The 'Wright' Debate: Price-cost Tests v. Raising Rivals' Costs for Loyalty Programs and its Implication for the Taking of Advantage of Market Power Provisions

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Abstract: 2013/2014 has seen two seemingly unrelated debates. One in New Zealand and Australia about the effectiveness of the "taking advantage of market power" provisions (known as abuse of dominance in most jurisdictions), and the second originating from the US Federal Trade Commission (FTC) about whether loyalty rebates should be analysed for anti-competitiveness through the lens of predation or exclusion. US FTC Commissioner Joshua Wright shook the antitrust world with a speech that indicated a break from what had been considered the standard US approach to loyalty programs. Rather than applying a price-cost test, Commissioner Wright advocated a raising rivals' cost approach as better allowing for an assessment of the potential exclusionary effects of loyalty programs. The debate about the effectiveness of the market power provisions meanwhile centres on whether the so-called counterfactual test is prone to allowing anti-competitive conduct to slip through. The Australian Competition and Consumer Commission in seeking change to the provisions and the related test came under criticism for not providing robust examples of such false negatives. Under the counterfactual test, however, it is not clear that this type of conduct would be captured regardless of whether one's theory of harm was something more akin to predation or exclusion. This leaves a whole area of potentially anti-competitive conduct that could escape sanction.

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1. Introduction

Both New Zealand and Australia are considering changing the "taking advantage of market power" provision of their respective competition laws.[2] These provisions are the trans-Tasman equivalent to what is better known internationally as either abuse of dominance or monopolisation. No matter the label, these types of provisions generally seek to limit anti-competitive acts by a firm with significant market power. The Australian and New Zealand version of these provisions have long been criticised for, one, lacking an effects based test and, two, for reliance on the "counterfactual test" as the means of distinguishing between anti-competitive and pro-competitive conduct.[3] This debate has recently come to a head in Australia with the Competition Policy Review Panel's consideration of Australia's competition policies, laws and institutions (the Harper Review Panel).[4] That review, which includes a review of the taking advantage provisions, culminated in a draft recommendation that an effects based approach be introduced. The recommendation, however, also introduces a defence that seems to retain a consideration of the counterfactual test. In New Zealand, the counterfactual test remains the status quo.

Critics of any reform on both sides of the Tasman have argued not only of the dangers of an effects based test, but also decry a lack of information substantiating that a problem or gap exists with the existing provisions and the counterfactual test in the first place. The recent "Wright debate" stemming from the US Federal Trade Commission (the US FTC) in regard to single-product loyalty discounts points to exactly that: a set of behaviour that is unlikely to be caught by the existing taking advantage provisions.

US FTC Commissioner Joshua Wright shook the antitrust world with a speech that indicated a break from what had been considered the standard US approach to loyalty programs.[5] Rather than applying a price-cost test, Commissioner Wright advocated a raising rivals' cost approach as better allowing for an assessment of the potential exclusionary effects of loyalty programs. This raising rival's cost approach has been criticised as essentially being too permissive, risking capturing conduct that is otherwise pro-competitive.[6] However, under the counterfactual test, it is not clear that the anti-competitive conduct of concern would be captured regardless of whether one's theory of harm was something more akin to predation or exclusion. This leaves a whole area of potentially anti-competitive conduct that could potentially escape sanction regardless of whether one's approach to the issues are "liberal" or "conservative".

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2 Commerce Act 1986, s 36 and Competition and Consumer Act 2010 (AUS), s 46.

3 The available tests are somewhat wider in Australia but the primary test remains the counterfactual one.

4 Government of Australia "Competition Policy Review: Draft Report" (September 2014) <www.competitionpolicyreview.gov.au>.

5 Joshua D. Wright "Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts", (Bates White 10th Annual Antitrust Conference 2013, Washington DC, 3 June 2013).

6 See for example, Dan Crane "Dan Crane on Commissioner Wright's Rejection of a Price-Cost Test for Loyalty Discounts" (2013) Truth on the Market <http://truthonthemarket.com>., and Thom Lambert "Should There Be a Safe Harbor for Above-Cost Loyalty Discounts? Why I Believe Wright's Wrong" (2013) Truth on the Market <http://truthonthemarket.com /2013/06/06/should-there-be-a-safe-harbor-for-above-cost-loyalty-discounts-why-i-believe-wrights-wrong/>.

2. Criticisms of the "taking advantage" provisions

While the taking advantage provisions in Australia and New Zealand differ somewhat in their wording, they consist of essentially of two requirements:

1) That there is conduct that involves a firm taking advantage of its substantial market power;[7] and

2) The conduct was undertaken for the purpose of eliminating a competitor, substantially damaging a competitor, or preventing entry.[8]

The problems generally considered to arise from this wording are twofold:

1) There is no consideration of the effect of the conduct on competition.[9] Rather the focus is the effect on competitors, who, of course, often struggle in a healthy and beneficial competitive process.

2) "Taking advantage" has been interpreted by the courts to require an assessment of whether the firm that otherwise has substantial market power would have acted in the same way in a hypothetically competitive market (the "counterfactual test").[10] This is seen as an inadequate filter because:

   - "it is absolute in that no matter what the impact of a firm's conduct on competition, if a firm without market power would have pursued that conduct no breach can occur; and,

   - the method by which it is applied – that is, the requirement of a consideration of a hypothetical world where all factors, apart from the firm-in-question's market power, are in place – is often difficult and unwieldy to apply in practice (particularly in comparison to a straightforward consideration of whether a rational business justification is likely)."[11]

3. Harper Review Draft Recommendations

In regard to the first criticism that there is no consideration of the effect of the conduct on competition, the Harper Review found that "the focus of the prohibition on showing a purpose of damaging a competitor is inconsistent with the overriding policy objective of the [Competition and

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7 A concern with the current wording of these provisions that is not fully addressed in this paper is the requirement that market power pre-exist the conduct. As such, engaging in anti-competitive conduct that obtains a firm market power is excluded from consideration under the provisions.

8 The New Zealand provision does not contain the "substantially damaging" language.

9 A common example of effects based language is that the conduct "has the purpose, or has or is likely to have the effect, of substantially lessening competition" (Section 27 (Contracts, arrangements, or understandings substantially lessening competition prohibited) of the New Zealand Commerce Act).

10 *Commerce Commission v. Telecom Corp of NZ Ltd* [2010] NZSC 113.

Consumer Act 2010] being to protect competition, not competitors."[12] As such, its draft recommendation is that the "purpose" test be altered to the "standard test in Australia's competition law: purpose, effect or likely effect of substantially lessening competition."[13]

The Harper Review does not, however, stop there. It further indicates that "to minimise the risk of inadvertently capturing pro-competitive conduct", it proposes "that a defence be introduced so that the primary prohibition would not apply if the conduct in question:

- would be a rational business decision by a corporation that did not have a substantial degree of power in the market; and
- would be likely to have the effect of advancing the long-term interests of consumers."[14]

The language around the first limb of this defence is virtually the same as the existing counterfactual test, leading the New Zealand Commerce Commission (NZCC) to submit to the Harper Review Panel that it "risks simply reintroducing the concepts that have made the counterfactual "taking advantage" test ill-suited to sorting conduct with pro-competitive effects and conduct with anti-competitive effects."[15] [16]

4. The Counterfactual Test Advocates

Advocates of the counterfactual test have dismissed criticisms of it on the following basis:

1) *Allows for a causal link*: "To have "taken advantage" of market power, there must be a causal link between the firm's market power and the conduct. Counterfactual flushes that out."[17]

2) *Other tests would cause business uncertainty*: Replacing the counterfactual test with some other test, such as an effects based approach, "may cause uncertainty about which business practices are permitted. This uncertainty could discourage innovation and other legitimate competitive activity."[18]

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12 Government of Australia "Competition Policy Review: Draft Report" (September 2014), at 43.
13 "Competition Policy Review: Draft Report", Government of Australia, September 2014, at 210.
14 "Competition Policy Review: Draft Report", Government of Australia, September 2014, at 210.
15 Commerce Commission New Zealand "Submission to Competition Policy Review Secretariat to the Treasury Australia" (November 2014), at 3.
16 There are also concerns about the proposed second limb of the defence: in particular the meaning of the "long-term interests of consumers" and how that may differ from a substantial lessening of competition. This, however, is not a subject of this paper.
17 Neil Anderson "What if we deep six section 36 and counterfactual? What then?" (2014) New Zealand Productivity Commission <http://www.productivity.govt.nz/inquiry-content/1624?stage=4)>.
18 New Zealand Productivity Commission "Boosting productivity in the services sector" (2014), at 128, <http://www.productivity.govt.nz/inquiry-content/1624?stage=4>.

3) *No compelling case to change*: There is nothing to support that the taking advantage provisions have not worked adequately.[19]

It is the last of these that is of interest in this paper, but the first two factors – the first in particular – are interlinked with the last one.

In posing whether a firm without market power, but otherwise facing the same market conditions, would have engaged in such conduct is essentially a means of trying to determine whether there is a reasonable business rationale for the conduct. In this way it is akin to the "no economic sense test" and so subject to the same criticisms. That is, if there is any business justification for the conduct, the conduct is allowed regardless of the extent of harm. That is, there is no consideration whatsoever of balancing pro- and anti-competitive effects.[20]

However any notion of a balancing or a lowering of the threshold for ascertaining whether certain conduct is anti-competitive is seen by advocates of the counterfactual test to create uncertainty, which would have a consequent adverse effect on pro-competitive behaviour. The former head of the Australian Competition and Consumer Commission (ACCC), Graeme Samuel, goes so far as to say in regard to an effects based test that "We think that that is economically very dangerous indeed, because what it does is say to big business that you can't engage in normal, commercial behaviour."[21] In a similar vein, turning the argument made by advocates for change on its head, Peter Costello, Australia's former federal treasurer, indicated, "The so-called effects test is designed to protect competitors, particularly less efficient ones, from a competitive challenge."[22]

Underscoring all of this is the criticism that the ACCC (and the NZCC) has failed to point to a set of cases that it would have liked to have taken but was unable to do so because the current wording of the law prevented it from doing so. Pegasus Economics, which provided input to a report by the Australian National Retailers Association, notes that as a consequence the Harper Review Panel was "addressing a problem that doesn't exist."[23]

As discussed in the section 5, single product loyalty rebates are a set of conduct that are likely to fail to be captured by the existing taking advantage provisions and the consequent application of the counterfactual test.

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19 "Boosting productivity in the services sector", New Zealand Productivity Commission, May 2014, at 129.

20 As previously noted, there also is no consideration of whether there is a more effective means of determining and assessing possible business justifications than the construction of a hypothetical world.

21 Lucy Barbour "Competition watchdog ACCC head Rod Sims denies claims an 'effects test' would be 'economically dangerous'" *ABC Rural* (Australia, 19 August 2014)

22 Sue Mitchell "Peter Costello buys into retail debate" The Sydney Morning Herald (Australia, August 18 2014).

23 Sue Mitchell and Matthew Knott "Australian National Retailers Association condemns Haper review's 'dangerous' competition law shake-up" The Sydney Morning Herald (Australia, October 27 2014).

5. Single Product Loyalty Rebates

There is a whole range of common conduct that would fail to be captured by the counterfactual test in its simplest application. Vertical restraints are at the same time ubiquitous and potentially the main means by which a firm may attempt monopolisation. To see this one need not look any further than the table of contents of the US Department of Justice's report on "Competition and Monopoly: Single-Firm Conduct and Section 2 of the Sherman Act"; topics include tying, bundled discounts and single-product loyalty discounts, refusals to deal, and exclusive dealing.[24] In its simplest form, the counterfactual test would suggest that because a firm without market power would engage in, for example, exclusive dealing, than a firm with market power doing so must be okay.

The test, however, is not quite so facile. It calls for a determination of whether a firm in the exact same circumstances as the dominant firm, but for substantial market power, would engage in such conduct. Ostensibly, assuming that the actions of a hypothetical firm in a similar fact situation absent market power can be determined, this allows for a determination of whether the particular firm in question would have, for example, engaged in exclusive dealing. If it would have, it presumably did so for good reason, for example to forestall free-riding. Only then would the firm-in-question be in the all clear.

Ignoring the possible disproportionality of any adverse effect of the conduct versus the pro-competitive or efficiency effect, and also ignoring the possibility that a firm without market power might effectively achieve dominance through anti-competitive conduct,[25] the test even when applied in a more case-specific way does not always give the right answer in that it may fail to filter for anti-competitive reasons for engaging in the conduct. A single product loyalty rebate is an example of such a situation. This is the case both when it is considered as a form of predation or as a means of raising rivals' costs.

Single product loyalty rebates are when a seller offers a rebate on all purchases, including those previously purchased, conditional on the percentage of needs purchased, e.g., a 10% rebate on all purchases – those already purchased in the last year and the remainder to be purchased in the calendar year – if a buyer purchases at least 80% of its total annual needs from the supplier.[26] This type of rebate is distinct from cases where the discount does not go back to earlier units purchased. For example, a coffee shop may offer a loyalty card where every tenth coffee purchased is free. In

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24 U.S. Department of Justice "Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act" (2008) <www.usdoj.gov/atr/public/reports/236681.htm>.

25 The most common example of this is predation. A firm that engages in predation to eliminate its rivals may not have market power. Market power is the ability to maintain prices above competitive levels in a non-transitory way. As such, a firm with market power is unlikely to feel the need to predate – that is price below cost so that it might eventually price above cost. Rather for predation to make sense, what a predating firm requires is deep pockets and the expectation of future market power post successful predation.

26 This type of loyalty program is distinct from volume discounts where the discount or rebate is conditional on the volume of product purchased rather than being tailored to a buyer's own requirements.

that case, the free tenth cup does not change the amount the consumer paid for coffees one through nine.

The reason for this distinction is that the theory of harm associated with single-product loyalty rebates is based on some portion of an incumbent firm's demand being a "must-have". Once buyers have purchased their requirements of the must-have, there may remain some contestable demand.

For example, in the Intel abuse case considered by the European Commission, the Commission found that Intel's x86 processors were a must-have for some portion of most original equipment manufacturers' (OEMs) processor needs.[27] Another example may be a branded food product carried by supermarkets; even though the margin the supermarkets earn on their own brand/private label version of the product are higher, a supermarket not carrying the branded version of the product would be at a competitive disadvantage as a result of consumer demand for those brands.

The remaining portion of demand is contestable. For example, in the Intel matter, the European Commission found that OEMs were willing and able to purchase some portion of their needs from AMD, Intel's main competitor.[28]

This split between must-haves and contestable demand is in contrast to the coffee shop example where all demand is contestable: buyers in a competitive market choose between a number of competing options and are induced to buy more or most of their coffee from one shop by the offer of a tenth free cup. The buyer is not, however, penalized for having bought, for example, their seventh cup of coffee in a month from a competitor. The buyer might have several coffee cards with no sanction other than it might take longer for them to "earn" their free cup.

In the case of the "must-have" theory of harm, the contestable portion of demand is sufficiently large to allow for entry. That is, having for example 20% of buyers' demand available is sufficient to attract entry. As a consequence, the incumbent firm has an incentive to offer rebates that induce a buyer to buy more than 80% of their requirements – that is, not just the must-have portion – from the incumbent. The incumbent has an incentive to do this not just to gain the remaining portion of demand, but to foreclose competitors who, if they were to be successful suppliers of contestable demand, could become positioned to make inroads into the must-have portion of demand as well.

At this point, the theory of anti-competitive harm splits into two:

1) Predation: competitive harm arises because an equally efficient competitor is foreclosed from the contestable portion of the market because of below cost pricing for that demand.

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27 European Commission "Commission Decision of relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement" (2009) COMP/C-3 /37.990 – Intel, May 13, 2009, at paragraphs 1010-1012.

28 "Commission Decision of relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement, COMP/C-3 /37.990 – Intel", European Commission, Brussels, May 13, 2009, at paragraphs 1010-1012.

2) Exclusion: an entrant is foreclosed because the demand it has left available to it is not large enough to generate positive expected profits.[29]

Neither of these methods by which harm could arise are likely captured by the counterfactual test.

5.1 Single Product Loyalty Rebates as Predation

Under a single product loyalty rebate predation theory of harm, if the entrant is equally efficient as the must-have supplier, it will be able to match the effective price being offered for the contestable portion of demand. As such, the rebate is only considered predatory if the effective price of the contestable portion of demand is priced less than cost. This is a standard (although not necessarily only) approach taken by many competition authorities.[30]

Such a price-cost test differs from the standard predation price-cost test in that the price at issue is not the invoiced per unit price but the effective price once all relevant rebates are accounted for and apportioned to the contestable portion of demand. The firm may remain profitable overall (in fact, it is expected to) but if the "effective" price of the contestable portion of demand is below cost, the practice is considered predatory.

For example, suppose a firm's total requirements are 100 units, where 80 units are must-have and 20 units are contestable. Further suppose the must-have supplier offers a discount of 10% on all units if more than 80 units are purchased. Further suppose the price is $2/unit. The buyer purchases 100 units from the must-have supplier. The effective price for the 20 contestable units would be $20 in total (($2x20) - ($2x100x0.1)). This $20 would then be compared to some appropriate measure of cost (typically the avoidable cost of the contestable portion of demand).

Whether the predatory conduct is also likely to be anti-competitive typically requires a consideration of whether there is a justifiable business reason for having engaged in the conduct. Factors such as the length of the conduct, for example whether it was short term to encourage the quick sale of a perishable product, would be considered. Depending on the relevant legislation and jurisprudence, such factors can be considered within the assessment of the substantial lessening of competition itself or by way of an explicit business justification defence.[31]

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29 In the case where a 100% of the market is tied up, foreclosure does not rely on economies of scale. The incumbent may simply be willing to pay more for exclusivity than an entrant because it will allow it to maintain monopoly profits.

30 Commission of the European Communities "Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings" (2008). "Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings", Commission of the European Communities, Brussels, 3 December 2008. The European Commission in discussing the price-cost test approach acknowledges that, "in certain circumstances a less efficient competitor may also exert a constraint which should be taken into account when considering whether a particular price-based conduct leads to anticompetitive foreclosure" (at paragraph 23).

31 For example, under section 27 of the New Zealand Commerce Act, which governs anti-competitive arrangements, the term "substantial lessening of competition" is considered to mean the net effect on

5.1.1 Single Product Loyalty Rebates as Predation Under the Counterfactual Test

Given a theory of harm of foreclosure of entrants through predation in the contestable portion of demand so as to foreclose entry and reduce the risk of erosion of the must-have portion of the incumbent's demand, how would the counterfactual test apply?

First, under the counterfactual test, technically there is no need even to develop a cogent theory of harm that seeks to understand how harm could arise in the first place. Rather one would just ask whether a firm that does not have market power but otherwise faces the same fact situation would offer single product loyalty discounts.

Taking our fact situation, an incumbent sells a product that is a must-have for a good portion of demand. Developing a hypothetical that denies that firm its market power would amount to denying the firm its must-have since this is the basis of its market power. This leaves all of demand contestable. As such asking whether a firm without market power would price below cost on the contestable *portion* of its sales is essentially meaningless.

It is not clear where this leaves us in regard to the counterfactual test. It essentially undermines the entire theory of harm.

An alternative possibility, although arguably a less likely one, is that predation through a loyalty program essentially devolves down into regular predation. That is, there would be a determination of whether the price of the product with the discount applied across *all* sales (rather than just contestable sales) is below cost. If yes, given the theory of harm, one would be at risk of false-negatives: conduct that would otherwise likely be considered problematic would pass the counterfactual test.

Some, however, would welcome such devolution, arguing that a determination of the contestable portion of demand is fraught with uncertainty, as would be determining the right measure of cost for the production of a *portion* of a single product.[32] Professor Herbert Hovenkamp, for example, acknowledged that an above-cost pricing (when measured against all units sold to a customer) loyalty rebate might be anti-competitive as a result of denying rivals economies of scale, but courts

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competition of an agreement. That is, a balancing of pro-competitive effects of the conduct against the anti-competitive effects (Fisher &Paykel Ltd (no 2) [1987] 1 NZBLC (Com) 104,377 at [3.21]). This confusingly in contrast to the use of substantial lessening of competition under the New Zealand merger provisions where substantial lessening of competition is understood to mean an enhancement of market power ("Mergers and Acquisitions Guidelines", Commerce Commission New Zealand, July 2013, at paragraph 2.20). In contrast, a business justification consideration was read into the Canadian abuse of dominance provisions by the Federal Court of Appeal: "An additional factor in the determination of whether an act is anti-competitive is whether it was in furtherance of a legitimate business objective." (Competition Bureau Canada "The Abuse of Dominance Provisions Enforcement Guidelines" (September 2012), at 11.

[32] 23. U.S. Department of Justice "Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act" (2008), at 112.

(and presumably competition authorities) could not apply such theories “without creating an intolerable risk of chilling procompetitive behaviour.”[33]

Regardless of whether one agreed with Professor Hovenkamp,[34] all that would be available under the counterfactual test in regard to loyalty programs in terms of a theory of harm would be traditional, i.e., all unit, predation.

The Privy Council, when deciding an appeal of a judgment of the Court of Appeal of New Zealand of an alleged case of predation, found that below cost pricing was not sufficient to establish predation because the conduct was not “any different from that which a non-dominant firm of equivalent financial strength would have resorted to in the same circumstances.”[35] Rather what was required was demonstration that the below cost pricing was done “with a view of charging supra-competitive prices at a later date on that or any other of its products.”[36]

While a demonstration of recoupment being likely post predation is laudable, “the charging of supra-competitive prices” post predation does not fit the theory of harm. Rather, prices are below cost for a portion of demand in order to *preserve* market power, and so prices, in the non-contestable portion of demand. As a result, the predation is indefinite and is sustainably so since the firm overall does not price below cost.[37]

5.2 Single Product Loyalty Rebates as a Means to Induce Exclusivity and so Raise Rivals’ Costs

There are also theories of harm associated with single-product loyalty discounts that rest on inducements to exclusivity or near-exclusivity rather than predation. These theories essentially argue that even price-cost tests that apply the entirety of the discount to the contestable portion of demand may fail to capture of the foreclosing effect that can result when there are economies of

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33 “Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act”, U.S. Department of Justice, September 2008, at 112.

34 Professor Robert Lande suggests that, “Professor Hovenkamp’s conclusions rest on the plausible but unproven assumptions about the relative importance of procompetitive and anticompetitive effects of single-product loyalty discounts. For example, he asks whether the assertion that most discounting practices are procompetitive is ‘still true when these discounts are given by monopolists, by monopolists for the first time facing the prospect of significant new entry, or by would-be monopolists that are targeting rivals?’” “Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act”, U.S. Department of Justice, September 2008, at 112.

35 *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2006] 1 NZLR 145, paragraph 68.

36 *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* [2006] 1 NZLR 145, paragraph 68.

37 All that said, it is not clear that a devolution to an all-unit price-cost test is what would result from the application of the counterfactual test. The courts might just ask whether firms without market power but selling similar products or the same product but in a different geographic market would offer a rebate once a firm buys a certain threshold of its requirements from the supplier in question. Posing such a question, even though there has been some attempt the preserve the firm-in-question’s fact situation, is really not much different from asking whether there are coffee shops with loyalty cards. What matters here is the must-have and so asking whether, for example, a branded grocery product supplier has a loyalty rebate when it already faces considerable private label competition, does not tell us why it also has such a scheme when it does not (let alone what the resulting harm might be).

scale. As Professor Timothy Muris put it, "All else equal, how can a firm that offers you less of what you want be equally efficient with a firm that offers you more?"[38]

It is such theories that were recently advocated by US FTC Commissioner Joshua Wright. Commissioner Wright indicated "exclusive dealing law is superior to price-cost legal standards for evaluating loyalty discounts."[39] More specifically, loyalty discounts can, "under certain circumstances, impair competitors' access to distribution and other sales outlets" and so "deprive rivals of the opportunity to achieve minimum efficient scale, potentially raising rivals' costs, and possibly harming competition and consumers".[40]

As with the case of exclusive dealing, the Chicago School contention that a distributor would not create a monopoly in its supply chain has to be considered.[41] One possible means by which such monopolisation may take place is that there are coordination issues in the distribution channels such that any one distributor foregoing the supply of the incumbent in favour of that of the entrant would disadvantage that distributor in its market.[42] Even where one available distributor is sufficient to prompt entry, a distributor may be reluctant to "break ranks" and forego the inducement to exclusivity if this risks a price war prompted by the incumbent supplier.[43]

Under exclusive dealing such breaking of ranks is less of a consideration since there is often a contract in place preventing such a possibility (which is why the length of such contracts and whether they overlap across distributors is often a key consideration in an assessment of their likely anti-competitive potential). Absent such contracts, inducements to exclusivity through loyalty programs relies on firms not breaking ranks for the usual reasons that facilitate successful coordinating behaviour. Repeated interaction and long-standing relationships, along with such factors as price transparency and the ability to punish any break are typically key.

Naturally, a competition authority would be required to test each element of such a theory of harm against the facts of the market. This not a straightforward task and its complexity is another reason why some advocate a price-cost test approach regardless.[44] Others note that approach is no more

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38 U.S. Department of Justice "Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act" (2008) at 100.

39 Joshua D. Wright "Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts", (Bates White 10th Annual Antitrust Conference 2013, Washington DC, 3 June 2013), at 33.

40 "Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts", Remarks of Joshua D. Wright, Bates White 10th Annual Antitrust Conference, Washington, DC, June 3, 2013, at 7.

41 Bork, R.H., *The Antitrust Paradox*, Basic Books, New York, 1978.

42 E.B. Rasmussen, J.M. Ramseyer and J.S. Wiley Jr, "Naked Exclusion" *The American Economic Review* (1991), pp 1137-1145.

43 DeGraba, Patrick and John Simpson, "Loyalty discounts and theories of harm in the Intel investigations", *Journal of Antitrust Enforcement*, 2013, pp 1-33.

44 Others indicate that the simplicity of price-cost tests, even where no applied across all units, is overstated. (for example, "Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts", Remarks of Joshua D. Wright, Bates White 10th Annual Antitrust Conference, Washington, DC, June 3, 2013, at 19).

difficult than the approach already taken to situations involving exclusive dealing.[45] However, in Australia and New Zealand, such an approach is much more likely to be available in actual cases of exclusive dealing since they are more likely to involve explicit contracts. The presence of such contracts, rather than a supply schedule with noted rebates, means that there is a much greater possibility of taking such an approach for exclusive dealing for the simple reason that these are more likely to involve a contract and so are more likely to fit under the anti-competitive arrangement provisions of the two countries' competition acts.[46]

5.2.1 Single Product Loyalty Discounts as Exclusion Under the Counterfactual Test

Given such an exclusionary/raising rivals' costs theory of harm, the question again is what response the counterfactual test would likely provide. As before, it is impossible to answer this in abstract since the facts are unknown. Presumably if there is a reasonable business justification, such the use of loyalty schemes to induce a retailer to better promote the supplier's product, than the answer would be that a firm without market power would use such schemes. As previously noted, such a business justification is something that any competition authority should consider regardless of how it arrives at that consideration. The problem here, as previously noted, is that the counterfactual test arriving at such a response would not mean that this is the reason that the dominant firm in question is engaging in the conduct.

More to the point, the counterfactual test might provide the wrong result in this situation because it is possible that a firm without market power would engage in such conduct even without any efficiency based business justification (with no ill effect). A supplier without market power might too seek to increase market share by convincing a distributor (through a loyalty scheme) to carry its product exclusively, without any expectation that the distributor as a consequence would devote more resources to promotion. It would essentially be competing with other suppliers for the distributor's shelf space, without any likely consequent anti-competitive effect because, for example, of low barriers to entry into distribution, because the percentage of distributors under exclusives remain small, or because the percentage of distributors exclusive to anyone supplier remains small. Such an action could even increase inter-brand competition with little ill effect on intra-brand competition.

That is, loyalty rebates, like exclusive dealing, may simply be a form of competition and so one would expect to see it without market power in otherwise the same fact situation. One would even expect suppliers to be engaged in it for the same reason both with and without market power: to gain or maintain market share. But, as in the case of exclusive dealing, what matters are factors like the extent of the market that is so tied up, the length of time for which the loyalty rebates are in place, their geographic distribution in cases where economies of density are relevant and so forth, all with

[45] U.S. Department of Justice "Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act" (2008), at 114.

[46] Section 27 of the New Zealand Commerce Act and section 45 of the Australian Competition and Consumer Act 2010, both of which have effects based tests and do not rely on the counterfactual test (as understood under the taking advantage provisions).

the aim of understanding whether, as a consequence, foreclosure (without reasonable business justification) is likely.

This again leaves us in the situation where the counterfactual test might result in a false negative. Moreover, simply asking whether a firm without market power would offer inducements to exclusivity is a long way from our original theory of foreclosure through inducements to reduce the amount of demand available to a potential entrant and so increasing their costs. This might suggest that the counterfactual test should be modified to ask questions like would, absent market power, the loyalty rebate be so widespread or be in place for as long, but this beggars the question.

6. Conclusion

The NZCC and the ACCC have both been criticised for failing to provide examples of anti-competitive conduct that fails to be captured under this existing taking advantage of market power provisions and the associated counterfactual test. Single-product loyalty rebate programs are an example of conduct that likely falls into this category. Most disturbingly this is the case regardless of one takes a "liberal" exclusionary approach or a more conservative predatory one. It is not even the case that the likelihood of a false-negative is likely diminished when the underlying theory of harm is a conservative approach to predation. Finally, most disturbingly, technically, a cogent theory of harm is at most an interesting sidebar in the application of the counterfactual test. It does not, Commissioner Wright advocates, require that an agency "select an appropriate theoretical model of harm and consider seriously whether the assumptions underlying that model fit the reality of the marketplace under investigation."[47]

[47] Joshua D. Wright "Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts", (Bates White 10th Annual Antitrust Conference 2013, Washington DC, 3 June 2013), at 21.

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