the rule of reason.

Increased precision enriches customers of firms hoping to offer discounts without running afoul of the antitrust laws. Particularly as scrutiny of conditional pricing practices increases, the antitrust community (practitioners, scholars and others) should encourage courts and the antitrust agencies to be precise where possible, and to set boundaries when applicable, to avoid deterioration of the rule of reason from merely flexible to virtually impenetrable.[33] Further yet, it seems clear that the time has come for the U.S. Supreme Court to provide guidance on when the price-cost test should be used, if ever, to evaluate loyalty and bundled discounts, and to hear cases implicating specific applications of the rule of reason to establish clarity around the economic factors and procedural steps that will best produce the most sensible case outcomes.[34]

In the meantime, practitioners must take care to advise clients on the continued tangle of legal and economic standards used to assess loyalty and bundled discounts until the courts and agencies settle on a reasonably structured, if not bright-line, approach.

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[30] *Id.* at *4, 7 (quoting Elhauge).

[31] We recognize that certain demand conditions may prove the theoretical exception (e.g., perfectly elastic demand or demand curves with constant elasticity). Such cases, if ever occurring in the real world, would constitute a tiny minority.

[32] The open-endedness of this inquiry has been reflected in both academic and regulatory discussions about conditional pricing practices. *See, e.g., supra* note 1, CONDITIONAL PRICING PRACTICES WORKSHOP TRANSCRIPT at 163 (comments of Deborah Feinstein, Director, Bureau of Competition, FTC) (''[I] think there's nothing on which there was consensus today . . . . Can we agree that price cost probably doesn't end the inquiry? Can we agree that we should only worry about this with dominant firms? What is it that we can agree on?'').

[33] *See, e.g.,* Victrex plc, et al., File No. 141-0042, ¶¶ 34, 43, 46 (F.T.C. April 27, 2016) (Complaint), available at www.ftc.gov/enforcement/cases-proceedings/141-0042/victrex-plc-et-al-matter (charging exclusive contracts enabled chemical-maker Invibio to maintain ''prices that were substantially higher than competing versions,'' despite two ''less effective'' competitors offering ''significantly lower prices,'' without quantifying these claims, or suggesting what threshold of foreclosed sales might raise competitive issues).

[34] Clarity from the Court on the metes and bounds of the rule of reason is particularly important in light of lower court confusion over rule of reason analysis following *FTC v. Actavis* , and the Court's nearly six decades of silence on exclusive dealing. 133 S. Ct. 2223 (2013) (''[T]rial courts can structure antitrust litigation so as to avoid, on the one hand, the use of antitrust theories too abbreviated to permit proper analysis, and, on the other, consideration of every possible fact or theory irrespective of the minimal light it may shed on the basic question . . . . We therefore leave to the lower courts the structuring of the present rule-of-reason antitrust litigation.''); *see Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961). *See alsoPacific Bell Telephone Co. v. LinkLine Communications, Inc.*, 555 U.S. 438, 453 (2009) (citations omitted) (stating somewhat ironically, ''antitrust rules 'must be clear enough for lawyers to explain them to clients . . . .' At least in the predatory pricing context, firms know they will not incur liability as long as their retail prices are above cost.'').

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