The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?

Daniel J Gifford, University of Minnesota
The Law and Economics of Price Discrimination in Modern Economies:

Time for Reconciliation?

Daniel J. Gifford
Robert T. Kudrle

Abstract

This paper examines the forms, goals, and results of price discrimination. It reviews various economic analyses and critiques of the three Pigovian types of price discrimination. It observes that economists’ traditional concern with aggregate welfare has not, until recently, been accompanied by a similar concern by lawyers. Until the late twentieth century lawyers tended to focus on “fairness” instead. These different concerns have impeded mutual understanding, as have the various meanings that lawyers and economists have attributed to such basic terms as “monopoly power,” “market power” and “competition” in the price discrimination context.

The paper examines the principal laws of the United States and the European Union that deal with price discrimination, focusing especially on the Robinson-Patman Act and Article 82(c) of the Treaty Establishing the European Union. The paper compares the operation of these two provisions, finding superficial resemblances but significant differences in practice. While the Robinson-Patman Act was designed to prevent powerful buyers from forcing price concessions from often weak producers to the detriment of small buyers, enforcement of Article 82(c) is directed differently. Although the language of Article 82(c) suggests that it is designed to protect purchasers-for-resale from discrimination by their suppliers, the European Commission employs Article 82(c) to protect competitors from aggressive pricing by dominant (generally producer) firms. The paper also examines the developing law on loyalty rebates on both sides of the Atlantic, again finding that the approaches of the two jurisdictions differ significantly, at least as exemplified by the most recent cases. It distinguishes between loyalty rebates offered by the seller of a single product and those offered by a multi-product seller. The paper’s main message is that price discrimination is an essential element in an effectively competitive economy and should be treated that way under the law.
I. Introduction: Laws Targeting Price Discrimination: ....................................................... 1

II. Economic Conceptions of Price Discrimination: A Brief Review................................. 2
   A. Price Discrimination Defined ..................................................................................... 3
   B. Arbitrage, Market Power and Price Discrimination ................................................... 5
   C. Price discrimination involving the rates of public utilities and carriers .................... 8

III. Identifying Concerns Over Price Discrimination ...................................................... 14
   A. Revenue Generation, Welfare, and Competition .................................................... 15
   B. Fairness ..................................................................................................................... 15
   C. Efficiency and “Consumer” Welfare ........................................................................ 18

IV. The Legal Treatment of Price Discrimination in the United States ......................... 19
   A. The Original Clayton Act ......................................................................................... 20
   B. The Robinson-Patman Act: Secondary-Line Effects .............................................. 21
   C. Primary-Line Effects ............................................................................................... 22
   D. Robinson-Patman Retrenchment ............................................................................ 25

V. Price Discrimination and the Law in the European Union ........................................ 27
   A. Price Discrimination and Article 82(c) of the EC Treaty ........................................ 27
   B. Comparing Article 82(c) with the Robinson Patman Act ........................................ 30
   C. Price Discrimination Beyond the Article 82(c) Context ........................................ 31

VII. Price Discrimination: An Overall Assessment .......................................................... 42
The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?

Daniel J. Gifford
Robert T. Kudrle

I. Introduction: Laws Targeting Price Discrimination:

The practice of selling the same good at different prices--generally referred to as price discrimination--has not fared well in the legal systems of modern economies. In the United States, price discrimination was attacked by the original section two of the Clayton Act¹ and by its later Amendments.² During the era of transportation regulation, price discrimination was targeted by various laws and regulations that governed railroad, motor vehicle, and air transport rates.³ In Europe, price discrimination is attacked by Article 82(c) of the EC Treaty.⁴ The United States, the European Union, Canada⁵ and dozens of other rich and poor states also target price discrimination in international trade through their anti-dumping and other trade laws.

Why have the laws of the world’s major economies attacked price discrimination? Is price discrimination the social evil that these laws appear to assume? This is not a new issue. Economists and lawyers have been concerned with price discrimination for decades. Their approaches sometimes overlap, but often they do not. Their concerns vary, and the language in which they cast them is frequently different. Economists tend to view price discrimination through the lens of welfare. For much of the twentieth century, antitrust lawyers typically assessed discrimination from a perspective of fairness.⁶ Since the antitrust “revolution” of the late 1970’s,⁷ the focus of the antitrust bar has shifted.

⁴ Treaty Establishing the European Community, art 81(1)(d), 82(c). See discussion of these provisions, infra, in Part V.
Now antitrust lawyers are beginning to view price discrimination as a species of competitive behavior.⁸

Different orientations typically produce different evaluations, and they also may engender misunderstanding, as when unsophisticated lawyers take economists’ disapproval of the welfare-reducing results of, say, third-degree price discrimination in static markets as providing support for legislation like the Robinson-Patman Act or Article 82(c) of the EC Treaty. But the newer focus of the antitrust bar on discrimination as a manifestation of competition may provide a framework in which lawyers’ concern for competition and economists’ concern for welfare mesh into a common stance towards public policy.

In this paper, we attempt to sort out the various critiques of discriminatory pricing that have been made by lawmakers and economists; to assess their validity; and to evaluate an assortment of price-discrimination provisions that are contained in laws of the United States and the European Union. We start by briefly reviewing some of the more prominent approaches taken by economists towards evaluating price discrimination. We proceed to examine the main economic concerns that price discrimination raises. We then explore in some detail the relevant law and policy on the both sides of the Atlantic. The paper concludes with continuing issues and suggestions for their resolution.

II. Economic Conceptions of Price Discrimination: A Brief Review

Economists have examined price discrimination over the years with a somewhat different focus than have lawyers and the legal system. In this section, we examine the economic approach. We consider the economic definition of price discrimination; its prerequisites; and the approaches that economists have taken towards analyzing price discrimination. We emphasize two principal lines of price discrimination analysis. First, starting with Jules Dupuit in the mid-nineteenth century,⁹ is a line of analysis concerned with the pricing of public utilities and carriers. The second, later and more general, line of analysis begins with A.C. Pigou, Alfred Marshall’s successor to the chair in Political Economy at Cambridge University.¹⁰ Pigou developed a typology for examining the ways in which a monopolist might maximize his profits by adopting selling prices that vary based on purchaser or number of units sold.¹¹ Pigou’s typology has been widely

---

¹¹ A.C. Pigou, The Economics of Welfare (1920).
employed by economists to demonstrate the variety of welfare effects that result from different types of price discrimination. We start our review of economic approaches to price discrimination by comparing the economic and legal definitions.

A. Price Discrimination Defined

Although legal and common usage equates price discrimination with a price difference, economists usually attach a different meaning to price discrimination. When economists use the term, they mean that two or more similar goods are being sold at prices that bear different ratios to their marginal costs. The Robinson-Patman Act takes the simpler view of discrimination that a price difference is price discrimination, but it does take costs into account in determining whether a violation has occurred. Thus that Act’s cost-justification defense makes otherwise prohibited discrimination lawful when the price difference does not exceed the difference in cost. Corwin Edwards explained the sources of these two views in his book on the Robinson-Patman Act. The economic view of price discrimination was rooted in the concern that goods and services be allocated to their highest valued uses. The then-prevailing legal view, Edwards described as a “political” one, which was rooted in the concept of equal treatment. In the immediately following paragraph, we contrast these two approaches to price discrimination.

The classic analysis of price discrimination involves action by a monopolist to enlarge profits by dividing the market in such a way that each buyer or class of buyers pays a price closer to the buyers’ reservation prices than would otherwise be the case. Although even the most experienced seller in a Levantine souk cannot “size up” his customers well enough to remove all consumer surplus, this example can be used to probe a priori prejudices about price discrimination. Is the merchant “unfair” by pricing as he does? Assuming that the buyer is assessing the product’s personal value accurately, is she being cheated by paying as much as she is willing to pay? What if you knew that the merchant was earning only a normal rate of return on his skills? We must confront the fact that the superiority of modern fixed pricing is based mainly on efficiency. Individual bargaining is simply too costly in terms of everyone’s valuable time to survive for most transactions in high-income societies. We argue that this efficiency concern and a few others—such as the fact that different purchase prices (relative to cost) mean that

---

15 15 U.S.C. § 13(a) (2000). The focus of the Robinson-Patman Act is thus on absolute values (i.e., whether the absolute value of the cost differences equal or exceed the price differences), while economists focus on ratios (i.e., whether the price/cost ratios are the same). In fact, Stole has avoided this problem with his recent definition: “price discrimination exists when prices vary across customer segments . . . that cannot be entirely explained by variations in marginal cost.” L.A. STOLE, PRICE DISCRIMINATION IN IMPERFECT COMPETITION, December 22, 2003 at 1.
goods are not allocated to maximize welfare—and not “fairness” should underlie antipathy towards price discrimination.\textsuperscript{17}

\textit{The Pigovian Typology.}

In his classic 1920 statement, \textit{The Economics of Welfare},\textsuperscript{18} A.C. Pigou identified three categories of price discrimination and assessed their effects. This are summarized below.

1.) \textbf{First-degree price discrimination}. First degree price discrimination involves charging every customer that person’s maximum willingness to pay for each unit of the product sold – this removes all “consumer surplus,” the usual excess of value that people get from buying multiple units of a good at a fixed price. In theory and, if perfectly carried out, however, first degree price discrimination would generate no deadweight loss.\textsuperscript{19} First degree discrimination can only be roughly approximated and only in specialized circumstances.

2.) \textbf{Second-degree price discrimination}. Second degree price discrimination describes the practice of setting two or more prices for a good depending on the amount purchased; the most familiar variant is the two-part tariff where there is an entrance fee into the market followed by a single price for all units purchased. Two or multi-part pricing is often used to increase output in a regulated monopoly while allowing total costs to be covered by total revenues. All buyers do not typically face the same price for marginal purchases under second degree price discrimination, however, a result that generates allocative inefficiencies. For example, if there are two or more prices, one for a set of initial units and a lower charge or charges for succeeding blocks, not everyone has sufficient demand to get past the first high price range, and increasingly rightward demand curves are likely to confront successive lower prices implying that everyone does not adjust purchases to the same marginal price. As a result, goods are not being allocated to their highest valued uses.

3.) \textbf{Third-degree price discrimination}. In third-degree price discrimination, a seller identifies separable market segments, each of which possesses its own demand for its product. The seller, accordingly, sets price for each segment in accordance with that segment’s demand elasticity. Joan Robinson\textsuperscript{20} demonstrated that a monopolist’s output (remains constant with linear demand curves whether or not the monopolist discriminates, and because under discrimination that output is misallocated by comparison with sales at a single monopoly price, the latter is superior in welfare terms. She also discovered that, when demand is not linear, output will expand when the more elastic of the two markets

\textsuperscript{17} The most widely accepted benchmark for antitrust – at least for non-economists –is the consumer surplus standard, and it rests on a notion of fairness: that only the welfare of buyers (and not sellers) counts. As a practical matter, however, it diverges only seldom from the total surplus standard.

\textsuperscript{18} \textsc{pigou}, supra note 11, at _.

\textsuperscript{19} A deadweight loss results in situations in which price and marginal cost are not equated.

\textsuperscript{20} \textsc{joan robinson}, \textit{the economics of imperfect competition} (1933).
is relatively convex (to the origin).21 This implies that, under discrimination, overall welfare can improve only if output expands enough to outweigh the inefficiency of different marginal prices when sales occur in both markets at the simple monopoly price. When the “weaker,” i.e. more elastic market is not served at that price, however, discrimination increases welfare even with linear demand curves. This is easily seen because in this case (1) discrimination leaves the “stronger” market unchanged and output expands in the “weaker” market; and (2) there is no uniform price at which the seller would choose to serve the second market. Because the relative demand elasticities of different markets vary, no further general propositions about the welfare effects of third-degree price discrimination are possible.

Schmalensee refined Robinson’s criterion for output expansion when both markets are served under discrimination and concluded that “[i]f one thinks that demand functions are as likely to be concave as convex, recognition of this effect, combined with the result that discrimination could lead to a “weak” market being served that would otherwise not be, would lead one to conclude that total output is more likely to be increased than decreased by allowing a monopoly to practice third-degree discrimination.”22 But he then immediately demonstrates that output expansion is only a necessary but not a sufficient condition for welfare expansion; output must expand more in the “weak” market that it contracts in the “strong” one because each unit is more highly valued in the latter.23

B. Arbitrage, Market Power and Price Discrimination

1) Arbitrage. All price discrimination turns on the infeasibility of arbitrage. Arbitrage occurs when buyers in the low-priced market resell in the high-priced market. To the extent that arbitrage is feasible, it would eventually bring the price levels of the different markets to the same level. In so doing, arbitrage would produce two effects: First, arbitrage would route the goods involved to their highest-valued users, thereby eliminating an inefficiency connected with discrimination and increasing welfare. Second, as arbitrage narrowed the difference between prices in the two markets, it would also be eroding the profitability of discriminatory selling. When prices in the two markets reached the same level, price discrimination would no longer be possible. Arbitrage is

21 Her precise criterion for overall output expansion, “the adjusted concavity ratio,” however, was not satisfactory. (See E.O. Edwards, The Analysis of Output Under Discrimination, 18 ECONOMETRICA 163 (1950); Schmalensee, Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination 17 AMERICAN ECONOMIC REVIEW 242 (1981)) When the aggregate demand curve in the linear case is established by adding two (or more) curves linearly, increased profitability requires that average revenue from discrimination must be greater than average revenue from simple monopoly. But the aggregate marginal revenue curve has twice the slope of the aggregate demand curve and its position depends only on a constant times total output. When demand is not linear, however, the position of the aggregate marginal revenue is no longer so simply determined. It is now a function not only of the total output across both (all) submarkets but of terms that contain the volume of sales in the individual markets; hence its intersection with marginal cost is not independent of the shapes of the individual demand curves.

22 Id., at 245. Schmalensee, supra note 21, at 245.

23 Id., at 246.
impractical in certain sets of circumstances: First, arbitrage is impractical or difficult when the good involved is not easily resold (as has been the case, until recently, for electricity), and arbitrage is generally impossible for most kinds of services. Second, there can be no arbitrage when the cost of transportation from one market to another (or other impediments) exceeds the price differential.

2) Market Power and Monopoly Power

In 1934, Abba Lerner offered a definition of “monopoly power” that focused attention on the common characteristic of sellers in imperfect competition: some power over price. Whenever a firm faces a downwards sloping demand curve for any reason, it possesses power over price, which, in Lerner’s usage is “monopoly power”. Lerner’s measure is inversely related to the elasticity of demand, the index falling as demand elasticity increases. Thus Lerner’s “monopoly power” exists whenever a seller markets a differentiated product, regardless of the number and volume of competing goods and regardless of the firm’s profits or (short-run) losses. The Lerner index, of course, will be lower as the competition to which the firm is subjected increases in intensity because, in that situation, the demand for its product will become increasingly elastic. 24

Lerner’s article appeared several years after the advent of Chamberlin’s The Theory of Monopolistic Competition. In that book, Chamberlin analyzed the effects of competition, first, among a substantial number of rivals offering heterogeneous products, 25 and, second, among a smaller group of rivals also selling heterogeneous products. 26 Most economists today reserve the term “monopolistic competition” for Chamberlin’s large group whose sellers typically lack substantial power over price. Lerner presumably used the term “monopoly power” because he wanted to stress the widely varying relation that can exist between prices and marginal costs across monopoly, oligopoly, and monopolistic competition. 27 Except for the definitional zero-profit condition of the third structure, the Lerner index allows for any level of profitability in the long-run (monopolies and oligopolies are not always profitable). But Lerner was not concerned in this article with policy towards profits, a central focus of industrial organization economists and lawyers.

Even though Lerner employed the term “monopoly power” to refer to all situations in which price exceeds marginal cost, others have used that term differently. A leading industrial organization textbook, for example, uses that term to refer to situations of supra-normal profits, while employing the term “market power” to describe firms that only break even. 28 Still others employ the term “monopoly power” to refer to the power

24 Thus while Lerner employed the language of “monopoly power”, he was providing a measure of the degree of that power. See discussion in Gregory J. Werden, Demand Elasticities in Antitrust Analysis, 66 ANTITRUST L.J. 363, 372 (1998).
25 EDWARD H. CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION, 81-100 (1933).
26 Id., at 100-04.
27 The very term “monopolistic competition” isolates price inelasticity as the “monopolistic” element and zero long-run profits as the “competitive” element.
28 DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION, 93 (4TH ed. 2004).
of a seller controlling the entire supply of a good, and “market power” to refer to a
significant power over price, even though less than that possessed by a firm controlling
the entire supply. In fact, “market power” is the term used by most competition policy
economists to describe the target of their efforts.\(^\text{29}\)

Most competition policy aims to control supernormal profitability. Profitability, in
turn, is simply the difference between total revenue and total cost denominated by some
measure of invested capital considered over a certain period of time. If average total cost
is equal to marginal cost, the Lerner index would accurately gauge relative profitability
across industries if the ratio of total sales to owners’ investment does not vary. Not only
does this ratio vary greatly, however, but industries also vary enormously in the ratio of
variable to fixed or sunk cost. Moreover, at any given time, short-run marginal cost may
be above or below its long-run value, so any simple use of the ratio of price to marginal
cost as an index of profitability can be completely misleading. Nonetheless, the Lerner
index is related to profitability in this way: the reciprocal of the Lerner index is demand
elasticity and all else equal, less elastic demand leads to a higher profitability.

“Monopoly power,” which in ordinary language might suggest a stronger version
of “market power” is still widely used in precisely the way Lerner originally used it and
may refer to situations that are utterly innocuous from a policy point of view. Conversely, the term “monopoly power” is also often used to suggest something stronger
than “market power,” especially in the antitrust caselaw: “Monopoly power under §2 of
[the Sherman Act] requires . . . something greater than market power under §1.”\(^\text{30}\) Einer
Elhauge points out that while the courts may effectively use the term “monopoly power”
as involving a “significant” or “substantial” degree of market power, market power under
section one is “normally defined as not just any ability to raise prices above competitive
levels but an ability to raise prices ‘substantially’ over those levels.”\(^\text{31}\) Thus Elhauge
concludes:

“We are thus left with a standard that defines itself as requiring a
substantial degree of a sort of power that is itself defined to exist only
when substantial. This builds vagueness upon vagueness.”\(^\text{32}\)

In still other instances, writers apparently apparently intend their usages of the terms
“monopoly power and “market power” to be synonymous.\(^\text{33}\) We are in no position to
clear up the language. We can only counsel careful attention to what the writer intends.

\(^{28}\) Id at 643. After setting forth their distinction between monopoly power and market power, the authors
observe that “. . . people do not always make this distinction and generally use the two terms
interchangeably, sometimes creating confusion.” As if to verify the latter point, the same textbook later
uses the term “market power” in the context of policy interventions that clearly aim at supernormal profits.
Id., at 643.

\(^{29}\) For example, Philip B. Nelson & Lawrence J. White, Market Definition and the Identification of Market
Power in Monopolization Cases: A Critique and a Proposal, Stern School of Business, New York
University, Department of Economics Working Paper EC-03-26, November 2003.

\(^{30}\) Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451, 481 (1992); Gregory Werden states
that “Circuit courts have commonly distinguished ‘market power’ from ‘monopoly power’ as a matter of
degree and the Supreme Court has used the two terms in essentially this manner.” Gregory Werden,


\(^{32}\) Id.
3) Price Discrimination and Profitability

The confusion grows as price discrimination is considered in the context of a firm’s power over price and its profitability. Judge Richard Posner, for example, recently referred to the association between price discrimination and profitability when he wrote that:

Price discrimination implies market power, that is, the power to charge a price above cost (including in "cost" an accounting profit equal to the cost of equity capital) without losing so much business so fast to competitors that the price is unsustainable. The reason price discrimination implies market power is that assuming the lower of the discriminatory prices covers cost, the higher must exceed cost.\(^{34}\)

Unfortunately, while Posner is using “market power” the way most industrial organization economists use it, the statement misleads exactly because the second sentence assumes that the lower price of a discriminating seller must cover cost. It must at least cover marginal cost, but need not exceed average total cost. Profitability results only when the revenue generated by total sales (including both sales at the lower and higher price levels) exceeds total costs (including fixed or sunk costs). Price discrimination increases the seller’s revenue (otherwise he would not engage in discrimination.) But nothing guarantees that a seller’s maximum revenue exceeds its total costs. Since there is no necessary association between price discrimination and profitability, it cannot surprise that discrimination can be practiced even by unprofitable firms (only in the short-run, of course).\(^{35}\) Moreover, the “market power” requisite to practicing price discrimination can be exceedingly low.\(^{36}\) Since sellers in most commercial markets face downward sloping demand curves for their products, it is probably accurate to say that (so long as arbitrage can be controlled), price discrimination is possible in most markets. Indeed, as the discussion below shows, economists have come to see that price discrimination can be a principal instrument of competitive behavior.

C. Price discrimination involving the rates of public utilities and carriers.

---

\(^{33}\) R.S. Pindyck & D.L. Rubinfeld, Microeconomics, 6th Ed. 2005 at 340. These and other writers use market power to refer to both monopoly and monopsony power where both concern power over price and not profitability.

\(^{34}\) In re Brand Name Prescription Drugs Antitrust Litigation, 186 F.3d 781, 783 (7th Cir. 1999).


\(^{36}\) Elhauge, supra note _ at 258 (“the price discrimination normally taken to evidence market power is so ubiquitous that it would indicate market power exists everywhere.”) See also William J. Baumol & David G. Swanson, The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power, 70 Antitrust L.J. 661 (2003).
The focus of much of the early analysis of price discrimination involved the charges of public utilities and carriers and how to generate sufficient revenues to cover fixed costs while maximizing production that was valued at equal to or greater than marginal cost. This implies that the central problem faced by regulators in public utility pricing is how to generate sufficient revenues to cover all of the utility’s costs while otherwise keeping those charges to a minimum. In the many years over which scholars have addressed the problem of maximizing welfare subject to a no-loss constraint, some form of price discrimination has been the answer.

In the mid-nineteenth century, Jules Dupuit, who supervised the inspection of French bridges and highways, focused much of his attention on the use of discrimination as a means for increasing both usage and toll revenues from these public works. His focus, which was upon the use of discrimination as a means for inducing greater usage of the industry’s product, led him to view what Pigou would later characterize as first-degree discrimination as the ideal, but because of the difficulties in implementing first-degree discrimination, Dupuit opted for the use of third-degree price discrimination as the vehicle by which output would be increased and welfare enhanced.

Later in the nineteenth century, F.W. Taussig concluded that because most costs of a railroad are joint costs that cannot be allocated to any particular shipped commodity, railroad pricing is almost necessarily based upon the varying elasticities of demand of the commodity shippers. So long as the rate for a particular commodity exceeded the marginal costs attributable to that particular commodity, the rate would be set at the level that the traffic would bear (i.e., at the profit-maximizing price for that commodity) and the excess over marginal cost would contribute to the coverage of the railroad’s fixed costs. Taussig’s conclusion thus was that a discriminatory pricing schedule was required for a railroad in order to cover its overall costs. Pigou challenged Taussig’s cost analysis but came to a similar conclusion about pricing. F.P. Ramsey addressed the problem of meeting a revenue constraint with the most efficient set of charges in 1927. Ramsey’s analysis – now widely employed by public-utility regulators – indicates that welfare will be maximized subject to the condition that revenues cover the utility’s costs, if rates are set on each class of customers in inverse proportion to the demand elasticity of that customer class. The Interstate Commerce Commission practiced a version of regulated pricing prior to railroad deregulation in the United States. Variants of Ramsey pricing are also widely practiced in Europe.

---

37 This assumes that when marginal cost equals marginal benefit, total benefit also exceeds total cost; this condition is typically met.
38 See Robert B. Ekelund, Jr., Price Discrimination and Product Differentiation in Economic Theory: An Early Analysis, 84 Q. J. ECON. 268 (1970). This description of Dupuit is drawn primarily from Ekelund’s commentary. See also Baumol & Swanson, supra note _ at 671.
39 For definition of the degrees of Pigovian discrimination, see p. 8 infra.
The natural monopoly problem can also be addressed by Pigovian second degree price discrimination such as the “two-part tariff” which involves a lump-sum entry fee plus another charge for each unit purchased. Such pricing could eliminate the inefficiency resulting from different marginal prices for different buyers (which characterize Ramsey pricing) but only if the first charge is set low enough not to exclude a significant number of potential purchasers. Moreover, all publicly regulated prices are subject to political influence, and the potential of devices such as two-part pricing are often totally lost as a result. For example, telephone subscribers typically pay a charge for connection to the network and also pay rates that are keyed to their use of the telephone service. Yet the connection cost frequently is less than the telephone company’s marginal cost of establishing the connection (especially in new residential or commercial developments in outlying areas), and the use charges generally exceed the marginal cost of usage, inefficiently discouraging use and subsidizing connection charges. 45 Whether actual regulation employing non-linear pricing typically increases or decreases welfare relative to feasible alternatives is not clear.

In summary, the economic literature on the welfare effects of price discrimination under monopoly can be usefully divided between unregulated and regulated outcomes. Price discrimination by unregulated private monopolies is most appropriately benchmarked by comparison with a situation in which such behavior is either banned or infeasible. An increase in output provides a necessary condition for social improvement which, if sufficiently small, might be overbalanced by the negative welfare effects resulting from all consumers not facing the same marginal prices if third degree price discrimination is practiced. A consumer surplus standard would judge the two situations by whether consumer surplus increases, a more stringent test. The most likely situation of substantial social gain from third degree discrimination by both measures results from a “weaker” market being served under discrimination with no change in the “stronger” one. And it is even possible that no output would be possible at all without third degree price discrimination. For example, prior to the widespread development of medical insurance, if a doctor in an isolated rural area could not charge more to the rich and less to the poor, he might not have been able to earn a normal return on his own (mainly human) capital, and no medical services would have been offered at all.46

E. Price Discrimination by Multiple Firms

The welfare effects of price discrimination by both regulated and unregulated monopolies deserve attention, but monopoly sellers are a small part of all economies. Most price discrimination everywhere results from competition against other firms. We must therefore determine when this enhances social welfare and when it does not.

46 This is an unregulated result that closely resembles Ramsey pricing.
Although Robinson, Schmalensee, and Varian added considerably to Pigou’s treatment of third degree monopoly price discrimination, the formal analysis of multi-firm markets did not appear until quite recently. Borenstein used simulation to demonstrate some suggestive results, and Holmes developed the first complete analytic presentation of an important special case.

If identical members of an oligopoly engage in lock-step “monopoloid” behavior, the outcomes are trivial variants of the monopoly case. Instead, Holmes investigates the case of a differentiated duopoly of a particularly simple kind: although the outputs of each firm are by assumption not identical, their costs and demands (within each of two markets) are conveniently treated as being the same (as in Chamberlin). Holmes assumes Bertrand competition, that is, each firm sets its price on the assumption that the price of the other firm is fixed. Although the model is very simple, the range of clearly developed possible outcomes is so broad as to provide virtually no guide for policy intervention. For example, Holmes demonstrates that optimal firm price depends on both overall market demand and intra-market cross-elasticity.

Differing intra-industry cross-elasticities across sub-markets might overbalance differences in industry elasticity for the combined outputs of the firms at identical prices. This means that when cross-elasticities between the firms differ sufficiently between the two markets, the price-cost margin can be higher in the (aggregately) “weaker” market producing a price ordering that would be the reverse of what would be established by a discriminating monopolist, although all prices would be still be lower in both markets than would be case under monopolistic price discrimination. These complications add to those resulting from ambiguity in output change with non-linear demand under discriminating monopoly. Therefore, even granting the other simplifying assumptions, only a detailed knowledge of demand conditions in specific submarkets would allow a confident judgment about the welfare impact of price discrimination.

Holmes’s model was a great advance, yet most patterns of actual discriminatory pricing rest on conditions at variance with his assumptions. For example, Corts relaxes the assumption that each firm faces the same cross-price elasticity within each submarket. As Holmes anticipated, this can change everything. For example, firms in a duopoly may have differing views about which is the strong and which is the weak market, and this could lead to lower prices in both submarkets. Unfortunately, for those seeking robust guidance for policy design, the same logic suggests that discrimination

47 ROBINSON, supra, note 17; Schmalensee, supra note 18; H.L. Varian, Price Discrimination and Social Welfare, 75 AMER. ECON. REV. 870 (1985).
50 CHAMBERLIN, supra note__ at __.
51 Holmes establishes that the elasticity of demand facing each firm in each submarket is the inverse of the sum of 1) the industry elasticity of demand and the 2) cross-elasticity of demand between the firms. Id., at 246.
53 Holmes, supra note 23 at 250.
could lead to *all* prices *rising*. But Corts demonstrates that if not every firm in an oligopoly regards the same submarket as stronger, “there is the potential for unilateral incentives towards more aggressive behavior in each individual market for some firm, and if the strategic complementarity of such aggressive pricing is strong enough, prices may fall in every market.” Although their models are different, both Holmes and Corts suggest situations in which discrimination can lower the profits of both or all firms, and those firms would therefore favor constraints that prevent discrimination across submarkets.

Monopoly models of all kinds share the great advantage that they simply assume overall “industry” demand without trying to explain it. The advantage remains when monopoly is replaced by simply posited duopoly or oligopoly. But in applying models, identifying the range of relevant actors on both sides of the markets is often not obvious. For example, in one scenario Corts considers a set of sellers discriminating temporally through periodic sales, which, in turn, intensifies competition with firms that sell similar goods at consistently lower prices. The introduction of the periodic sales drives down the prices of the consistently cheaper firms still further. In the real world, it is clear that the number, aggregate market share, and cohesion of the set of firms engaging in such temporal third degree price discrimination as well as the number, share and cohesion of their consistently lower priced rivals would likely vary greatly across geographic markets.

The academic literature establishes definite welfare results for price discrimination only for a small set of well-defined cases, which, in general, would be hard to identify in the real world. In addition, as soon as one tries to marry any insights from formal models with the facts of actual situations, the specific context in such dimensions as seller cohesion and entry conditions adds so much complication that the application of special theoretical insights appears to be almost a matter of faith. This may be particularly true where markets are separated spatially with a varying set of established firms playing the role of best placed potential entrants (a typical situation not just within national markets but as characteristics of increasing “globalization”). Such potential participants may induce price restraint in tacitly collusive oligopoly, and, when and if entry takes place, may diminish the previous level of effective cohesion on a range of behaviors including price-setting.

The economic literature as a whole suggests that, absent sufficient entry and sufficiently intense price competition, many counterintuitive and seemingly perverse results are possible. Price discrimination can clearly lower welfare in some circumstances, but this does not leave us undecided about policy. We think that the law should view the possibility of harm from price discrimination with greater skepticism that it presently

54 Corts, *supra* note 26 at 321.
55 Holmes, *supra* note 23 at 249; Corts, *supra* note 26 at 321
56 Corts, *supra* note 26 at 308.
57 In a recent survey of price discrimination and oligopoly by Stole (*supra* note 4), a wide variety of models are developed including those that allow for entry. Far more often than not, whether price discrimination increases or lowers welfare depends on parameter values in a way that is difficult to summarize; the survey offers discouragingly little in the way of policy-relevant generalizations.
does. For example, Judge Posner is famous for having observed that “The purchaser to whom the discriminating seller sells at a lower price may be no more efficient than the competing purchaser who is charged a higher price”. But this formal possibility does not provide a good basis for policy. Where is the evidence that equally efficient retailers have often been harmed by discrimination, or that final output has diminished?

Greenhut and Ohta, leading scholars of spatial competition, note that “... a laissez-faire approach in place of anti-trust restrictions on spatial pricing would allow firms to select the price policy that conforms best to the market conditions to which they are subject. *Ceteris paribus*, output would be maximized under the spatial price policy that happens to maximize the profits of the representative firm.”

We also think it is significant that economists writing on price discrimination from an empirical perspective almost always stress the use of discrimination as a welfare-improving competitive weapon. For example, Corts admits the possibility of negative results, but he emphasizes in conclusion: “Competitive price discrimination may intensify competition by giving firms more weapons with which to wage their war. Allowing firms to set market-specific prices through discrimination breaks the cross-market profit implications of aggressive price moves that may restrain price competition when firms are limited to uniform pricing.” And, while acknowledging the possibility of other results, O’Brien and Shaffer attack the Robinson-Patman Act by stressing the pervasiveness of bargaining in intermediate good markets and the consequently misleading models that ignore this reality. They argue that forbidding price discrimination “constrains the bargaining process by inhibiting buyers from seeking marginal price concessions that lower retail prices.”

Economists have recognized for decades that oligopolistic pricing is likely to foster secret price-cutting. In his seminal article on oligopoly, George Stigler presented a theory tying the vulnerability of oligopolistic pricing to the market-share dispersion of its members because small sellers can cheat with less chance of detection. As Stigler argued, oligopolistic pricing breaks down when members depart from the target pricing levels that its members have tacitly agreed upon. While it is in the collective interest of its members to maintain the oligopolistic price, each of its members has an incentive to increase its profits by increasing its own sales, if it can do so without immediately undermining the oligopoly. In any particular case, therefore, the question is whether an

58 R. A. POSNER, ANTITRUST LAW, 2ND ED. (2001). Part of Posner’s objection to price discrimination also derives from his continuing concern that increased monopoly profits lead to greater social waste generated by attempts to appropriate them. Not only has this hypothesis not been treated kindly by economists, however, but assumptions informing his discussion ignore the role of discrimination in rapidly changing markets – just the problem considered in much of the literature.


60 Corts, supra note 26 at 329.


oligopolist can reduce its price in order to make an attractive sale while keeping information about its price-cutting from the other members of the oligopoly.

Stigler also points out that sellers tend to seek out larger (rather than smaller) purchasers for the selective price cuts that will expand their volume while minimizing the possibility of detection by other members of the oligopoly. If the probabilities of detection for any one undercutting sale are approximately the same, those sellers who concentrate their sales efforts on larger buyers maximize the ratio of their sales volume to the risk of being detected. An attempt to obtain the same volume by sales to smaller buyers would increase the chances of detection exponentially. The result is that smaller buyers generally pay more to oligopolistic sellers than do larger buyers. In Stigler’s words:

It follows that oligopolistic collusion will often be effective against small buyers even when it is ineffective against large buyers. When the oligopolists sell to numerous small retailers, for example, they will adhere to the agreed-upon price, even though they are cutting prices to larger chain stores and industrial buyers.

Stigler presents a case in which the general welfare is served by practices that disadvantage smaller resellers. Such selective price cutting is a mechanism through which the behavior of sellers, seeking to expand their profits, is likely to lead to a general reduction in the price level. Antitrust policy, therefore, should encourage that practice.

In a recent article in the Antitrust Law Journal, William Baumol and Daniel Swanson have argued that not only is price discrimination compatible with competition, but that in industries characterized by high fixed costs—especially industries characterized by repeated high-fixed-cost investments—competition would compel producers to engage in differential pricing. This practice parallels the familiar predicament of some unregulated utilities and carriers facing the necessity to raise sufficient revenue to cover their fixed costs. When arbitrage is impossible, third degree price discrimination is a way of increasing revenue relative to cost—that is of increasing profit. Baumol and Swanson point out that when such industries are characterized by intense competition, each firm is likely to find its price structure under intense downward pressure resulting in each firm engaging in price discrimination “across distinct and non-trade compartments” but earning zero profits in the long run. Hence, in this special case, the invisible hand produces an outcome similar to Ramsey pricing.

III. Identifying Concerns Over Price Discrimination.

63 Id., at 47.
64 Id.
66 Id, at 665.

As the discussion above has shown over the century before World War II, economists focused on price discrimination as a technique for enlarging monopoly profits generally and also as means by which capital-intensive utilities and carriers could cover their fixed costs. In fact, it is likely that elite opinion in the West concluded that price discrimination was legitimate only under public control. This certainly seems to have been the dominant view among lawyers until quite recently. Careful economists, however, have always considered increasing the size of the pie (greater efficiency) and the allocation of its pieces (equity) separately. Both second and third degree price discrimination (first degree is seldom feasible) can often increase efficiency. Moreover, economists starting with Robinson were able to develop special cases in which all prices could fall under discrimination, or rise only for the relatively well off, so both efficiency and dominant views of equity could sometimes be satisfied at once. But this was all prologue to the consideration of discrimination in multiple firm contexts. When economists confronted price discrimination as an element of competitive strategy, they found a wide range of possible outcomes in which such behavior both increased efficiency and lowered prices for final purchasers. But the fate of agents other than a product’s maker and a final purchaser also had to be considered.

B. Fairness

Even as economists were examining the effects of price discrimination on welfare, lawyers were assessing its “fairness”. Indeed, lawyers--and the public at large—had tended to view price discrimination as raising fairness concerns, at least since the late nineteenth century. When Congress responded to the agitation of farmers and others with legislation prohibiting the railroads from discriminating in their hauling charges, it described the practice of discrimination as unfair. During the early twentieth century particularly, lawyers tended to focus upon the disadvantages faced by business firms that paid more for a product than did one or more of their rivals. This disadvantage again was perceived as “unfair”.

During this same period, lawyers also tended to reinforce their intuitive sense of unfairness with norms drawn from the operation of competitive markets. Under those...

---

68 See, e.g., New York, New Haven & Hartford R. R. v. ICC, 200 U.S. 361, 391 (1906) (“[T]he great purpose of the act to regulate commerce . . . was to secure equality of rates to all, and to destroy favoritism . . .”)
69 Thus the House report on section 2 of the CIAct spoke of discrimination (albeit predatory discrimination) as unfair. H.R. Rep. No. 627, 63d Cong., 2d Sess. 6 (1914). See also Charles G. Hainer, Efforts to Define Unfair Competition, 29 YALE L.J. 1, 2 &n.4 (1919).
70 See CARL KAYSEN & DONALD F. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS 16 (1959). Writing at mid-century, these antitrust scholars recognized that one understanding of “fairness” was...
norms, price discrimination would be viewed as unfair, because (in addition to intuitive reasons) it was inconsistent with the conditions that would characterize a perfectly operating competitive market, where all purchasers would pay the same price for any given product.\footnote{71} Finally, during that period, a widely shared view among lawyers was that the antitrust laws incorporated fairness norms,\footnote{72} most of which were inferred from competitive market operations (in the manner explained above).\footnote{73} Thus business firms that possessed the power to discriminate were perceived as acting both anti-competitively and unfairly. For example, Standard Oil Company’s practice of selling at higher prices in some geographic markets than in others was condemned as both anti-competitive and unfair.\footnote{74}

This equation of unfairness with anti-competitive behavior was also used to justify the antidumping laws of that period. When Congress enacted anti-dumping laws, it portrayed its legislation as directed against unfair practices.\footnote{75} Congress probably believed that German chemical and steel cartels were selling at monopoly prices in their home market and at marginal-cost prices in the United States,\footnote{76} and it viewed those practices as “unfair” to domestic manufacturers.\footnote{77} Indeed, the anti-dumping laws continue to be directed towards ensuring that foreign goods are sold at “fair value” in the United States.\footnote{78} This concern, moreover, was emphasized in the Tariff Act of 1922, which contained provisions directed against “unfair methods of competition” and “unfair acts in the importation of articles into the United States.”\footnote{79} The “unfair” methods of competition and “unfair” acts included dumping, i.e., international price discrimination.\footnote{80} Public discourse about trade legislation continues to be permeated with references to “fairness” in trading relationships to this day.\footnote{81} This is not surprising, because all interest groups seek to cast their positions in favorable language. And it has been easy for protectionist interests to describe their position in the language of fairness.

\footnote{72} Kaysen & Turner, supra note _ at _ (“Fair dealing” as a standard of business conduct is now and historically has been an important element of antitrust law.”)
\footnote{73} Kaysen & Turner, supra note _ at 45-46. See also Eyal Zamir, The Efficiency of Paternalism, 48 VA. L. REV. 229, 246 (1998) (describing the competitive-market model).
\footnote{74} H.R. Rep. No. 627, 63d Cong., 2d Sess. 8 (1914); S. Rep. No. 698, 63d Cong., 2d Sess. 2-4 (1914).
\footnote{75} H.R. Rep. No. 479, 66th Cong., 2d Sess. 1 (1919) (describing pending antidumping legislation as direct against “discriminations and unfair practices from abroad”).
\footnote{80} Gifford, supra note 70 at 295.
The treatment of price discrimination in international trade law essentially abandons concern for domestic welfare completely and focuses exclusively on the welfare of domestic producers. Laws against “dumping” use some measure of the home market prices of foreign sellers as benchmarks, forbidding the foreign sellers from pricing below those benchmarks. The market actually benefiting from the discrimination objects because its producers are disadvantaged. When there is a problem of predatory pricing in a specific market, such behavior should be attacked by a state’s competition laws. Widespread imitation of American legislation has resulted in similar laws in most modern and many developing countries.\textsuperscript{82} “Antidumping” is an element of trade law that essentially turns competition policy on its head.\textsuperscript{83} Little more can be said except that such laws should be abandoned as soon as politically feasible. This means that they will almost certainly be bargained – rather than given – away.

Like international trade measures and laws directed against international price discrimination, antitrust legislation, during its first eighty years, had been associated with issues of “fairness.” Indeed, in the antitrust context, the rhetorics of competition and fairness had often blended together. Normal competitive behavior has been seen as “fair” and thus opposed to monopolistic behavior which has been seen as “unfair.” The language of fairness was explicitly incorporated into the Federal Trade Commission Act in 1914,\textsuperscript{84} when, in Section 5, the Congress prohibited “unfair” methods of competition. In the early twentieth century, observers often viewed the Sherman Act’s strictures against monopolization as protections against big business treating small businesses unfairly.\textsuperscript{85}

The historical preoccupation of lawyers with fairness issues generated by price discrimination provided them with a very different perspective from those of economists concerned with the welfare effects of discrimination. These different perspectives are reflected in their different vocabularies. The terms “welfare” or “aggregate welfare” have not been part of the traditional legal vocabulary. Until the “antitrust revolution” of the 1970s when the furtherance of “consumer welfare” was recognized by the courts as the ultimate goal of antitrust law, the closest analogue in the professional vocabulary of


\textsuperscript{83} Lipstein argues that moving some procedures towards “dumping” closer to those used for the Robinson-Patman Act would be an improvement (though he disapproves of both). R. A. Lipstein, \textit{Using Antitrust Principles to Reform Antidumping Law}, in E.M GRAHAM AND J.D. RICHARDSON, EDS. GLOBAL COMPETITION POLICY, 1997. Our argument applies equally to “countervailing duties” that allegedly protect domestic producers from low prices due to foreign government intervention. In both cases, as Milton Friedman so memorably put it, “we should just smile and say ‘thank you.’” Third degree price discrimination does not, of course, lead to maximum welfare worldwide. But those with high prices, not low prices, have the national interest incentive to fix the problem. And they can do so by discovering why arbitrage into their markets fails to erase any price differences not based on differing cost.


\textsuperscript{85} [cite]
lawyers to the economist’s “welfare” had been perhaps the “public interest”. The latter term, however, lacks the precision of the former, and is less amenable to quantification. Not surprisingly, even today government officials and politicians frequently refer to the public interest but rarely to welfare or aggregate welfare. The rhetoric of fairness that lawyers and officials have employed also carries a potential for obscuring the tension between the desires of politically active constituents and their lobbyists, on the one hand, and the interests of the mass of citizens, on the other. Indeed, goals that can plausibly be described as “fair” often reduce aggregate welfare.

C. Efficiency and “Consumer” Welfare

With the antitrust revolution of the late 1970s, the focus of the American antitrust bar shifted to efficiency as the ultimate antitrust concern. Fairness has largely disappeared as a factor in antitrust analysis. Because welfare is maximized as efficiency is maximized, the new focus of the antitrust bar on efficiency necessarily is also a focus upon welfare, if only by implication. As a result, the antitrust bar now largely approaches price discrimination from an efficiency or welfare perspective. This shift moves legal practitioners closer to economists in assessing the impact of price discrimination. As economists shift their focus away from a static analysis of price discrimination by a monopolist towards the dynamic effects of discrimination in competitive settings, the orientation of lawyers and economists are beginning to converge.

Despite this convergence, however, things are not quite so simple. Although efficiency is now widely referred to as the ultimate norm underlying antitrust law by antitrust practitioners, academic lawyers, and the courts, the courts also have repeatedly stated the ultimate goal of antitrust law as the furtherance of “consumer welfare.” But the legal use of this latter phrase is ambiguous. Robert Bork in his influential book, The Antitrust Paradox, equated consumer welfare with efficiency and aggregate welfare by equating “consumers” with everyone, including both consumers (narrowly defined) and producers. Yet many courts appear to use that phrase in the narrower, more familiar sense, equating (in the analysis of particular transactions) consumer welfare with the surplus of final purchasers (consumer surplus). In the EU the consumer surplus standard completely dominates the aggregate welfare standard.

---

86 KWOKA & WHITE, supra note 6.
87 Aggregate welfare is maximized when the net of allocative and productive efficiencies is maximized. When antitrust law fosters net efficiency, therefore, it fosters aggregate welfare. See, e.g., Alan Devlin & Bruno Peixoto, Reformulating Antitrust Rules to Safeguard Societal Wealth, 13 STAN. J.L. BUS. & FIN. 225, 259 (2008); Yedida Z. Stern, A General Model for Corporate Acquisition Law, 26 J. CORP. L. 675, 678 (2001).
89 See Daniel J. Gifford and Robert T. Kudrle, Rhetoric and Reality in the Merger Standards of the United States, Canada, and the European Union, 72 ANTITRUST L.J. 423, 446-50 (2005). As a practical matter, the two criteria lead to differing policy conclusions in only a very few cases.
IV. The Legal Treatment of Price Discrimination in the United States.

It is a truism that lawmakers respond to the demands of their constituents, especially those who have organized effectively and can exert the greatest political pressures. 90 This—and the then prevalent belief that price discrimination was “unfair”—largely explains why Congress viewed price discrimination warily in 1887 when it enacted the Interstate Commerce Act. 91 This responsiveness to a broad base of constituents, the perceived unfairness of price discrimination, and the long-held view that price discrimination was itself anticompetitive behavior, explains why Congress has enacted an array of laws condemning that practice. The Interstate Commerce Act prohibited rail carriers from engaging in “unjust” discrimination, 92 which it equated with charging shippers different amounts for similar service. Congress was responding to widespread dissatisfaction with discriminatory railroad rates, dissatisfaction that had been pressed by farmers’ organizations throughout the 1870s and by manufacturing and commercial interests in the 1880s. 93 The farmers complained that railroads were imposing higher charges where they had no competition than they were when they were subject to competition. 94 In response to these complaints, numerous states had enacted anti-discrimination legislation directed at the railroads, and when the Supreme Court invalidated the state legislation in 1886, 95 Congress responded by enacting the Interstate Commerce Act. Even at this early date, a connection between price discrimination and monopoly had become part of the public consciousness. From a political point of view, discrimination appeared to document monopoly by presenting a clear benchmark against which exploitatively higher charges could be compared. Much of the farmers’ concern would have remained if all producers of the same commodity (or all products) faced the same (hypothetical) monopoly transport prices. The political power of farmers already had been manifested in the so-called Granger Movement which had obtained anti-price discrimination legislation in a number of states. 97 The Interstate Commerce Act was later followed in numerous regulatory acts, many of which contained analogous provisions prohibiting unjust discriminations in the rates charged. 98 In 1914 (and again in 1936), Congress would target price discrimination throughout the entire economy.

92 Id., § 2 (prohibiting unjust discrimination. See also § 1 (prohibiting “every unjust and unreasonable charge”).
94 BUCK, supra note 93 at 14-15.
96 If the differing prices resulted from differing strength of competition, the benchmark would be more meaningful than if differing pricing were based on differing elasticities of user demand (“value of service” pricing). In the latter case, banning discrimination would increase low prices as it lowered high ones.
97 See BUCK, supra note 93, at 123-205 (1913) (describing legislation, inter alia, in Illinois, Minnesota, Iowa, Wisconsin, Missouri, Nebraska, Kansas, California, and Oregon).
98 Motor Carrier Act of 1935; Civil aeronautics Act of 1938, Ch. 601, 52 Stat. 977.
A. The Original Clayton Act

In 1914, Congress passed the Clayton Act,\(^99\) where, in section two, it addressed price discrimination generally. Responding to complaints about the behavior of the Standard Oil Company and the American Tobacco Company, Congress prohibited discrimination in prices where the effect was likely to lessen competition or tend toward monopoly. Committee Reports from both the House and Senate describe these companies as having been engaging in behavior that we now would call predatory pricing. These Reports also asserted that these companies were supporting their predatorily-low prices in some markets from monopoly revenues that they were earning in other markets.\(^{100}\) Scholars have since pointed out that this Congressional understanding was flawed and that the companies probably were not in fact acting predatorily.\(^{101}\) Congress addressed discrimination again in the Antidumping Act of 1916.\(^{102}\) In that legislation, and in subsequent antidumping legislation beginning with the Antidumping Act of 1921,\(^{103}\) Congress sought to prohibit foreign producers from selling their goods in the United States at lower prices than those sellers were charging in their home markets. In the 1916 Act, the prohibition took effect only when the seller was proved to possess a predatory intent. In later legislation, that intent requirement was eliminated.\(^{104}\) The legislative history of the early twentieth-century anti-dumping acts shows that Congress viewed the practice of foreign firms selling in the United States at prices below their home-market prices as “unfair”.\(^{105}\)

In the two decades following the end of World War I, Congress readdressed domestic and international price discrimination and did so in ways that patently reduced the nation’s aggregate welfare. The 1921 Antidumping Act was a harbinger of bad things to come. Congress’s failure to include a predatory-intent element in that Act resulted in a law whose sole object was protectionist: to protect domestic producers from international competition.\(^{106}\) That Act therefore unambiguously damaged national economic welfare. Aggrieved final purchasers under third degree price discrimination are presumably those facing higher prices than those offered elsewhere. Under the several antidumping acts, Americans would be offered the opposite: “fairness” to domestic producers required that they always paid top dollar.

When Congress re-approached domestic price discrimination in 1936, it again revealed a stunning ignorance of, or disdain for, the economics underlying its legislation.

---

100 H.R. REP. No. 627, 63d Cong., 2d Sess. 8-9 (1914); S. REP. No. 698, 63d Cong., 2d Sess. 2-4 (1914).
104 See Antidumping Act of 1921, supra note 103.
106 Antidumping Act of 1921, § 201, supra note 103.
In its 1936 legislation, Congress attempted to protect small retailers from the competition of their larger rivals, especially from the chain stores. Again, this legislation appears to have diminished aggregate economic welfare, whereas its earlier anti-price-discrimination legislation, the Clayton Act of 1914 and the Anti-Dumping Act of 1916, had been directed only against discrimination that contained a predatory-pricing component. (Earlier, in the Interstate Commerce Act of 1887, Congress had targeted discrimination combined with alleged natural monopoly.) Congress subsequently shifted its focus to the protection of competitors.

B. The Robinson-Patman Act: Secondary-Line Effects

The emergence of chain stores, principally in the grocery and drug-store sectors, propelled Congress to enact the 1936 Robinson-Patman Amendments\(^\text{107}\) to the Clayton Act. The proponents of the legislation were the United States Wholesale Grocers Association whose members were losing business to the new chains and small, often family-run, retail grocery enterprises, retail druggists and food brokers that found themselves in competition with the new chains.\(^\text{108}\) The chains were efficiently run\(^\text{109}\) and, because they were able to purchase in bulk, they often were able to obtain their inventories at lower cost than were their more traditional competitors.\(^\text{110}\) The Federal Trade Commission, after studying the operation of the chains, had issued a critical Report on Chain Stores.\(^\text{111}\) That Report and the lobbying efforts of the small retailers and their trade associations persuaded Congress to respond.

When Congress enacted the Robinson-Patman Act in 1936, it sought explicitly to eliminate a “competitive advantage” that it believed the large chain stores unfairly held over the traditional smaller retailers.\(^\text{112}\) Although the term “unfair” does not appear in that Act, the Act itself and its objectives were widely described as directed towards the elimination of this unfair advantage and the imposition of an even playing field between the chains and their smaller competitors. As several courts have stressed, “it is fairness, as Congress perceives it, that Robinson Patman is all about.”\(^\text{113}\)

\(^\text{111}\) Chain Store Report, supra note 110. See Rowe, supra note 108 at 9.
\(^\text{112}\) See discussion in FTC v. Morton Salt co., 334 U.S. 37, 43 (1948) (“The legislative history of the Robinson-Patman Act makes it abundantly clear that Congress considered it to be an evil that a large buyer could secure a competitive advantage over a small buyer solely because of the large buyer’s quantity purchasing ability.”)
\(^\text{113}\) Dagher v. Saudi Refining, Inc., 369 F.3d 1108, 1123 (9th Cir. 2004), rev’d, 126 S.Ct. 1276 (2006); Alan’s of Atlanta, Inc. v. Minolta Corp., 903 F.2d 1414, 1422 (11th Cir. 1990).
During the incubation period of the Robinson-Patman Act, large scale retailers such as A&P clearly benefited from both greater efficiency and superior bargaining power. Innovative resource savings in distribution during this period rivaled other economic advances in quantitative importance. To the extent that the low prices obtained by A&P reflected cost differences, there was no price discrimination in an economic sense. But superior bargaining power was not an illegitimate advantage. A&P’s ability to lower the price of its purchases was correctly cited by John Kenneth Galbraith as an example of “countervailing power” between large buyers and sellers. Strong and increasing retail competition passed most of the savings through to the final purchaser.

The Robinson-Patman Act was aggressively enforced by the Federal Trade Commission until the 1970s. The Supreme Court’s Morton Salt decision assisted both the Commission’s enforcement efforts and plaintiffs in private lawsuits by erecting a presumption of illegality whenever it was shown that a defendant supplier sold goods at different prices to competing merchants. Because the bargaining power of chains purchasing in bulk forced concessions from suppliers, the Act protected small retailers at the expense of consumers. Indeed, the objective of the Act was to burden consumers with higher chain store prices, just as the anti-dumping laws have raised import prices faced by consumers.

C. Primary-Line Effects

The original version of section two of the Clayton Act had been directed against predatory pricing, but the addition of the new Robinson-Patman language expanded the focus of section two to include a concern with protecting the reselling customers of the discriminating seller and their own customer resellers. The Robinson-Patman Amendments did nothing to detract from the Act’s original concern with protecting the rivals of the discriminating seller from the impact of its low prices. Indeed, in the three decades following the enactment of the Robinson-Patman Act, the Federal Trade Commission and the courts began to direct section two against price discrimination whose effects were felt primarily by the seller’s rivals, even when the seller was not acting predatorily as the enacting Congress had envisioned in 1914.

---

114 Adelman, supra note --.
116 J.K. GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (1952)
117 See discussion, supra, text at notes 99-101.
119 See, e.g., ROWE, supra, note 108 at 4.
120 See text, supra, at notes 99-101.
This expansion of the scope of the amended section two against non-predatory price discrimination adversely affecting the rivals of the discriminating seller, so-called “primary line” effects, was related to the confusing language that Congress employed in its Robinson-Patman Amendments. In the amendments, the Congress made price discrimination unlawful where the discrimination might “injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.”122 That part of this language that refers to injuring, destroying or preventing competition with a person who knowingly receives the benefit of discrimination was meant to prohibit discrimination that imposed a competitive disadvantage upon the customers of the discriminating seller.123 The choice of words was particularly unfortunate, however, because the provision appears to equate harm to the customer with harm to competition, when it refers to injuring “competition” with that customer. In so doing, it attributes a meaning to “competition” that is significantly different from its commonly-understood meaning. By an analogous construction of the statutory language, the reference to injuring, destroying or preventing competition with “any person who grants . . . such discrimination” would equate harm to rivals of the discriminating seller with harm to competition, thereby making the discrimination unlawful. For a time extending into the late 1960s, this construction appears to have influenced the way the courts approached claims of primary line injury.124

As antitrust observers have long remarked, competition (as generally understood by business persons, economists, and the public at large) involves business firms attempting to take sales away from their competitors, by undercutting them or surpassing them on the quality or attractiveness of their products. Whenever a firm succeeds in taking business away from one of its rivals, it has “harmed” or “injured” that rival. Injuring rivals by diverting business away from them is competitive activity par excellence. Yet the Federal Trade Commission and the courts soon found exactly that kind of activity unlawful under the amended Clayton Act.

Within the Robinson-Patman Act’s first decade, the Federal Trade Commission had ruled that a company had unlawfully discriminated because its lower prices “have tended to divert trade to the respondent from its competitors.”125 On review of the Commission’s order, the U.S. Court of Appeals for the Second Circuit upheld the Commission, asserting “That these findings supported the Commission’s order is too obvious to admit of discussion.”126 In the course of its opinion, the court construed the statutory language quoted above:

124 See, e.g., cases cited in note 121, supra.
that no doubt means that the lower price must prevent, or tend to prevent, competitors from taking business away from the merchant which they might have got, had the merchant not lowered his price below what he was charging elsewhere.”  

Under the approach of the Second Circuit, proof that a seller sold at two prices was sufficient to raise a presumption of unlawfulness. The defendant seller could overcome that presumption by proving that its low prices did not in fact divert sales away from its competitors (or otherwise bringing itself within one of the Act’s defenses). Although other circuits did not always deem any diversion of sales to be unlawful, they (and the Commission) tended to find a seller’s discriminatorily low prices increasingly problematic as those prices undercut its rivals deeply and when that undercutting significantly altered market shares. Thus the Commission’s 1957 ruling against Anheuser-Busch’s localized price reduction in St. Louis took this approach. In that case, the Commission equated a substantial diversion of business with competitive harm:

“No other circumstance [than the discriminatorily-low price] will account for the fact that, while respondent more than tripled its sales, most of its competition suffered such serious declines. This almost speaks for itself. Respondent’s gains could only have been made at the expense of competition since the total sales in the St. Louis market did not increase by any such substantial amount as the sales of respondent and the small combined increase in sales by all of the other competitors could not begin to account for the losses experienced by Falstaff, G.B. and G.W. Respondent’s price discriminations manifestly resulted in a substantial diversion of sales from competitors to itself.”

This use of the Act to protect competitors became especially perverse when the Commission and the courts condemned local price reductions that reflected scale economies. In several cases, a business firm that reduced local prices in order to

---

127 148 F.2d at 379. The Commission took a similar approach in Anheuser-Busch, Inc., 54 F.T.C. 277, 300 (1957), rev’d, 265 F.2d 677 (7th Cir. 1959), rev’d, 363 U.S. 536 (1960), order vacated, 289 F.2d 835 (7th Cir. 1961).
128 148 F.2d at 379. The presumption used by the Commission and the Second Circuit in Moss made possible the proof of a primary-line case (a case in which competitors of the discriminating seller were adversely affected) through proof only of discrimination. In FTC v. Morton Salt Co., 334 U.S. 37 (1948), the Supreme Court authored a presumption was directed towards proof of a secondary-line case (a case in which the purchasers or their customers were adversely affected) through proof only of discrimination in a “substantial” amount and proof that the favored and disfavored purchasers were in competition for the resale of the goods involved.
129 Id.
131 Anheuser-Busch, supra note 127.
132 54 F.T.C. at 300.
increase its sales from a plant with significant scale economies was condemned under the Robinson-Patman Act. In these cases, the changes in the local market share that resulted from the seller’s high-volume, low-price sales were equated with injury to the seller’s rivals and thence with harm to competition. In 1967, the use of the Robinson-Patman Act to protect rivals of a discriminating seller reached its apogee in the now infamous Utah Pie case. In that case, the Supreme Court construed the Act to protect local suppliers against a national rival’s attempt to enlarge its local sales by geographically-limited price reductions. The Court there referred to “radical price cuts” and “drastically declining price structure” as indicative of competitive harm. Actually, the localized price cuts gave rise to a period of intense price competition that eroded the market share of the locally dominant seller and substantially expanded the total volume of product sold by all companies.

D. Robinson-Patman Retrenchment

In the last quarter century the Robinson-Patman Act has come into disfavor. The so-called antitrust revolution that occurred in the 1970s reflected a new understanding by the courts that the antitrust laws should be focused upon efficiency (and thus the generation of income and wealth) rather than upon fairness or even rivalry for its own sake. The first hint of this new focus came in 1974. In three merger cases that year, the Court ruled against the government in a merger case for the first time in over a quarter century, holding that the government had failed to show by economically viable evidence that the mergers would be likely to affect competition adversely. Subsequent cases, especially the Court’s 1977 Sylvania decision, confirmed this new orientation. Under the previous approach in which rivalry had been largely equated with competition, the law could really protect producers (rather than consumers or total welfare) under the guise of maintaining rivalry. Indeed, prior to the revolution of the 1970s, the courts had indicated that there was a place in antitrust law for the protection of small business firms, just because they were small. From at least 1977 onwards, there

---

135 386 U.S. at 703 & n.14.
136 386 U.S. at 691-92 n.7 (tables).
141 See, e.g., Olympia Equipment Leasing Co. v. Western Union Tel. Co., 797 F.2d 370, 375 (7th Cir. 1986) (referring to the change in emphasis in antitrust law from promoting rivalry to fostering efficiency).
was no room in antitrust law for the protection of competitors (even small ones) from intense competition. This new focus upon efficiency has affected the way that section two of the Clayton Act is now construed.

In its *Brooke-Group* decision, the Supreme Court reconsidered the structure of section two of the Clayton Act. The Court concluded that under the Amendment cases concerned with so-called primary-line harm must meet the same standards for proof of predatory pricing as do cases under the Sherman Act. Although the Court did not parse section two’s language, its decision effectively said that section two in effect contains two sets of provisions: the first set dates from 1914 and is directed only against predatory pricing. This interpretation would be based upon the apparent intent of the 1914 Congress. The second provision is composed of the language added in 1936 by the Robinson-Patman Act that directed against discrimination affecting resellers. The 1936 language is effectively confined to that Act’s main objective: deterring discrimination that disadvantages some business firms purchasing from a discriminating seller vis-à-vis their rivals.

Even under this new approach to the interpretation of the Robinson-Patman Act, its anticompetitive potential remains substantial. Primary-line harm is no longer a matter of concern unless discriminatorily-low prices are below the measures of cost employed by the courts to identify predatory pricing. Yet the Act continues to make discrimination that disadvantages business customers (or those customers’ own business customers) vis-à-vis their rivals unlawful. Although the Act’s objectives are ostensibly to secure “fair” competitive conditions, that objective is widely seen as misplaced. Strict enforcement of the Act would likely impose rigidity upon pricing that would discourage price competition and foster oligopolistic pricing behavior, effects that run counter to the pro-competitive policies of the other antitrust laws. Indeed, the Supreme Court has always recognized the possibility of conflict between the Robinson-Patman Act and the Sherman Act, and has indicated that in cases of conflict the pro-competitive policies of the Sherman Act should prevail. The Federal Trade Commission no longer sees

---

144 509 U.S. at 222.
145 See text at notes 99-101.
146 509 U.S. at 222.
147 United States v. United States Gypsum Co., 438 U.S. 422, 458 (1978). See also *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 74 (1953) (upholding Sherman Act policies over potentially conflicting Robinson-Patman Act policies). In the recent *Simco* decision finding *Volvo* not in violation of the Robinson Patman Act in its differential treatment of dealers, Justice Stevens’ dissenting opinion hinted that the myriad technical arguments made by the majority could mask antipathy to the substance of the law — “although I do not suggest that disagreement with the policy of the Act played a conscious role in my colleagues’ unprecedented decision today.” Stevens’s dissent (for himself and Thomas) pointedly noted that “the exceptional quality of this case provides strong reason to enforce the Act’s prohibition against discrimination even if Judge Bork’s evaluation [that the law was based on ‘wholly mistaken economic theory’] (with which I happened to agree) is completely accurate.” One inference from all of this is that the entire Supreme Court rejects Robinson-Patman, but members differ in how that rejection should be expressed.
enforcement of the Robinson-Patman Act as a priority.148 Recently, the Antitrust Modernization Commission has called for the repeal of the Robinson-Patman Act on the grounds that it hinders competitive behavior.149 Although the courts continue, as they must, to apply its provisions in cases brought before them, they do not construe them expansively. Indeed, a number of lower courts have taken new interpretative approaches that have breathed elements of flexibility into the language of 1936.150

V. Price Discrimination and the Law in the European Union

A. Price Discrimination and Article 82(c) of the EC Treaty.

When the European Common Market was created in 1957 by the Treaty of Rome,151 that Treaty included the Articles that are now Articles 81 and 82. Articles 81 and 82 are the foundation of European competition law. These Articles, however, contain provisions that target price discrimination. Article 81(1)(d) specifically bars agreements that “apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.”152 Article 82 uses virtually identical language to prohibit dominant firms from “applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.”153 On their face, these provisions appear to prohibit price discrimination by a supplier between two competing purchasers, as a higher price to one dealer might well be deemed to competitively disadvantage it vis-à-vis the other. The focus of these provisions thus is ostensibly upon protecting purchasers from what is called “secondary-line” harm when similar situations are considered under the U.S. Robinson-Patman Act.

It is not at all surprising that the Treaty would incorporate policies similar to those of the Robinson-Patman Act, as the drafters of the antitrust provisions of the Treaty of Rome drew heavily upon the models provided by American antitrust law.154 Indeed, in the first decade or so of its operation, the decisions of the European Commission and of

148 See Scott Martin & Irving Scher, The Robinson-Patman Act: Sellers’ and Buyers’ Violations and Defenses, 1649 PLI/Corp 553, 561 (2008) (reporting that the FTC had brought an average of 40 Robinson-Patman cases per year from 1937 to 1971, that after 1980, the FTC instituted only 1-2 cases per year and that currently there are no Robinson-Patman cases on the Commission’s docket.)
150 See Boise Cascade Corp. v. FTC, 837 F.2d 1127 (D.C. Cir. 1988); Richard Short Oil Co. v. Texaco, Inc., 799 F.2d 415 (8th Cir. 1986).
151 Treaty of Rome Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 11. Several treaties have amended the initial treaty. Unless otherwise specified, all citations will accordingly be made to the current Consolidated Version of the Treaty Establishing the European Community (EC Treaty).
152 EC Treaty, Art. 81(1)(d).
153 EC Treaty, Art. 82(c).
the Court of Justice embodied policies that resembled those underlying the U.S. decisions of that period. After the so-called U.S. antitrust revolution in the 1970s, however, the two legal systems grew less alike, although there are some signs that the gap is now narrowing.

When the Treaty was being drafted in the late 1950’s, the Robinson-Patman Act was widely seen as a major component of U.S. antitrust law. During this period enforcement action by the Federal Trade Commission was large and growing. That Commission and the courts were repeatedly construing the Act to prohibit price discriminations that would confer “competitive advantages” on favored buyers. The widespread public acceptance of the policy goals of the Robinson-Patman Act during this period may have been felt in Europe by the drafters of the competition law provisions of the new European Common Market. We know that an analogous concern that competitive disadvantages not be imposed upon customers vis-à-vis their rivals is written into the text of Articles 81(1)(d) and 82(c).

In Europe, however, the provisions of Article 81(1)(d) have a more limited application than the analogous provisions of the Robinson-Patman Act. Although the Robinson-Patman Act extends to all sales, the coverage of Article 81 is limited to agreements or other concerted action. And ordinary sales transactions are considered unilateral actions by European antitrust authorities. Thus they do not fall within the scope of Article 81.

Because of this somewhat narrow understanding of agreement, the only sales transactions that fall within Article 81(1)(d) appear to be those that are covered by agreements between independent companies that mandate discriminatory pricing practices, a construction that effectively removes price discrimination from the purview of Article 81(1)(d). Thus the concerns of the European authorities over price discrimination are concentrated largely on price discrimination by dominant firms under Article 82. The emphasis on price discrimination by dominant firms appears to be an

---

155 Thus, for example, in a contemporary discussion of antitrust policy, Carl Kaysen and Donald Turner, although criticizing the rigidities of the Robinson-Patman Act, nonetheless contemplated that a prohibition of price discrimination should be a part of the antitrust laws. Indeed, these authors provided a model for legislation prohibiting price discrimination that they believed was superior to the Robinson-Patman Act. See CARL KAYSEN & DONALD F. TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS 184-85 (1959).


157 See note 155 supra.


159 See note 154, supra and accompanying text.

160 Viho Europe BV v. Commission of the European Communities, Case C-73/95, [1996] ECR I-5457. In that decision Viho complained that a supplier (Parker) offered it discriminatorily unfavorable supply prices. The Court rejected that contention on the ground that the discrimination at which Article 81(1)(d) is directed cannot be “the result of unilateral conduct by a single undertaking.”. Id., at ¶61. See discussion in Michel Waelbroeck, Price Discrimination and Rebate Policies under EU Competition Law, 1995 FORDHAM CORP. L. INST. 147, 149 (Barry E. Hawk, ed., 1996); S.O. Spinks, Exclusive Dealing, Discrimination, and Discounts Under EC Competition Law, 67 ANTITRUST L.J. 641, 668-69 (2000).
advance over the American approach which has taken no account of the size or prominence of the discriminating seller. Yet the European authorities have taken a broad approach to dominance: a firm need not be a monopoly in order to be deemed “dominant.” Accordingly, price discrimination in the European Community by large and successful firms among competing customers is potentially vulnerable to attack under Article 82.

Europe offers a rich caselaw on price discrimination as one form of abuse of a dominant position. In *United Brands*, one of Article 82’s foundational cases, the Court of Justice ruled that United contravened Article 82(c) by selling bananas to several national distributors at different prices. Since those distributors each resold their banana inventories in different local markets, they were in fact not in competition with each other, and thus none of them could be disadvantaged in competition with any of the others. It is unclear whether the Court failed to understand the competitive relationships among the distributors or whether it was ruling that a showing of competitive disadvantage was not required under Article 82(c) despite its language. The Court, however, appears to have mistakenly equated United’s pricing practices with dividing the banana market along national lines, a practice that (in the Court’s view) strikes at the heart of the single-market objective of the Treaty. In another foundational case, *Hoffmann-La Roche*, the Court condemned so-called “fidelity rebates” as violations of Article 82(c). These consisted of rebates conditioned upon the purchasers buying all or a large percentage of their requirements from the seller. In that case, the Court appears to have been primarily concerned with the effects of fidelity rebates impeding Hoffmann-La Roche’s rivals from selling to the latter’s customers. The Court thus appeared to be using Article 82(c)--whose ostensible concern is with protecting the seller’s customers--as a means for protecting Hoffmann-La Roche’s rivals. In the language employed in Robinson-Patman analysis, the Court appears to have been principally concerned with primary-line effects, i.e., effects on the rivals of the discriminating seller. The Court nonetheless employed a legal provision directed at secondary-line effects, i.e., effects on the seller’s customers, to support its condemnation of Hoffmann-La Roche’s discrimination.

A significant part of EU caselaw is concerned with protecting competitors of a dominant firm. The European courts have been especially concerned with a dominant firm’s discount practices that impede rivals from selling to the dominant firm’s customers. These practices are considered exclusionary. They include “fidelity” or “loyalty” rebate systems, such as those involved in *Hoffman-La Roche* (in which rebates are keyed to a customer purchasing a specified percentage of its requirements from a seller) as well as so-called “target” or “objective” rebate systems in which rebates are

---

163 Consten and Grundig v. Commission, joined cases 56/64 & 58/64, 1966 E.C.R. 299.
165 Id., at ¶ 90.
keyed to the customer’s satisfaction of sales objectives set in absolute amounts. By contrast, so called quantity discounts – in which the price to all buyers is reduced on a uniform schedule as the quantity purchased increases – have generally been upheld as lawful, even when granted by a dominant firm. In its recent British Airways decision,\(^\text{167}\) however, the Court of First Instance observed that the implicit justification for quantity discounts is that they reflect the lower unit costs often incurred by sellers in large-volume transactions. Accordingly, the Court hinted that when a dominant firm’s criteria for granting such a rebate reveal that it is not cost-related, then the rebate may be viewed more like a fidelity or target rebate impeding rivals from selling to the dominant firm’s customers.\(^\text{168}\) Moreover, discount systems in which the discounts are computed on sales over a long reference period, such as a year, have been deemed to have similar exclusionary effects, since the value of the discount significantly increases over the length of the period and thus exerts growing pressure on the buyer to remain with its current supplier.\(^\text{169}\) Although the Court of Justice has condemned fidelity and target rebates under Article 82(c), it has also condemned fidelity and target rebate systems as abuses under Article 82’s general language, without invoking clause (c).\(^\text{170}\) Indeed, in British Airways the Court of First Instance asserted that a dominant supplier’s fidelity rebate system requiring customers to obtain their supplies exclusively or almost exclusively from it is abusive and therefore in violation of the basic prohibition of Article 82.\(^\text{171}\) Nonetheless, that Court also ruled that the rebate system before it was in fact discriminatory and imposed competitive disadvantages upon customers within the meaning of Article 82(c).\(^\text{172}\)

The European authorities have been criticized for misusing Article 82(c) as a means for protecting the rivals of dominant firms.\(^\text{173}\) These commentators contend that Article 82(c) is thus misused whenever it is applied in the absence of a showing that buyers have been placed at a competitive disadvantage. In those cases, the court appears to be concerned with primary-line effects, patently not a matter dealt with by Article 82(c). When the latter is invoked, that article appears to have been diverted from its ostensible objective of protecting customers of dominant firms into the very different task of protecting rivals of dominant firms.

B. Comparing Article 82(c) with the Robinson Patman Act.

---


\(^{168}\) Id., at ¶¶ 246-47.


\(^{170}\) NV Michelin, supra note 169, ¶ 86, 91.

\(^{171}\) Id., at ¶¶ 244-45, 248.

\(^{172}\) British Airways, supra note 167, at __.

As observed above, the Robinson-Patman Act was adopted as a response to the complaints of small business firms that they were being unfairly exposed to the competition of large grocery and drug-store chains that were able to obtain their supplies at lower prices than were their smaller rivals. The Act was Congress’s attempt to neutralize the bargaining power of the chains vis-à-vis their suppliers, who were frequently small or medium-size companies. Although the Act directs most of its provisions against the discriminating sellers, its premise is that buying power is being misused at the purchaser level. By contrast, Article 82(c) applies only to large sellers that can meet the criteria for “dominance” as used in the Treaty. Thus while Article 82(c) and the Robinson-Patman Act are ostensibly designed to prevent buyers from being competitively disadvantaged, the two provisions actually direct their focus in opposite directions: Article 82(c) focuses on the pricing behavior of powerful sellers while the core concern of the Robinson-Patman Act is upon the purchasing behavior of powerful buyers. During the middle of the twentieth century, the Robinson-Patman Act was also employed—as Article 82(c) is today—to protect the rivals of a discriminating seller. But under the current interpretation of that Act, the seller’s rivals are protected only against predatory pricing.

Overall, the dominant thrusts of U.S. and European legal concerns come close to being mirror images: The U.S law represents an historic desire to protect small retail merchants from the competition of powerful buyers while the European law in practice appears to be focused on protecting initial sellers from the competition of their powerful rivals.

C. Price Discrimination Beyond the Article 82(c) Context.

Article 82(c) is not the only provision in Article 82 that targets price discrimination. Clause (c) is but one of four clauses that describe particular types of behavior that fall within that Article’s general prohibition against abuses of dominant position. The structure of Article 82, however, makes clear that abuse can take forms other than those referred to in the four clauses. The Commission and, as indicated above, the courts are increasingly targeting price discrimination as an abuse under Article 82’s general clause. In doing so, these authorities frequently describe this abuse as involving “selective” price cuts, a phrase that literally is coextensive with all price discrimination.

---

174 See text, supra at notes 107-108.
175 See id.
176 See note 112 supra and accompanying text.
177 See text, supra, at notes 120-136.
In general, the European authorities see selective price cutting as subject to the prohibition against “abuses” of dominant position because they view it as a tool for deterring entry by rivals or for forcing them to exit the market, and thus as a device for obtaining or preserving a dominant position. As pointed out below, European authorities appear to rank selective price cutting as at least as much of a threat to a competitive market structure as below-cost predatory pricing. Indeed, they approach selective price cutting as on a par with selling below average variable cost, behavior which the Court of Justice views as unambiguously abusive. This is an approach that differs radically from U.S. antitrust law, which protects competitors only from predatory pricing but which does not normally protect competitors from above-cost price competition. What is the rationale for the different European approach?

In the EU caselaw, both predatory pricing and selective price cutting are seen as fostering dominance and thus as threatening to competitive market conditions. In Akzo,⁴⁸⁰ an early and leading case, the abuse consisted of both predatory pricing and selective price cuts. Because the selective price cuts were at below-cost levels, the independent significance of selective price cutting was unclear. In the later Hilti case,⁴⁸¹ however, the Commission explicitly declared that selective price reductions need not be at below-cost levels in order to constitute abuse.⁴⁸² In that case, the Commission held a producer of nail guns⁴⁸³ to have abused its dominant position by offering its devices at reduced prices to the customers of new entrants, thereby discouraging entry,⁴⁸⁴ a ruling that was upheld on appeal.⁴⁸⁵ In Compagnie Maritime Belge,⁴⁸⁶ a shipping conference was held to have abused its dominant position when it employed so-called “fighting ships” to offer carriage at reduced rates in competition with rivals, although the reduced rates were not shown to have been below cost.

The results in these cases appear to be connected to the way the Commission and the courts analyze the dominant firm’s intention. Intent plays a role in the predatory pricing cases, and those cases are instructive about how the EU authorities approach selective price cutting. The Court of Justice has identified two possible types of predatory pricing. The first type consists of a dominant seller offering its goods at prices below average variable cost.⁴⁸⁷ The Court views such behavior as unambiguously predatory and hence abusive. The second type of possibly predatory pricing consists of a dominant seller offering its goods at prices that are below average total cost but above average variable cost. This behavior is not treated as presumptively predatory, because there are

---

⁴⁸³ These devices are known as PAF nail guns, PAF standing for “power actuated fastening”.
⁴⁸⁴ Hilti, supra note 182 at ¶ 80.
⁴⁸⁵ Hilti AG, supra note 181 at ¶ 100.
⁴⁸⁶ Compagnie Maritime Belge Transports SA, supra note 179.
legitimate economic rationales for such behavior. Such sales, for example, can minimize losses in a situation of falling demand. In the case of above-average-variable-cost pricing, the sales must be shown to have been part of a plan to eliminate a competitor before they will be deemed an abuse.\textsuperscript{188} Thus the Court takes the position that the second category of pricing is ambiguous and, before it can be condemned as abusive, evidence of the seller’s intent is needed to resolve that ambiguity. This Court’s insistence upon evidence of intent as a means of resolving the ambiguous nature of the firm’s behavior in the predatory context appears to be repeated in the context of discriminatory pricing challenged under the general clause of Article 82.

In the cases in which the Court of Justice has condemned selective price cutting, the firm in question appears to have directed its price cutting towards customers of one or more rivals. In the view of the Court and other EU authorities, this targeting reveals the dominant seller’s intention to injure the particular rivals that are threatening its dominance. With the actor’s intent seemingly clarified, its actions are treated as abuses, forbidden by Article 82. Thus in \textit{Akzo}, the Court of Justice construed that company’s selectively low prices to the customers of ECS [its rival] as evidence of its intention “to adopt a strategy that could damage ECS”\textsuperscript{189} and thus constitute abuse.

European competition law is ostensibly concerned with selective price cutting for the same reason that it is concerned with predatory pricing. Both practices are understood to threaten the maintenance of a competitive market structure. Yet the danger in prohibiting various forms of low pricing is that, unless the prohibitions are narrowed to embrace only unambiguously anticompetitive behavior, the prohibitions themselves can create price umbrellas under which inefficient sellers are protected from legitimate price competition, a result that conflicts with the core purpose of competition law. The EU prohibition against selling at below-average-variable-cost prices is finely tuned to target anticompetitive behavior. The Court of Justice correctly states that such pricing has no legitimate economic rationale. But when the EU authorities target selective price cutting, they cannot claim to be limiting their sanctions to behavior that is unambiguously anticompetitive. Indeed, when a firm lowers its price to respond to a rival’s incursions on its market, that behavior appears to constitute the very price competitive behavior that competition laws are designed to foster. The EU authorities appear to be operating on a false dichotomy. In the arena of market competition, it is impossible to draw a distinction between an intent to take sales away from a rival and an intent to injury the rival (by taking sales away from it).\textsuperscript{190} Evidence that a dominant firm intended to injure a rival by diverting sales away from it, therefore, is nothing more than evidence of an intent to compete. The underlying flaw in the EU analysis appears to lie in the premise that competition is legitimate when it is conducted on the basis of market-wide uniform pricing, but that price reductions targeted to the areas of intense rivalry are suspect.

\textsuperscript{188} \textit{Akzo}, supra note 187 at ¶ 72.

\textsuperscript{189} \textit{Akzo}, supra note 180 ¶ 115. See also the opinion of the Advocate General in \textit{Compagnie Maritime Belge Transports SA v. EC Commission} [2000] 4 C.M.L.R. 1076 ¶ 128 (5\textsuperscript{th} Chamber).

\textsuperscript{190} See discussion, supra, at notes ____.
Many American antitrust observers would view these attempts by EU authorities to distinguish between competition on the basis of market-wide pricing and competition employing selective price reductions as an unfortunate repetition of U.S. experience under the Robinson-Patman Act during the middle of the twentieth century, i.e., before the Supreme Court reinterpreted the Act no longer to protect firms from the price competition of rivals.

When Article 82(c) of the EC Treaty is construed to prohibit selective price-cutting—just as when the Robinson-Patman Act was construed to target nonpredatory primary-line injury\(^\text{191}\)—it does so in pursuit of a policy of “fairness” to rivals of the favored seller. That “fairness”, however, comes at the expense of society. In so far as selective price-cutting operates as a mechanism for breaking down supra-competitive pricing, the social cost of “fairness” is a reinforcement of anticompetitive pricing and a reduction of social welfare, as measured by both the consumer surplus and total surplus standards. As in many other realms, the political feasibility of cleaving ever closer to one of the latter two standards in judging price discrimination is easier in the U.S. than in Europe: In Europe competition-law authorities appear more concerned with the welfare of all incumbent economic actors than with the competitive process itself.


A widely used form of discounting that rewards sales above a certain level with a lower price on a firm’s entire purchases of a product over a specified period of time (often a year) are frequently referred to by several names: “target rebates (because the rebates are earned after the buyer’s accumulated purchases reach a specified target amount), or “fidelity” or “loyalty” rebates (because they have the effect of maintaining the buyer’s loyalty to the seller as a source of supply). We generally employ the term “loyalty” rebates in the discussion below to refer to this class of rebates. Although loyalty rebates have been the subject of antitrust concern in Europe for some time, only a few U.S. cases have considered their lawfulness.\(^\text{192}\) While the European authorities generally view loyalty rebates granted by “dominant” firms as unlawful, U.S. courts have generally been reluctant to condemn them. European and U.S. courts and antitrust authorities have tended focus on different aspects of these rebates. For reasons that we develop below, we believe that the European courts have misunderstood the likely effects of loyalty rebates and have consequently found antitrust violations where none should

\(^{191}\) See text at notes 120-146, supra.

have been found. Conversely, we believe that the U.S. courts and antitrust authorities are in the process of developing a properly nuanced evaluation of these practices.

Because the seller offering loyalty rebates extends them to some purchasers but not to others, they involve price discrimination. As with simple price discrimination, loyalty rebates may generate effects on the primary or secondary lines. The EC Treaty seems to focus on secondary-line effects, but the Court of Justice has directed much of its attention to their effects on the primary line: it tends to see loyalty rebates as an anticompetitive weapon directed against competitors of the seller offering those rebates. The U.S. cases that have dealt with loyalty rebates have seen them as raising issues under the monopolization or attempted monopolization clauses of Section Two of the Sherman Act. Loyalty rebates fall into two broad classes: single-product rebates and multi-product (or bundled) rebates. Because

1) Single Product Loyalty Rebates.

It will be observed that buyers from a seller that offers such rebates are increasingly tied to that seller as their total purchases approach the target amount. Thus, for example, consider the case of a seller (firm X) who offers widgets at a price of $10, but offers a $1 per unit rebate to buyers who buy 100,000 widgets over the course of a year. For buyers who expect to purchase 100,000 widgets during the year, this may be an attractive offer. They have an incentive to confine their purchases to that one seller. When such a buyer buys the first widget, it would consider competing offers from rival suppliers. Indeed, these other suppliers may be offering competing discounts. When the buyer purchases its second widget, it would incur a slight cost should it decide to switch suppliers, say to firm Y. Then (assuming that firm Y was offering an identical target rebate), the buyer would forfeit the $1 rebate on its first purchase that it would have received from firm X had it continued to deal with firm X until its purchases reached the target amount. If the buyer switches after purchasing its second widget from firm X, it would forfeit $2. Thus the cost of switching suppliers increases as the buyer’s purchases from firm X increase. The cost of switching increases gradually at first but grows rapidly later on. After the buyer has purchased 90,000 widgets, the cost of switching would be $90,000.

A number of European critics have taken the view that loyalty rebates are anticompetitive, because they make it increasingly difficult for rivals (including possible new entrants into the industry) to sell to the customers of a firm (like firm X) that is offering those rebates. Indeed, these critics have also contended that a firm offering fidelity rebates will necessarily be selling its product below cost. That position draws upon the analysis described in the prior paragraph. As a buyer’s purchases increase, the seller is effectively offering that buyer a greater incentive to continue purchasing from that seller. As the buyer’s purchases increase, he pays less and less for incremental units. The price for incremental units is effectively the discount price ($9) per unit less the rebate on past purchases. As the buyer’s purchases increase, the rebate on past purchases increases in amount, eventually growing to the point where the per-unit price of incremental units is negative. This can be represented symbolically as follows:
Let:

\[
p = \text{list price};
\]

\[
d = \text{discount}
\]

\[
T = \text{target}
\]

\[
q = \text{amount already purchased}
\]

The average per-unit effective price for the block of additional purchases required to meet the target is then:

\[
\frac{(p - d)(T - q) - qd}{T - q} = p - d - \left\lfloor \frac{qd}{T - q} \right\rfloor
\]

The effective price decline is rapid as the quantity purchased approaches the target. Let’s illustrate the hypothetical discussed above on a graph, where the list price is $10, the rebate is $1 and the target is 100,000 units. The rapid decline in the effective unit price is apparent in the graph below:

Under this view, the effective unit price (factoring in the rebate) starts at $9, then gradually declines as the rebates accumulate. When the buyer has purchased 90,000 units, the effective unit price for the additional 10,000 that will take the buyer to the target is zero. At 95,000 units, the effective unit price for the remaining 5,000 units necessary to reach the target is a minus ten dollars (–$10). The unit price continues to fall rapidly. This rapid fall in the unit price of additional purchases has been referred to in the literature as a “suction effect”, apparently referring to the increasing incentive of the buyer to
continue purchasing from the same supplier.193 At 100,000 units the unit price for additional units climbs abruptly to $9 and holds steady thereafter.

The potential significance of the mechanism generating the “suction effect” becomes clear when viewed from the standpoint of an alternative seller, perhaps an entrant. Assume that the purchaser has the characteristics previously described and that this purchaser is buying above the target amount at 105,000 units. Assume further that the entrant faces sharply declining cost with a minimum efficient scale of 10,000 at which point its costs match those of the incumbent. The entrant, however, has little chance of selling the 10,000 units to the purchaser. If the purchaser has already bought 95,000 units from the incumbent, it would lose $95,000 by purchasing the next 5,000 units from the entrant. After attaining the target amount of purchases ($100,000), the purchaser would be free to buy additional units from others (including the entrant) at prices of $9.00 or below without losing money. If the purchaser in question is the only market for the entrant’s goods (and if the purchaser’s needs do not reach 110,000 units), the entrant would be incapable of attaining minimum efficient scale.

The effect of loyalty rebates in tying the purchaser increasingly to the supplier offering them has received attention from a number of scholars.194 Frank P. Maier-Rigaud of the European Commission’s General Competition Directorate, for example, demonstrates the high switching costs that would be incurred by a purchaser as it approached the target amount.195 Indeed, the purpose of Maier-Rigaud’s article is to challenge other writers who had contended that the “suction” effect was overstated. Thus Maier-Rigaud directs his attention to the argument that when the demand of a particular customer is greater than the target amount, there are no suction effects on its purchases that exceed the latter. Maier-Rigaud is particularly concerned with the contention of G. Frederico who argued that the price that a competitor would have to offer to persuade the customer to switch prior to the point at which its purchases reached the target amount would increase as demand increases, because it could offer a price in which the post-target price was averaged in with the low pre-target prices.196 Maier-Rigaud dismisses these contentions on the ground that it would be irrational for a seller offering a target rebate to set the target in excess of the expected demand of the customer or substantially below it.197 These alternative views should be tested with facts.

The flaw in the “suction effect” analysis is that it directs attention away from the focus of competition. The “suction effect” analysis is not wrong. It is just simplistic. Of

195 Maier-Rigaud offers a diagram similar to the one above to demonstrate the “suction effect” encountered by any purchaser approaching the target (Maier-Rigaud, supra note 91, at 4.)
197 Maier-Rigaud, supra note 193, at 5-6.
course, a customer becomes more committed to a supplier as its purchases approach the target amount that triggers a rebate. Of course, it becomes increasingly difficult for a rival supplier to divert away that customer’s trade until its purchases reach the target amount. The competitive issues involved may be illustrated best by considering the differences between a loyalty rebate and an exclusive supply contract.

During the term of an exclusive supply contract, the customer is committed to its supplier. During the term of such a contract, rival suppliers find it difficult to divert away those customers. The differences between a target or fidelity rebate and an exclusive supply contract lie in their different incentive structures. With the rebate scheme, the incentive for a customer to remain “loyal” to the supplier increases as the customer’s purchases approach the target amount. In the typical exclusive supply contract, the customer is bound by contract to remain loyal to the supplier. The customer can break the contract, but will have to pay damages if it does. The normal damages would be the seller’s lost profits. Since the seller would have already earned its profits on its sales up to the time of the breach, the profits are those that the seller would lose from future sales that have been diverted to a rival.

Let’s take the figures from the example above to examine a supply contract. Assume that firm X offers a price of $9 per unit to customer A, who commits to purchase its entire year’s requirements (of say 100,000 units) from firm X. Let’s further assume that firm X can produce widgets at a cost of $7 per unit, so firm X earns a profit of $2 per unit. If customer A decides during the term of the contract to purchase from a different supplier, it will be liable in damages for the profits lost to X as a result of A’s breach of contract. Thus a rival will have to offer a price to customer A that not only meets firm X’s price but that also compensates customer A for the $2 profit per unit that constitutes A’s liability to X for the sales lost to X. Thus the rival would have to offer a price of $7 ($9 - $2 = $7) per unit for new purchases. We observe that a rival could induce the customer to switch at any time by offering a price of just under $7 per unit for all new purchases. In order for this to be an attractive option to the rival, however, the rival’s costs would have to be less than $7 per unit.

If firm X had instead employed the loyalty rebate technique by offering widgets in amounts of less than 100,000 units but at a retroactive price of $9 for firms purchasing 100,000 units, a rival offering widgets at $7 for new purchases would undercut firm X up to the time that the customer had purchased approximately 67,000 widgets. Thereafter, switching costs would exert an increasing incentive for the customer to remain with firm X. So up to approximately 67,000 units, an equally efficient rival (i.e., with costs not exceeding $7 per unit) could induce a switch under either an exclusive supply contract or a loyalty rebate offer. Beyond approximately 67,000 units, a rival would be able to divert sales when the buyer is bound by an exclusive supply contract but not when it is the potential recipient of a target rebate.

198 More precisely the number is 66,666.7 units. \( x = \text{number of units purchased from incumbent and therefore the dollar amount of the potential rebate. (100,000 - x)2 = the $2 per unit savings on purchases from the entrant times the remaining sales.} \)
Exclusive supply contracts raise antitrust concerns when they prevent a more efficient firm from entering an industry. They can do this when they prevent such a firm from attaining minimum efficient scale. This implies that exclusive supply contracts raise antitrust concerns only to the extent that they could foreclose a sufficient share of the market to deny an entrant the possibility of operating at a minimum efficient scale, and there is a dispute in the literature about the practical relevance of the possibility. We think a similar approach should be taken to loyalty and fidelity rebates.

In most cases, neither exclusive supply contracts nor loyalty rebates will pose a foreclosure risk, because rivals can compete for the exclusive supply contract or can offer a competing rebate bid at the times that the contracts are entered or offers are extended. In an industry in which many suppliers enter such contracts or provide extensive loyalty rebates, the locus of competition may have moved from sales for particular units (analogous to sales of a commodity on the spot market) to competition for exclusive supply contracts or rebate relationships. Similarly, there is no obvious reason why at the time at which a rebate is offered, rivals cannot compete by offering similar rebates (or prices that have the same effect as the rebate). Viewed from the perspective of the locus of competition, many of the concerns expressed by European authorities about loyalty rebates disappear.

2) Multiproduct loyalty rebates (bundled rebates).

Although U.S. courts have viewed single-product loyalty rebates with equanimity, they have become increasingly concerned with multi-product rebates. Until recently, the leading U.S. case finding target rebates unlawful was the en banc decision of the Third Circuit in LePage’s Inc. v. 3M (Minnesota Mining & Mfg. Co.)

LePage’s involved rebates offered by 3M to a number of large customers. 3M produces an array of products, including many different types of office products. It produces “Scotch” brand transparent tape, which is stocked by most office supply stores,

199 This reflects at least a concern for the total surplus principle; in some cases successful lower cost firms may also sell at lower prices and hence meet the consumer surplus criterion as well.
200 Christodoulos Stefanadis, Selective Contracts, Foreclosure, and the Chicago School View, 41 J. L. & ECON. 429 (1998); Bruce H. Kobayashi, The Economics of Loyalty Discounts and Antitrust Law in the United States, (George Mason Univ. School of Law Working Paper) SSRN.com/abstract_id=794944; Ilya R. Segal & Michael D. Whinston, Naked Exclusion: Comment, 90 AM. ECON. REV. 296 (2000); Philippe Aghion & Patrick Bolton, Contracts as a Barrier to Entry, 77 AM. ECON. REV. 388 (1987); Richard A. Posner, ANTITRUST LAW 230-34 (2d ed. 2001). Under one line of analysis, represented by Posner, where a dominant seller’s use of exclusive supply contracts threatens to block entry by others, buyers will not sign an exclusive contract unless they are compensated by a price discount. If the situation is such that entry is likely to force a monopoly price down to a near competitive level, the discount that the seller must offer is likely to rise to a level that makes such contracting unprofitable. The alternative line of analysis asserts that a monopolist could find it profitable to share its monopoly profits with a critical number of buyers, preventing an entrant from attaining minimum efficient scale. But the information requirements of both scenarios are formidable.
and until the early 1990’s held over 90% of the transparent tape market. During the early 1990’s 3M also began selling private-label transparent tape. LePage’s began to supply a line of transparent tape in 1980 to stores wanting their own “house” brand of tape and ultimately accounted for 88% of private-label transparent tape sales. In the middle to late 1990s, 3M began offering rebates to certain large retailers keyed to their meeting pre-selected sales targets. Since 3M was offering rebates that were computed on the aggregate sales of the several categories of goods purchased on which the customer attained targeted sales goals, these retailers felt significant pressure to meet the sales targets. The retailers, accordingly, diverted their orders on many office items, including transparent tape, to 3M in order to qualify for the maximum available rebate. As a result, LePage’s claimed, customers seeking the 3M rebates were pressured to switch their transparent-tape orders from LePage’s to 3M in order to qualify for the rebates. Since LePage’s did not produce the wide product line that 3M produced, LePage’s claimed that it would have had to match the total dollar rebate that 3M offered on a wide product line with a rebate solely on tape but in an equal dollar amount. This, it claimed, it was unable to do.

The Third Circuit determined that 3M’s target rebate program constituted a means by which 3M maintained its effective monopoly in transparent tape and thus constituted monopolization under section two of the Sherman Act. In so ruling, the court rejected 3M’s contention that so long as its prices were above cost and thus not predatory, it could not violate the Sherman Act. The court failed to discuss, however, the impact of 3M’s pricing upon the particular market for transparent tape but discussed only its impact on particular buyers. If the entire discount over a buyer’s purchases of several 3M products were allocated to transparent tape, would the result be that 3M was selling tape at prices below its marginal or average variable cost? If so, would that constitute predatory pricing? In a lengthy opinion of __ pages, the court majority failed to address these questions.

More recently, the Ninth Circuit in *Cascade Health Solutions v. Peacehealth* has examined multi-product bundled discounts with more care. That case involved two hospital providers in Lane County, Oregon. Cascade offered primary and secondary acute care in its only hospital. Peacehealth, which operated three hospitals, offered primary, secondary and tertiary acute care. It possessed a 75% market share in primary and secondary care services, a 90% share in tertiary neonatal services and a 93% share of tertiary cardiovascular services. Cascade charged that Peacehealth attempted to monopolize by providing a lower reimbursement rate to health insurers that made Peacehealth their sole preferred provider than to health insurers that included both Peacehealth and Cascade as preferred providers. A jury verdict in favor of Cascade was set aside on appeal on the ground that the jury instructions were faulty.

The Ninth Circuit adopted an approach to bundled discounts that drew from recommendations of the Antitrust Modernization Commission, but modified them in significant ways. In April of 2007, the Commission issued its Report in which it

---

203 515 F.3d 883 (9th Cir. 2007, 2008).
204 ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS (2007).
criticized the Third Circuit’s decision in *LePage’s* for failing to articulate standards that would distinguish legitimate competitive pricing from pricing that was unlawfully exclusionary. The Commission then made a three-part recommendation for assessing the lawfulness of bundled rebates. First, the rebate over all products should be aggregated and applied to the product in issue. In the *LePage’s* case that would require that the entire amount of the rebates on all sales to affected buyers be allocated to the sales of transparent tape. If, when so allocated, the defendant’s price is below its incremental cost, the analysis proceeds to the next step. In the second step, an inquiry is made as to whether the defendant is likely to recoup its losses on the product in question (as determined above). If recoupment is likely, then the analysis continues to the third step. In the third and final step, an assessment is made as to whether the rebate program is likely to have an adverse effect on competition. If such an adverse effect is determined to be likely, then a violation of section 2 of the Sherman Act is established.

In *Cascade*, the Ninth Circuit accepted the first recommendation: that of aggregating the rebates and allocating the total of all of the rebates to the product in question, a technique that the court referred to as a “discount attribution” standard. If the price of that product, as reduced by the rebates, falls below an appropriate measure of incremental costs, then the plaintiff will have succeeded in establishing a necessary component of its case. The court then ruled that an appropriate measure of incremental costs to be used in this analysis was average variable cost. This approach, the court explained, will bar rebates that carry the potential for excluding equally efficient rivals and are relatively easy for business firms to employ, because they need merely to compare the rebates that they are providing with their own average variable costs. Moreover, applying the test—in the judgment of the court—is within the competence of the judiciary.

The Ninth Circuit, however, rejected the Commission’s recommendation that the plaintiff establish the likelihood that the defendant would recoup its losses, and rejected the Commission’s further recommendation that the plaintiff also establish the likelihood of a lessening of competition. The court rested it’s ruling that a likelihood of recoupment need not be shown on the ground that in a multi-product bundled rebate context, predatoriness can be established under the discount attribution standard, even though the defendant incurred no actual losses. Reasoning that if the defendant incurred no losses, there are no losses to recoup: thus a recoupment requirement does not fit the method of determining liability. We view the court’s position on this issue as unsound. Although a defendant could be found to have acted predatorily without having incurred actual losses, it would have incurred losses in the form of opportunity costs: that is, the granting of the rebates reduced the revenues that the defendant would otherwise have earned. This conduct, therefore, is economically irrational unless it is an investment in a prospective

---

205 *Id.*, Ch. I.C. at 97.
206 *Id.*, at 99-100.
207 515 F.3d at 906.
208 515 F.3d at 909.
209 515 F.3d at 910.
210 515 F.3d at 907-08.
211 515 F.3d at 908.
monopoly that would generate future revenues sufficient to compensate the defendant for this reduction in revenue. The court, however, may have felt compelled to rule against a recoupment requirement on the ground that a defendant’s need to recoup its losses here means losses whose calculation involved opportunity costs, and the Ninth Circuit had previously rejected opportunity costs as an element in predatory-pricing calculations. The court, however, failed to recognize that the recoupment requirement was intended by the Commission as a means for ensuring against false positives. By eliminating the recoupment requirement, the court removed a critical check against a false determination of liability.

The court also rejected the Commission’s recommendation that the plaintiff be required to show that the bundled rebate program is likely to have an adverse effect on competition. The Commission’s rationale for requiring this showing lay in its concern that bundled discounts should not be impeded unless they produced (or were likely to produce) an adverse effect on competition in the market. The court’s rationale for rejecting the Commission’s recommendation was that the requirement was redundant, because a private antitrust plaintiff must show a lessening of competition in the process of establishing standing. Although this part of the court’s analysis possesses a superficial appeal, it is also problematic. To establish standing in an antitrust case, a private plaintiff must establish that it has been injured by the defendant’s challenged conduct and that the injury “is of the type that the antitrust laws were intended to prevent and that flows from that which makes the defendant’s acts unlawful.” This proof overlaps with proof (on the merits) that the defendant’s conduct was unreasonable under the rule of reason. Although analytically correct, the court’s ruling has broad ramifications about how we conceptualize rule-of-reason cases. Under its approach there should be no separate requirement, in a rule-of-reason case, of proving the unreasonableness of the defendant’s conduct, because the plaintiff will already have established that unreasonableness when it established its standing. This analysis does not apply to government-instituted suits, where the government always has standing. In such suits, a showing of lessening of competition would have to be reincorporated into the elements of the offense, in bundled discount cases, as well as all other rule-of-reason cases that the government may wish to bring. Whether this and other courts will wish to collapse the substantive unreasonableness issue into the antitrust injury requirement in all private actions remains to be seen.

VII. Price Discrimination: An Overall Assessment

The preceding pages have argued that price discrimination is an important element in competition as well as regulation and does not deserve the suspicion with
which many continue to view it. Some review may be in order to put price discrimination in what we regard as the appropriate context.

Firms in perfect competition cannot price discriminate, but they cannot sell differentiated products either. And when firms do sell differentiated products they, by definition, face downward sloping demand curves. Such demand curves imply some discretion over price, and that discretion may be used differentially across units sold, across purchasers, or both, yielding price discrimination. Yet profits may be only normal or even negative. This situation may approximate the current predicament of the airline industry. Perhaps more frequently, firms in industries that might otherwise have quasi-collusive excess profits based on entry barriers and mutual dependence recognized can be destabilized by the ability of participants to nibble at each other’s markets through selective price competition rather than only charging prices such that no purchasers receive any better deal than any others. Finally, in some cases, firms may well use targeted discrimination to hinder the competitive progress of rivals who would benefit if they could not be singled out for special attack. This behavior can include certain fidelity rebates. This third category is the only one that deserves special scrutiny from competition authorities.

There is now consensus in the U.S. and the EU that the appropriate goal of competition policy is some measure of social welfare. There is considerable dispute about whether that measure should be the maximization of consumer surplus or total surplus. Therefore all rules and indices concerning price discrimination should be evaluated in relation to their likelihood to improve welfare by one or both of these criteria.

Everything we have argued hitherto suggests that price discrimination meets the total surplus test more often than the consumer surplus standard under monopoly. Most output expanding discrimination passes the first test, but not necessarily the second. More specifically, second degree price discrimination almost always expands output but may well reduce consumer surplus. Alternatively, third degree discrimination will necessarily reduce consumer surplus if output remains unchanged or is reduced because it generates increased profits. But total surplus is also reduced in such circumstances because a new inefficiency is introduced by different marginal prices. Alternatively, some increase in output could overcome that inefficiency while still leaving consumers as a group worse off. When some markets are served only under discrimination, welfare may rise under both measures. In multiple-firm markets, some formal models based on fixed behavioral assumptions find reduced output when discrimination is introduced, but the most realistic models suggest that the permissibility of price discrimination changes firm behavior by increasing price competition and thereby increases welfare by both

---

216 See references in Gifford & Kudrle supra note 39.

217 Cf. W. Kip Viscusi, Joseph E. Harrington, Jr. and John M. Vernon, Economics of Regulation and Antitrust, Fourth Edition, 2005, p. 269: “discrimination is not necessarily anti-competitive and, in fact, generally raises social welfare though perhaps benefiting firms at the cost of consumers.” (These authors mean “inefficient” when they say “anticompetitive” because they employ an efficiency or total surplus standard.)
standards.\textsuperscript{218} Put otherwise, the mere availability of price discrimination necessitates the use of a different and more competitive model.

In a recent symposium, Hurdle and McFarland\textsuperscript{219} argued that price discrimination deserves attention parallel to entry and profitability as a likely indicator of a malfunctioning market. We disagree. There can be no single, infallible index of good market performance. Entry is neither sufficient nor necessary. Profitability, too, has its limitations; an inefficient firm of unremarkable profitability may sometimes succeed in blocking the entry or expansion of a rival with superior potential. But we think that is rare. Despite practical problems of measurement, chronic excess profits (suitably corrected for risk), particularly for more than one incumbent firm, should be the premier indicator of competitive failure in any part of the economy. Some form of public intervention may or may not be judged likely to improve such a situation. But price discrimination deserves no more special attention in the evaluation of a market than many other elements of firm behavior.

\textsuperscript{218} See, for example, Corts \textit{supra} note 37.