Courts struggle to sort out bundled discounts
Two circuits and a congressional panel land in different places.

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Anyone who has bought a value meal at a fast food restaurant, cable and Internet service from the same provider or a computer with preloaded software likely has received a bundled discount. These packaged discounts provide purchasers the opportunity to pay less for a bundle of goods than if they purchased each item separately. These package deals can benefit consumers and often represent the type of competition that the antitrust laws were designed to protect. But, in some rare situations, companies with market power can use bundled discounts to exclude from the market single-product firms that, although more efficient than the dominant, multiproduct firm, just simply cannot compete with discounts across several product lines.

The extent to which bundled discounts should raise concern under the antitrust laws has been the subject of some debate. Two circuits that have addressed the issue have reached conflicting conclusions. And the Antitrust Modernization Committee (AMC), a congressional panel focused on updating the antitrust laws, has recommended a different standard for evaluating bundled discounts than those used by these two circuits. AMC, Report and Recommendations 99, (April 2007).

The debate was sparked in 2003, when the 3d U.S. Circuit Court of Appeals, in LePage's Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003), upheld a jury verdict against 3M Co. for unlawfully monopolizing the transparent-tape market by giving retailers bundled discounts across a broad array of 3M products. 3M argued that even a company with monopoly power could not violate the antitrust laws by giving customers discounts that exceeded the company's costs of making and selling the products in question. After all, the antitrust laws seek to protect and enhance consumer welfare, and discounts generally benefit consumers. But the 3d Circuit ruled that bundled discounts, even those that exceed the seller's costs, could have an unlawful exclusionary effect. LePage's has received significant criticism from antitrust practitioners and scholars, but also some support in lower-court decisions from other circuits.

The 9th Circuit, the other circuit to address this issue, rejected the 3d Circuit's approach. In Cascade Health Solutions v. PeaceHealth, nos. 05-35627, 05-35640, 05-36153, 05-36202 2007 WL 2473229 (9th Cir. Sept. 4, 2007), the 9th Circuit held that above-cost bundled discounts are not the sort of anti-competitive conduct that can trigger liability for monopolization or attempted monopolization. PeaceHealth borrows some elements from the standard for evaluating bundled discounts recommended by the AMC, but stops short of adopting all of the elements of the AMC's proposed test.
Some consensus seems to exist that bundled discounts can harm legitimate competition from single-product firms in limited circumstances. A hypothetical situation sometimes used to illustrate this problem posits a manufacturer that makes and sells both shampoo and conditioner competing against a company that makes only shampoo. Even if the multiproduct firm operates less efficiently in producing the competitive product — i.e., the one that both companies sell — it can offer a bundled discount price that exceeds its costs in making and selling both products and yet foreclose the more efficient single-product firm from the shampoo market.

This hypothetical example, discussed in *PeaceHealth*, assumes that the average variable costs of the multiproduct firm, Firm A, to make shampoo and conditioner are $1.50 and $2.50, respectively. The single-product firm, Firm B, operates more efficiently, with an average variable cost to produce shampoo of $1.25. Firm A might decide to price shampoo and conditioner separately at $3 and $5, respectively, but at $2.25 and $3 if purchased in a bundle. Absent the bundled price, Firm A's combined price would be $8. But because Firm A has set its bundled price at $5.25, which is still above its average variable costs for both products, Firm B has to sell its shampoo at $0.25 in order to compete against Firm A's bundle. Thus, it will be driven out of the shampoo market despite being the more efficient producer.

The problem lies in crafting a legal standard that forecloses with surgical precision this potential problem without chilling pro-competitive discounting.

Many have criticized *LePage's* for not clearly articulating any standard for judging bundled discounts and for suggesting a legal rule that would sweep too broadly.

*LePage's* manufactured and sold "private label" transparent tape — tape that bore a retailer's brand rather than *LePage's* own — to large office supply chains and mass retailers such as Office Depot Inc. and Wal-Mart Stores Inc. 3M Co., the producer of the well-known Scotch-brand tape, dominated the relevant market for transparent tape. *LePage's*, however, developed sizable market share within the private-label segment of the market, threatening 3M's monopoly on transparent tape.

3M, unlike *LePage's*, sold to retailers across six different product lines: health care, home care, home improvement, stationery (including transparent tape), retail auto and leisure time. Rather than offer volume discounts on Scotch tape, 3M offered discounts conditioned on a retailer's meeting purchasing targets across all six 3M product lines. If a customer missed the target for any one product, it would lose the entire rebate. *LePage's* claimed that 3M had monopolized the transparent-tape market in violation of 2 of the Sherman Act by offering multitiered rebates to retailers to exclude *LePage's* from that market. A jury found 3M liable for nearly $68.5 million after trebling.

3M argued that monopolization claims premised on bundled discounting should be treated the same as those based on predatory pricing; i.e., discounted prices above an appropriate measure of the seller's costs cannot result in antitrust liability. The court rejected this argument, refusing to declare above-cost bundled prices per se lawful.

Rather, the 3d Circuit held that above-cost bundled prices could constitute unlawful exclusionary conduct if undertaken by a seller with monopoly power. The court found that 3M had no legitimate business justification for the exclusionary practice. *LePage's* suggests, however, that the liability determination turns on an absence of a legitimate business justification for the bundled discounts. The 3d Circuit ruled that 3M gained no efficiencies through its bundling practices and therefore could not justify the discounts.

The rule emanating from *LePage's* appears to be that bundled discounts violate the antitrust laws, or at least raise antitrust concerns, if the party offering those discounts has market power, competes against rivals that do not sell the full array of product lines that it sells and cannot justify the discounts as economically efficient, e.g., by showing that it achieved greater cost savings in selling a broad bundle of goods. Notably, then-Judge, now Justice, Samuel A. Alito Jr. dissented from the 3d Circuit's en banc decision.
AMC report

In its recommendations to Congress in April, the AMC joined critics of LePage's in lamenting that the ruling "offers no clear standards by which firms can assess whether their bundled rebates are likely to pass antitrust muster." Such a deficiency could chill bundled discounting in the overwhelming number of instances in which it is pro-competitive. The AMC recommended a three-part test by which a plaintiff would show:

- After allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product.
- The defendant is likely to recoup these short-term losses.
- The bundled discount is likely to have an adverse effect on competition.

The AMC's test is meant to meet two goals: to subject bundled discounts to antitrust scrutiny only if they could exclude a hypothetical equally efficient competitor; and to provide sufficient clarity for businesses to determine whether their bundled discounting practices run afoul of 2 of the Sherman Act.

In PeaceHealth, the 9th Circuit expressly rejected LePage's and held that bundled discounts could satisfy the exclusionary conduct element of a monopolization claim only if the discounts, after they have all been allocated to the competitive product, result in a price below the defendant's incremental cost to produce the competitive product. Thus, the court embraced the first prong of the AMC's proposed three-part test. The court refused, however, to adopt the AMC's recoupment requirement, because unlawful bundled discounting will not necessarily result in a loss when measured against the entire bundle. Thus, there may be no losses to recoup. The court also refused to require a showing of an anti-competitive effect, reasoning that this already is required as part of the antitrust injury analysis and therefore would be superfluous.

PeaceHealth involved the only two providers of hospital care in Lane County, Ore.: McKenzie-Willamette Hospital and PeaceHealth, a nonprofit corporation that runs hospitals in the Pacific Northwest. PeaceHealth provided primary, secondary and tertiary care, while McKenzie offered only primary and secondary care. PeaceHealth offered discounts of 35% to 40% on all tertiary services to insurers that made PeaceHealth their sole preferred provider in all three markets: primary, secondary and tertiary. McKenzie — which later changed its name to Cascade Health Solutions — sued PeaceHealth, alleging monopolization and attempted monopolization of the primary and secondary hospital service markets. A jury awarded McKenzie $5.4 million, trebled to $16.2 million, and more than $1.5 million in attorney fees on the attempted monopolization claim. Notably, the district court based its jury instructions on LePage's.

On appeal, the 9th Circuit recognized the task before it: "How . . . to discern where antitrust law draws the line between bundled discounts that are pro-competitive and part of the normal rough-and-tumble of our competitive economy and bundled discounts, offered by firms holding or on the verge of gaining monopoly power in the relevant market, that harm competition and are thus proscribed by § 2 of the Sherman Act." 2007 WL 2473229, at *6.

In sum, the 3d and 9th circuits have adopted and the AMC has recommended approaches for evaluating bundled discounts under the antitrust laws that differ markedly from one another. Dominant companies should recognize the risks resulting from these conflicting approaches in evaluating any bundled discounts that they may offer.

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