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FORMALISM AND FUNCTIONALISM IN THE ANTITRUST TREATMENT OF LOYALTY REBATES: A COMPARATIVE PERSPECTIVE

Daniel A. Crane*

It is a widely held belief that U.S. antitrust law has long been characterized by economic functionalism and that European antitrust law has long been characterized by legal formalism.[1] The received wisdom began to change in Europe a decade ago when the Directorate General Competition of the European Commission (DG Comp) began to advocate a more "effects-based" analysis of abuse of dominance. Two factors arguably contributed to this change. First, the DG Comp became increasingly influenced by economists who had little use for the old formalism. Second, as Europe tried to spread antitrust to developing antitrust regimes across the world—and, in particular, to urge these regimes to adopt an EU-style competition law—it faced pressure to respond to American critics who charged that European antitrust law was too stodgy and formalistic. Effects-based economic analysis was the sort of state-of-the-art technocratic reasoning that could be sold as a neutral regulatory tool irrespective of local or regional circumstances, customs, or preferences.

Exhibit A for the new European functionalism is the Commission's abrupt change of view on loyalty rebates. In a long line of precedent, exemplified

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[1] *See, e.g.*, Louis Kaplow, *Direct Versus Communications-Based Prohibitions on Price Fixing*, 3 J. Legal Analysis 449, 526 (2011) (asserting that U.S. law favors "economically grounded analysis in lieu of formalistic thinking" and that this impulse has traditionally been weaker in Europe but is now growing); William Kolasky, *Reinvigorating Antitrust Enforcement in the United States: A Proposal*, Antitrust, Spring 2008, at 85, 86 (asserting that "the competition regime in Europe has only recently been converted from a highly bureaucratic system with formalistic rules and procedures to a more effects-based system in which economics plays a more central role in shaping competition policy and enforcement"); Roger Van den Bergh & Peter Camesasca, European competition Law and Economics: A Comparative Perspective 1 (2d ed. 2006) ("For a long time, European competition law was permeated by legal formalism. [Thus,] [t]he permissibility of certain business practices was decided upon the basis of technical legal distinctions rather than their economic effects.").

particularly by *Hoffmann-La Roche*[2] and *Michelin*,[3] the European Court of Justice (ECJ) had adopted a presumption that discounts or rebates offered by dominant firms to induce customer loyalty were incompatible with Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU). However, in a December 2008 Guidance Paper on the application of Article 102's prohibition on abuse of dominance, the Commission staff suggested determining whether loyalty discounts are anticompetitive by using a modified predatory pricing analysis, similar to what some U.S. courts and agencies have suggested.[4] The European antitrust community has understood the Guidance Paper as reflecting a movement away from a "form-based" analysis and toward an "effects-based" or functional economic analysis.[5]

In this essay, I shall examine the evidence that Europe has abandoned formalism in the analysis of loyalty rebates and has converged with American functionalism. While this narrative is more right than wrong, it is also too simple. As evidenced in the Commission's *Intel* decision[6] and the General Court decision affirming the Commission's decision,[7] European treatment of loyalty rebates retains a schizophrenic relationship with both formalism and functionalism. And so does the United States, although with different values and assumptions. Whereas European law is more likely to draw on formal rules to prohibit loyalty rebates, U.S. law is more likely to draw on formal rules to permit them. Europe employs legal formalism, and the United States uses economic formalism. Neither system employs an open-ended rule of reason type approach to loyalty rebates or is likely to do so any time soon. Both systems employ a mixture of functional and formal considerations.

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[2] Case 85/76, Hoffmann-La Roche & Co. v. Comm'n, 1979 E.C.R. 461.

[3] Case 322/81, NV Nederlandsche Banden-Industrie Michelin v. Comm'n, 1983 E.C.R. 3461, 3475–86.

[4] Eur. Comm'n, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings*, 2009 O.J. (C 45) 7. The Commission's analysis was similar to that in the U.S. Justice Department's contemporaneous report on monopolization. U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT § 6 (II) (2008), www.justice.gov/atr/public/reports/236681.htm (discussing legal and economic standard for judging legality of loyalty discounts). Three Commissioners of the Federal Trade Commission criticized the Justice Department's report as too protective of dominant firms. Press Release, Fed. Trade Comm'n, FTC Commissioners React to Department of Justice Report, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (Sept. 8, 2008), www.ftc.gov/news-events/press-releases/2008/09/ftc-commissioners-react-department-justice-report-competition-and. The Obama Antitrust Division withdrew the report in one of its first official acts. Press Release, U.S. Dep't of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), www.justice.gov/atr/public/press_releases/2009/245710.htm.

[5] *See* Neelie Kroes, Member, Eur. Comm'n in Charge of Competition Policy, Speech at the Fordham Corporate Law Institute: Preliminary Thoughts on Policy Review of Article 82, at 2 (Sept. 23, 2005) (advocating an effects-based approach to Article 82 enforcement).

[6] Case COMP/C-3/37.990—Intel, Comm'n Decision (Summary), 2009 O.J. (C 227) 13.

[7] Case T-286/09, Intel v. Comm'n, ECLI:EU:T:2014:547 (GC June 12, 2014).

I. FORMALISM AND FUNCTIONALISM: SOME PRELIMINARIES

To American lawyers, inculcated through education to legal realism, formalism is an epithet describing a legal system where linguistically defined rules constrict the choice of the decision maker.[8] American lawyers often assume that European civil law systems, untouched by the kind of legal realist movement that swept through American law schools in the inter-war period, embody a formalistic approach to jurisprudence.[9] In fact, the story is considerably more nuanced. Many aspects of contemporary U.S. jurisprudence could be described as formalistic as compared to their counterparts in the doctrines of various civil law countries. U.S. jurisprudence employs a variety of approaches along the continuum of "rules versus standards," as it is often stylized in jurisprudential and economic literature.[10]

This is true in antitrust law, as elsewhere. Contemporary U.S. antitrust jurisprudence is characterized by elements of both open-ended rule of reason analysis—which invites detailed economic analysis—and more rule-bound approaches to certain problems of market power, where analysis turns principally on the application of one or two factor liability determinants. The rule of per se illegality for price-fixing agreements is an obvious example of a liability determinant that approaches a single-factor rule. Once a defendant is found to have fixed prices (an inquiry that, admittedly, sometimes requires the consideration of economic factors),[11] the conclusion inevitably follows that the defendant has violated the law, regardless of whether there is a good explanation for the price fixing or it can be economically justified.

Academic commentators tend to view the last several decades in U.S. antitrust jurisprudence as moving away from this sort of rule-based approach toward a more flexible, standards-based approach. The evidence for this is primarily the courts' retreat from the per se rule and toward the rule of reason

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[8] Frederick Schauer, *Formalism*, 97 Yale L.J. 509 (1988); *see also* H.L.A. HART, THE CONCEPT OF LAW 124–30 (3d ed. 2012) (defining formalism as a decision maker's refusal to acknowledge the necessity of choosing between results); MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780–1860, at 253–54 (1977) (defining formalism and refusal to recognize that legal decision making serves instrumental functions); KARL N. LLEWELLYN, JURISPRUDENCE: REALISM IN THEORY AND PRACTICE 183–88 (1962) (describing formalism as over-reliance on canons of decision).

[9] DUNCAN KENNEDY, A CRITIQUE OF ADJUDICATION (FIN DE SIÈCLE) 107 (1997); Kristoffel Grechenig & Martin Gelter, *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism*, 31 HASTINGS INT'L & COMPARATIVE L. REV. 295 (2008).

[10] *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992); Kathleen M. Sullivan, *The Supreme Court, 1991 Term—Foreword: The Justices of Rules and Standards*, 106 HARV. L. REV. 22 (1992).

[11] *See* DANIEL A. CRANE, ANTITRUST 60–62 (2014).

on intrabrand vertical restraints,[12] horizontal group boycotts,[13] and tying arrangements.[14] But even while moving away from bright-line rules *creating* liability, U.S. courts have increasingly created bright line rules *insulating from* liability. In a number of contexts, mostly dominance, the courts have created safe harbors that categorically immunize defendants from liability, even if the relevant conduct is alleged to have reduced market competitiveness or harmed consumer welfare. Thus, for example, the courts have held that defendants are categorically immune from antitrust liability for above-cost price cuts,[15] almost all refusals to deal,[16] and bundled discounts that pass the attribution test.[17] These sorts of bright-line immunity zones replicate a kind of economic formalism that had previously been seen primarily on the liability-creating side of the ledger.

A recent example of economic formalism appears in the U.S. Supreme Court's decision in *Pacific Bell v. linkLine*[18] rejecting price squeeze (known in Europe as margin squeeze) liability. The plaintiffs in *linkLine* were four independent DSL providers who alleged that AT&T engaged in an exclusionary "price squeeze." Specifically, plaintiffs alleged that AT&T set a high wholesale price to them but then a low retail price to its own customers, and that the effect of this squeeze was that they could not profitably compete against AT&T.[19] The plaintiffs did not allege that AT&T's retail price was predatory—that is to say, set below marginal cost.[20]

Although the majority opinion for five Justices also contains some institutionalist analysis, the core of this opinion is formalistic. Price-squeeze claims,

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[12] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 908 (2007) (holding that minimum resale price maintenance agreements were no longer per se illegal); State Oil Co. v. Khan, 522 U.S. 3, 7 (1997) (holding that maximum resale price maintenance agreements are no longer per se illegal under the Sherman Act).

[13] *See, e.g.*, FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986).

[14] Illinois Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006) (jettisoning long-standing presumption of market power where tying firm had a patent in tying market); United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (rejecting application of per se rule to technological ties).

[15] Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222 (1993) (holding that a defendant cannot be liable for predatory pricing unless it prices below "an appropriate measure of cost").

[16] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004) (holding that even a monopolist has no antitrust duty to deal).

[17] Cascade Health Sols. v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008) (applying discount attribution test to allegations of anticompetitive bundled discounts).

[18] Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc., 555 U.S. 438 (2009).

[19] *linkLine*, 555 U.S. at 443.

[20] Under U.S. predatory pricing principles, the plaintiff usually must show that the defendant priced below some measure of incremental or marginal cost, although the Supreme Court still has not decided exactly what measure of cost should be employed. *See* CRANE, *supra* note 11, at 110–12.

reasoned the Court, necessarily involve defendants who operate in two markets—an upstream and a downstream market—and a plaintiff that operates in only the downstream market. The plaintiff must buy from the defendant in the upstream market to compete with the defendant in the downstream market. The plaintiff alleges that the defendant misbehaved in both markets. First, the defendant charged too high a price in the upstream market. That claim is foreclosed by the Court's decision in *Trinko*,[21] which held that even dominant firms have no duty to share their infrastructure with rivals to facilitate competition. Since the dominant firm has no antitrust duty to deal at all in the upstream market, if it does choose to deal, it can charge whatever price it wants, reasoned the Court. Second, a price-squeeze plaintiff alleges that the defendant priced too low in the downstream market. But unless the plaintiff alleges that the defendant priced below cost in the downstream market, it runs into the Supreme Court's *Brooke Group* decision, which immunizes low prices from liability unless they are below cost. The Court summed up its holding as follows:

> Plaintiffs' price-squeeze claim, looking at the relation between retail and wholesale prices, is thus nothing more than an amalgamation of a meritless claim at the retail level and a meritless claim at the wholesale level. If there is no duty to deal at the wholesale level and no predatory pricing at the retail level, then a firm is certainly not required to price *both* of these services in a manner that preserves its rivals' profit margins.[22]

The core of the *linkLine* decision thus rests on the interaction of two legal doctrines—the absence of a duty to deal and the right to price at any level above marginal cost. The recitation of these two doctrines was sufficient to resolve the matter, without consideration of rule of reason factors, such as whether AT&T had market power, whether the alleged price squeeze foreclosed competition or harmed consumer welfare, and whether AT&T could offer any procompetitive justifications for the alleged price squeeze.

The ECJ, by contrast, has upheld liability for margin squeezes that would likely have been categorically immunized from liability under *linkLine*.[23] It would be difficult to sustain an argument that the ECJ precedents on margin squeeze reflect a greater degree of formalism than do the U.S. precedents. If anything, it is just the opposite.

II. THE EVOLVING JURISPRUDENCE OF LOYALTY REBATES

Before turning to a comparison of the functional and formal elements in the United States' and the European Union's treatment of loyalty rebates, it would

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[21] *Trinko*, 540 U.S. at 411.
[22] *linkLine*, 555 U.S. at 452.
[23] Case C-52/09, Konkurrensverket v. TeliaSonera Sverige AB, 2011 E.C.R. I-527.

be useful to provide a sketch of the doctrinal development in this area in the past decade. Two cases that were litigated roughly in parallel on both sides of the Atlantic—*British Airways* and *Intel*—illustrate the apparent (and perhaps illusory) convergence that has occurred in recent years.[24]

The *BA* litigation grew out of Virgin Atlantic's entry into the trans-Atlantic market in the mid-1980s and emergence as a serious competitor to other major U.S.–London carriers, particularly American Airlines and British Airways.[25] In the mid-1990s, partly in response to competition from Virgin, British Airways introduced a series of "Incentive Agreements" targeted at travel agents and corporate buyers.[26] Although some of the incentives were based on volume (how much revenue a travel agent pushed in BA's direction), others were based on market share—BA's percentage share of the U.S.-UK flights booked by the agent.[27] The discounts were typically "first dollar," meaning that when a customer reached the target threshold, it received a discounted price on earlier purchases.[28] Virgin brought suit, alleging that the incentive agreements, along with BA's ability to prevent Virgin from obtaining necessary slots at London's Heathrow airport, were part of an anticompetitive scheme to slow Virgin's growth as a competitor.[29]

The U.S. District Court for the Southern District of New York granted summary judgment for BA,[30] and the U.S Court of Appeals for the Second Circuit affirmed.[31] The Second Circuit first found that Virgin's Sherman Act Section 1 claims failed because Virgin failed to show "actual adverse effects" on consumer welfare.[32] It then affirmed the dismissal of Virgin's attempted monopolization claim on the grounds that Virgin failed to show that the incentive agreements resulted in BA pricing airline tickets below cost—a requirement for predatory pricing claims.[33] Reflecting a long line of precedents granting even dominant firms latitude on unilateral price cuts, the court observed that

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[24] A brief discussion of the treatment of loyalty discounts or rebates outside the United States and European Union can be found in EINER ELHAUGE & DAMIEN GERADIN, GLOBAL ANTITRUST LAW AND ECONOMICS 693–94 (2d ed. 2011).

[25] Virgin Atl. Airways Ltd. v. British Airways PLC, 257 F.3d 256, 260 (2d Cir. 2001).

[26] *Id.* at 261–62.

[27] Virgin Atl. Airways Ltd. v. British Airways PLC, 69 F. Supp. 2d 571, 574 (S.D.N.Y. 1999) ("Some of the targets are market-share targets (i.e., targets based on British Airways' percentage share of the corporation's U.S.-U.K. flights) . . . . Others are total-revenue targets.").

[28] *British Airways*, 257 F.3d at 261.

[29] *Id.* at 259.

[30] *British Airways*, 69 F. Supp. 2d at 582.

[31] *British Airways*, 257 F.3d at 273.

[32] *Id.* at 264-65.

[33] *Id.* at 265–69.

"[t]hese kinds of agreements allow firms to reward their most loyal customers. Rewarding customer loyalty promotes competition on the merits."[34]

The European Commission,[35] the General Court,[36] and European Court of Justice (ECJ)[37] reached a very different conclusion on the same facts. In *British Airways*, the ECJ found that the incentives were prima facie anticompetitive because they had the effect of inducing loyalty to a dominant firm.[38] The Court did not cite evidence of actual anticompetitive effects in the sense of higher consumer prices or diminished output, finding that evidence of actual anticompetitive effects was unnecessary.[39] Rather, in keeping with ECJ precedents, it focused on the generic exclusionary potential of loyalty rebates when exercised by dominant undertakings.[40]

Having found the incentive rebates to be suspect fidelity-building devices, the Court then considered whether BA had offered an "objective economic justification" sufficient to overcome the prima facie presumption of illegality.[41] BA argued that the rebates were objectively justified because they helped BA fill empty airplane seats and hence contribute toward its high fixed operational costs.[42] The ECJ affirmed the General Court's rejection of this argument, essentially finding that only direct cost savings from the loyalty program were the kinds of objective economic justifications sufficient to overcome the presumption of illegality for the deployment of fidelity discounts by dominant firms.[43]

The *Intel* case followed on the heels of *Virgin*. The computer central processing unit (CPU) market has been essentially a duopoly since the 1990s, with Intel controlling roughly 80 percent and Advanced Micro Devices (AMD) controlling the other 15 to 20 percent.[44] In the late 1990s, Intel began to offer Original Equipment Manufacturers (OEMs) financial incentives to purchase specified levels of their CPU requirements—typically around 80 or

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[34] *Id.* at 265.

[35] Case IV/D-2/34.780—Virgin/British Airways, Comm'n Decision, 2000 O.J. L (30) 1.

[36] Case T-219/99, British Airways plc v. Comm'n, 2003 E.C.R. II-5917.

[37] Case C-95/04 P, British Airways plc v. Comm'n, 2007 E.C.R. I-2331.

[38] *Id.* ¶ 77 (affirming General Court's finding that "the bonus schemes at issue had a fidelity-building effect capable of producing an exclusionary effect").

[39] *Id.* ¶ 30 ("[I]t [was] not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned.").

[40] *Id.*

[41] *Id.* ¶ 69.

[42] *Id.* ¶ 27.

[43] *Id.* ¶ 98.

[44] *See* Daniel A. Crane & Graciella Miralles, *Toward a Unified Theory of Exclusionary Vertical Restraints*, 84 S. CAL. L. REV. 605, 647–49 (2011) (explaining background to *AMD/Intel* litigation).

85 percent—from Intel.[45] AMD complained that these loyalty rebates slowed its market share growth and starved it of the capital needed to invest in developing new products.[46] From the early 2000s and continuing to some degree until the present, AMD and Intel waged a global antitrust war over the legal treatment of Intel's loyalty discounts. To summarize the headlines briefly, AMD secured early decisions against Intel in Japan and Korea, a favorable decision and €1.06 billion (almost $1.5 billion) fine against Intel from the European Commission, a $1.25 billion settlement payment from Intel, and a complaint from the Federal Trade Commission that Intel quickly settled.[47]

Although we have not yet heard the final word from Europe,[48] the *Intel* case seems to suggest some provisional and fragile rapprochement between the U.S. and EU treatment of loyalty discounts—at least at the level of public enforcement. For its part, the European Commission seemed to back away from the view expressed in *Hoffmann-La Roche*, *Michelin*, and *BA* that loyalty discounts by dominant firms should be treated as prima facie illegal and only permitted if the dominant firm can overcome the high hurdle of proving marginal cost efficiencies. The key turn came in its December 2008 Guidance Paper on application of Article 102's prohibition on abuse of dominance. In its Prohibition Decision, the Commission began by invoking the "form-based" precedents (*Hoffmann-La Roche*, *Michelin*, and *BA*), but then conducted an "effects-based" modified predation analysis to conclude that Intel's loyalty rebates had an exclusionary effect on AMD, and hence on competition.[49]

A few months after the Commission decision, the FTC brought its own action against Intel.[50] If the Europeans had moved a few yards in the American direction, the Americans moved a few feet in the European direction. Consistent with U.S. predatory pricing precedent, the Commission alleged that Intel's rebates would have forced an equally efficient competitor to price below cost in order to compete.[51]

However, the Commission also gave notice that it intended to push the boundaries of traditional, pro-defendant predatory pricing law as applied to loyalty discounts. First, the Commission's complaint alleged that the measure of cost below which Intel priced included "average variable cost plus an ap-

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[45] *Id.*

[46] *Id.*

[47] *Id.* at 648.

[48] As of this writing, the General Court has issued its decision affirming the Commission's finding of liability, and an appeal to the ECJ is still possible. *See* Case T-286/09, Intel v. Comm'n, ECLI:EU:T:2014:547 (GC June 12, 2014).

[49] *See* Crane & Miralles, *supra* note 44, at 648–49 (describing Commission's approach).

[50] Complaint, Intel, FTC Docket No. 9341 (Dec. 16, 2009) [hereinafter *Intel* Administrative Complaint], www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf.

[51] *Id.* ¶ 53.

propriate level of contribution towards sunk costs."[52] Since most U.S. courts consider only variable or marginal costs in predatory pricing cases,[53] this was a direct challenge to the application of a predatory pricing model in bundled discount cases.[54] Second, the complaint alleged that, while the Commission was prepared to show that Intel was able to recoup its costs of giving loyalty discounts through supracompetitive pricing, recoupment should not be a mandatory element of an FTC case challenging loyalty discounts.[55] Since recoupment is an element of a predatory pricing case,[56] this statement also signaled the FTC's intention to move away from restrictive predation rules and analogies toward a more interventionist approach toward loyalty discounts. It is impossible to know whether these theories would ultimately have held up had the *Intel* case been litigated because Intel settled with the Commission a few months later.[57]

Most recently, the General Court affirmed the European Commission's decision on the formalistic reasoning of *Hoffmann-La Roche*, *Michelin*, and *BA*.[58] The Court held that the Commission was not required to show that the rebates in question actually foreclosed competition and rejected the applicability of "as efficient competitor" and "price-cost" tests.[59] The Court also held that the economic approach staked out in the 2008 Guidance Paper was not relevant to the Court's legal analysis, since the Guidance Paper was issued after the events challenged by the Commission in *Intel*.[60] Although some commentators have understood the General Court's decision as a throw-back to the formalistic dogma of pre-2008 judicial decisions, the Court's opinion did not reject the application of economic analysis under the Guidance Paper in future cases, leaving open the possibility that such analysis becomes the framework for decision down the road.

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[52] *Id.*

[53] 3 PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW §§ 739–40 (4th ed. 2015) (explaining application of average variable cost test).

[54] *See* Daniel A. Crane, *Predation Analysis and the FTC's Case Against Intel* (Univ. of Mich. Law & Econ. Empirical Legal Stud. Ctr., Working Paper No. 10-014, 2010) (examining ways in which FTC's proposed cost definition faced difficulties given prevailing legal standards).

[55] *Intel* Administrative Complaint, *supra* note 50, ¶ 53.

[56] Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993) ("The second prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that the competitor had a reasonable prospect, or, under § 2 of the Sherman Act, a dangerous probability, of recouping its investment in below-cost prices.").

[57] Press Release, Fed. Trade Comm'n, FTC Approves Modified Intel Settlement Order (Nov. 2, 2010), www.ftc.gov/opa/2010/11/intel.shtm.

[58] Case T-286/09, Intel v. Comm'n, ECLI:EU:T:2014:547 (GC June 12, 2014).

[59] *Id.* ¶¶ 151–153.

[60] *Id.* ¶¶ 154–161.

III. FORMALISMS AND FUNCTIONALISMS IN LOYALTY REBATE ANALYSIS

A. FORMALISM IS DEAD. LONG LIVE FORMALISM!

At one level, it is easy to tell a story of recent convergence between U.S. and EU rebate analysis. In this story, *Hoffmann-La Roche, Michelin*, and *BA* represent an older EU formalism that no longer made sense in light of evolving economic understanding and demands for the harmonization of abuse of dominance principles in a world of interdependent global antitrust enforcement. *Intel* and the Guidance Paper (with the caveats discussed with respect to the General Court decision) mark a turning point, away from formalism and toward a U.S.-style rule of reason functionalism. And the FTC returned the favor by relaxing some of the bright-line rules (such as the inclusion of only short-run incremental costs in the price-cost calculation) and thus converging toward Europe.

This story, however, overstates both the level of convergence and the level of economic functionalism prevailing on either side of the Atlantic. In a variety of ways, whether loyalty rebates will be treated with sympathy or hostility, and whether they will be subject to prohibitory or immunizing bright-line rules or open-ended rule of reason analysis remains very much contested in both the United States and the European Union.

In Europe, neither the European Commission, nor the General Court, nor the ECJ has abandoned the form-based approach to loyalty rebates reflected in *Hoffmann-LaRoche* and *Michelin*. In *Intel*, the Commission performed a comprehensive legal analysis under the older precedents, finding that since Intel's discounts amounted to fidelity rebates that restricted customer freedom, they were illegal under EC precedent.[61] Only after finding liability under the form-based approach did the Commission turn to an equally efficient competitor analysis, which seems superfluous if liability could be found solely based on the facts that Intel was dominant and used rebates to induce loyalty. Thus far, the effects-based approach suggested by the Guidance Paper seems to be used merely to confirm the economic rationality of a prohibition decision based on the form-based precedents. What would happen in a case where the form- and effects-based analyses reached different results is unclear.

The situation in the United States is also quite uncertain, with a wide range of outcomes possible in any particular case given the Supreme Court's refusal

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[61] Case COMP/C-3/37.990—Intel, Comm'n Decision ¶ 1001, ec.europa.eu/competition/antitrust/cases/dec_docs/37990/37990_3581_18.pdf ("The rebates and payments in question constitute fidelity rebates which fulfil the conditions of the relevant case law for qualification as abusive. . . . In addition, they had the effect of restricting the freedom to choose of the respective OEMs and of MSH.").

to consider a loyalty rebate case thus far. It is far from a given that the U.S. courts would follow the FTC's position in *Intel*. One of the leading court of appeals precedents seems to hold that loyalty rebates are not illegal unless they result in below-cost pricing, without any consideration of performing the price-cost test after the allocation of discounts to the contestable segment of the market.[62] Others seem to suggest that price-cost tests should not be used at all if the loss of the rebate is used to penalize disloyalty rather than to reward loyalty[63] (a distinction that is mysterious at best).[64] No court has yet squarely embraced the discount attribution test in the loyalty rebate context.[65] In the meantime, loyalty rebates continue to be sharply contested in private litigation, with varying results in the courts of appeal.[66] Thus, aspects of formalism may continue to characterize analysis of loyalty rebates on both sides of the Atlantic, although in opposite directions. Europe may preserve the *Hoffmann-La Roche/Michelin* line of legal formalism, in which any rebate that induces loyalty to a dominant undertaking is deemed prima facie illegal. The United States, in the meanwhile, may decide in favor of economic formalism, adopting some version of the price-cost test with marginal cost as the appropriate measure of cost as an absolute safe-harbor against liability. In that event, trans-Atlantic comparisons will continue to resemble the divisions reflected in *BA* rather than the rapprochement reflected in *Intel*.

B. Formalism Is Not an Epithet

I began this essay by observing that, to most American lawyers at least, formalism is an epithet describing a cramped, crude form of legal reasoning. This is not, however, my own view.[67] Competition law does not inherently need to be governed by open-ended rule of reason analysis and economic functionalism. There remains a need for clear rules of demarcation, both cre-

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[62] Cascade Health Sols. v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008).

[63] Daniel A. Crane, *Bargaining over Loyalty*, 92 TEX. L. REV. 253, 278 n.147 (2014) (collecting sources making the "disloyalty penalty" claim).

[64] *See id.* at 278–84 (critiquing penalty theory).

[65] Two recent decisions have addressed the relationship between the price-cost test and loyalty discounts. In *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254 (3d Cir. 2012), a federal court of appeals upheld a jury verdict finding the defendant liable for monopolization based in part on its use of market share rebates. The court rejected the defendant's argument that it could not be liable since it did not price below cost, holding that price was not the "clearly predominant mechanism of exclusion" and therefore that the price-cost test should not apply. *Id.* at 269. Conversely, in *Eisai Inc. v. Sanofi-Aventis U.S., LLC*, No. CIV.A. 08-4168 MLC, 2014 WL 1343254, at *26 (D.N.J. Mar. 28, 2014), *aff'd*, 821 F.3d 394 (3d Cir. 2016), the district court held that since price was the alleged principal mechanism of exclusion, the price-cost test applied to the defendant's market share rebates.

[66] *See* cases cited *supra* note 65.

[67] *See generally* Daniel A. Crane, *Rules Versus Standards in Antitrust Adjudication*, 64 WASH. & LEE L. REV. 49 (2007) (arguing that, under some circumstances, rules are preferable to standards in antitrust analysis).

ating liability and insulating against it, as to various aspects of antitrust analysis.

Indeed, it would be naïve to expect that either European or U.S. competition law will inevitably progress toward an unstructured effects-based analysis that eschews any use of strong legal or economic presumptions or rules. Legal historians and scholars of jurisprudence point out that every legal system vacillates over time between hard-edged rules and open-ended standards.[68] Often, a legal system will create new formal rules governing some issues even as it trends toward a more flexible approach to other issues. It is only a slight exaggeration to say that for every action toward functionalist standards, there is an equal and opposite reaction toward formal rules. This is arguably the correct understanding of U.S. antitrust history since the rise of the Chicago School in the 1970s. Prohibitory rules have relaxed in favor of prohibitory standards even while immunizing standards have morphed into immunizing rules.

In part, the choice between rules and standards as to loyalty rebates turns on background ideological assumptions about the role and limits of dominant firms in market-oriented economies. The *Hoffmann-La Roche/Michelin* approach imagines dominant firms as aberrations with special responsibilities to avoiding perpetuating dominance and to avoid distortions of the competitive playing field. The most immunizing versions of the price/cost test imagine dominant firms as beneficial actors deserving of protection against antitrust challenges except in extreme cases of objectively predatory behavior. Differing Bayesian prior beliefs about dominance and the role of competition law in achieving a level playing field explain many of the differences.

But the choice between formal rules and flexible standards is only partly a question of background assumptions about dominance or ideology more generally. It also involves an expression of views about the dynamics of agency or court decision making and other institutional factors such as the role of private litigation and damages. Two people with common background beliefs about loyalty rebates may come out differently on the appropriate analytical mode because of different perspectives on institutional questions. For example, former FTC Commissioner Joshua Wright—who is quite sympathetic to dominant firms and loyalty rebates in most circumstances—has come out

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[68] For example, the philosopher Morris Cohen argued that "periodic waves of reform during which the sense of justice, natural law, or equity introduces life and flexibility into the law and makes it adjustable to its work" are often followed by periods where "under the social demand for certainty, equity gets hardened and reduced to rigid rules." MORRIS R. COHEN, LAW AND THE SOCIAL ORDER 261 (1933). Similarly, property law scholar Carol Rose has documented a tendency in property law to "shift back and forth between hard-edged, yes-or-no crystalline rules and discretion-laden, post hoc muddy rules." Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 590 (1988).

against the application of any version of the price-cost test.[69] Wright has long advocated in favor of "evidence-based" antitrust analysis, which means diminished reliance on a priori conceptions or formal rules but instead a fact-intensive exploration of the circumstances of each case. I share many of Wright's sympathies, but have advocated in favor of the discount attribution approach in large part because of concerns that open-ended rule of reason analysis makes it less likely that courts will dismiss meritless complaints at the pretrial stage or otherwise cabin the jury's discretion to punish loyalty programs for reasons other than a reduction in market competition. I support a price-cost safe harbor not because loyalty programs within the safe harbor are in every case incapable of harming competition, but because, given the relevant institutions, the error costs of scrutinizing those cases are high.

Debates of these kinds are unlikely to disappear. On both sides of the Atlantic, elements of formalism and functionalism will continue to characterize antitrust analysis of loyalty rebates, even though they may appear in different places at different times.

IV. CONCLUSION

Many American antitrust practitioners welcomed Europe's ostensible shift from form-based to effects-based analysis as a step in a westward direction. But even as contestation over this potential shift continues in Europe, the United States continues its own contestation over the extent to which antitrust analysis should rely on formal rules or more open-ended standards. The major difference is that the existing European rules create liability in a large swath of cases whereas some U.S. rules would prevent it in an equally large swath. The stakes on both sides of the Atlantic are not just over whether formal or functional liability determinants should be employed, but whether loyalty rebates should be received with sympathy or hostility.

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[69] Joshua D. Wright, Comm'r, Fed. Trade Comm'n, Remarks at Bates White 10th Annual Antitrust Conference: Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts (June 3, 2013), www.ftc.gov/sites/default/files/documents/public_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf.