US And EU Converging On Dominant-Firm-Abuse Theory

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There is recent evidence of possible greater convergence between the United States and the European Union on issues of abusive market conduct by dominant firms.

Previously, the two leading antitrust regimes were seen as split on the regulation of market dominance. In simple terms, the United States antitrust law was viewed as prioritizing the protection of the competitive market process.[1] Such a U.S. policy perspective was considered as according firms with large market shares broad discretion in adopting profit maximizing practices. It placed little responsibility on such firms for the restrictive trade effects such conduct might have on their business rivals.

In the European Union, on the other hand, firms with dominant positions were held to a higher standard and were required to refrain from engaging in so-called abusive practices that might in the United States be viewed as efficiency enhancing.[2] In the EU, dominant firms were held to have a “special responsibility” to avoid competitor injury from a wide range of trade practices.

While it may be too early to tell, the recent decision of the Third Circuit Court of Appeals in ZF Meritor v. Eaton Corp.,[3] and very recent pronouncements by Federal Trade Commission Commissioner Joshua Wright[4] (citing several recent FTC decisions) suggest that the EU’s abuse-of-dominance theories may be gaining greater currency at least in some quarters in the United States. If so, the protection provided to dominant firms for restrictive practices involving above-cost pricing strategies may be put at risk by theories of liability — long accepted in the EU — that focus on competitor exclusion resulting from “raising rivals' costs.”[5]

For 20 years since the decision of the U.S. Supreme Court in Brooke Group[6], above-cost discounts offered to secure and maintain customer loyalty were safeguarded from liability under Section 2 of the Sherman Act, 15 USC §2, even if the effect of the discounts was to foreclose rivals from a substantial share of the market opportunities and ultimately force them to exit the market.

The notion was that unless the pricing strategies of a dominant firm were predatory (below an appropriate measure of cost coupled with an opportunity for recoupment), the dominant firm's pricing strategy was beyond challenge despite the market effect of making it difficult or impossible for its rivals to compete.

However, through a series of decisions over the last 10 years[7] and as reflected most recently in the ZF Meritor decision, the Third Circuit has articulated a view that has attracted considerable attention. These decisions postulate that above-cost discounting by a dominant firm can violate U.S. antitrust laws. Indeed, such "nonpredatory" conduct that can have extremely negative consequences is seen as an exercise of market power (or monopolization) that should be proscribed.

In LePage, the court said that 3M's bundled discounts, while operating in terms of pricing, effectively and illegally shut the market from competitor access just as if they had been the product of an exclusive dealing arrangement.

In ZF Meritor, the court rejected Eaton's argument that above-cost pricing was per se legal whatever their effects. According to the court, when a supplier with a significant market position offers substantial discounts to all the market's customers, and such discounts preclude the supplier's rivals to compete, the exclusivity resulting from the discounting practices, albeit in a de facto fashion, violates Section 2 of the Sherman Act.

Commissioner Wright strongly endorses the result reached in ZF Meritor. More importantly, the commissioner supports the underlying legal and economic analysis on which the decision rests. Thus, he rejects as simplistic the notion of per se legality for above-cost pricing that Eaton argued to shield its allegedly market foreclosing market share discounts.

He states the issue this way: "the choice in this context is between a simple legal test based on the wrong economic model and a legal test — albeit a more complex rule of reason analysis — based on a more accurate set of economic models. In his view, "exclusive dealing law is superior to price-cost legal standard for evaluating loyalty discounts." Thus, predation is not, in the commissioner's opinion, a necessary recondition on which to base a violation. Raising a rival's costs using market share-based loyalty discounts to achieve exclusion can, as he believed in ZF Meritor, be sufficient.[8]

These developments in the U.S. — however controversial to some — would be considered routine in the EU. The theory of abuse or monopolization relied on in ZF Meritor and supported by Commissioner Wright has long been at the heart of Article 102 of the Treaty on the Functioning of the European Union. Article 102 is the EU equivalent to Section 2 of the Sherman Act. It imposes strict and — some would say — unfair responsibilities on firms with dominant market positions not to abuse their market power.

In the United States, large firms are often granted wide latitude in the competitive strategies they employ. In contrast, the EU has long proceeded on the assumption that the preservation of effective competition can be achieved by making sure competitors are protected from abuse, particularly denial of market access even if the result is not necessarily efficiency enhancing.

Thus, decisions like ZF Meritor would not engender the controversy that they have in the United States. For many years, fidelity rebates have been repeatedly determined as illegal abuses where their effect, like an exclusive dealing arrangement, has been to make it difficult or impossible for a competitor to gain access or remain a viable market participant. Reviewing prior European Court of Justice judgments, the European Commission articulated what it considered to be a general principle:

A dominant supplier can give discounts that relate to efficiencies, for example, discounts for large orders that allow the supplier to produce large batches of products, but it cannot give discounts or incentive to encourage loyalty, that is for avoiding purchases from a competitor of a dominant firm.[9]

Indeed, in the Michelin II decision,[10] the European Commission tightened the screws further by gutting large portions of Michelin's discount and rebate programs on the grounds that Michelin's discount and rebate programs trapped Michelin's customers in a web of exclusivity and had an impermissible "loyalty-inducing effect." That made it impossible for Michelin rivals to gain market access.[11] At no point in any of these European cases was there any consideration to the question of whether the discounts were or were not above or below cost. The market freedom accorded to dominant firms by the U.S. Supreme Court in Brooke Group and Trinko has little or no place in European law.

While the evidence is still limited, the foregoing indicates that there are some signs of growing support in the United States, at least among certain regulators and members of the judiciary, for the view that competition enforcement should assess “nonpredatory” pricing, rebate and discounting practices from a broader market foreclosure perspective given their potential exclusionary consequences.

Commissioner Wright observed[12] that proper antitrust analysis of loyalty-inducing discounts requires more than reference to the simple bright-line safe-harbor rule on above-cost pricing announced in Brooke Group.

Under such an approach, in order to assess fully the competitive implications of such discounting practices, it is necessary to more fully explore their market impact. The EU has long recognized that such pricing practices can have impermissible exclusionary effects that are detrimental to competition. Thus, firms with large market shares in the United States should consider carefully the discounting and rebating practices they might desire to implement.

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[1] Verizon Communications v. Trinko, 540 U.S. 398 (2004) (Section 2 imposes no duty on a dominant market participant to aid a smaller competitor rival); Brooke Group Ltd. V. Brown Williamson Tobacco, 509 U.S. 209 (1993). Compare Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985) and Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451 (1992) with United States v. Colgate & Co., 250 U.S. 3000 (1019).

[2] See, e.g., Hoffmann-LaRoche v. Commission [1979] ECR 461, 3 CMLR 211; NV Nederlandsche Banden Industrie Michelin [1983] ECR 3491. 4 CMLR 1076; Case T-203/01; Manufacture Française des pneumatiques Michelin v. Commission, Judgment of the Court of First Instance of 30 September 2003 (the author represented an interested party in this Michelin case (often referred to as “Michelin II”).

[3] 696 F.3d 254 (3d Cir. 2012).

[4] Wright, “Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to evaluating Loyalty Discounts” (June 13, 2013).

[5] Krattenmaker & Salop, “Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power over Price,” 96 Yale L. J. 209 (186).

[6] Brooke Group, supra n.1.

[7] ZF Meritor v. Eaton, supra n.1; United States v. Dentsply Int’l, 399 F.3d 181 (3d Cir. 2005); LePage, Inc. v. 3M, 324 F.3d 142 (3d Cir. 2003), cert. denied, 542 U.S. 953 (2004).

[8] Commissioner Wright cites a number of recent FTC enforcement decisions which he believes were based properly on such an exclusive dealing model. See, e.g., In re Intel Corp. Docket No. 9341, 2009 WL 4999728 (FTC Dec. 16, 2009); In re McCormick & Co., File No. 961-0050, 2000 WL 264190 (FTC Mar. 8, 2000).

[9] OJ [2000] L 30/1, [2000] 4 CMLR 999.

[10] Michelin II, supra n. 2.

[11] Id.

[12] Supra n. 4.