***On Antitrust***

The question of the Sherman Act's application to bundled product discounts has vexed courts for some time. In a recent decision, the Ninth Circuit has limited defendants' antitrust liability in this situation, but in doing so has also complicated the analysis.

Manufacturers of two or more products sometimes offer bundled discounts. For example, a manufacturer of shampoo and conditioner may sell the shampoo for $5, the conditioner for $3, but sell both together for $7. Rivals – particularly rivals that offer only one of the competing products, say conditioner – may complain that the bundled discounts foreclose competition and violate Section 2 of the Sherman Act.

Courts have struggled with the question of whether such bundled discounting should be analyzed under an exclusive dealing analysis, a tying analysis, or a predatory pricing analysis. Under the exclusive dealing rubric, the question is whether the manufacturer essentially gives purchasers no choice but to buy its products. Under a tying analysis, the primary questions are whether the manufacturer conditions purchase of one product upon purchase of the other, and whether it has market power in the "tying" product market. Under a predatory pricing analysis, the main questions are whether the manufacturer is selling its product below some measure of incremental cost, and whether it has a dangerous probability of recouping its losses after its rival is driven from the market. Defendants generally prefer the predatory pricing analysis because its use of a cost/price screen is thought to be clear and to result in fewer "false positives."

In a heavily-criticized opinion, the Third Circuit in *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (*en banc*), *cert. denied*, 542 U.S. 953 (2004), condemned bundled discounts even when they were above any measure of the defendant's cost. 3M had above a 90% market share in the transparent tape market and was a conceded monopolist. LePage's offered cheaper, "second brand" and private label transparent tape. LePage's challenged 3M's multi-tiered bundled rebate structure, which offered higher rebates when customers purchased products in a number of 3M's different product lines (not just tape). LePage's asserted claims under Sherman Act Section 2. It did not, however, bring a predatory pricing claim. *See id*. at 151.

The *en banc* court, upholding the jury's Section 2 verdict against 3M, analogized the bundled discounts, not to predatory pricing, but to tying or exclusive dealing. "The principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer." *Id*. at 155. The court did not require LePage's to prove that it or a hypothetical equally efficient competitor could not meet the discounts without pricing below cost. Rather, the court endorsed the trial court's jury instruction that conduct that "has made it very difficult or impossible for competitors to engage in fair competition" is actionable under Section 2. *Id*. at 168.

In *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008), the Ninth Circuit declined to follow *LePage's*, and applied a cost-based test to bundled discounts. In that case, plaintiff and defendant each provided primary and secondary acute-care hospital services. Defendant also provided tertiary-care services, and had a very high market share in that market (approaching 90% in some sub-specialties). The plaintiff did not compete in the tertiary-care market. The plaintiff brought a Section 2 claim against defendant, alleging that it offered bundled-service packages to some customers (such as insurance companies). The bundled discounts applied to all services if the insurance companies made defendant their sole preferred provider for primary, secondary, and tertiary care services. *See id*. at 892.

In the Ninth Circuit's view, the fundamental problem with *LePage's* is that it "concludes that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line" and that it fails to consider whether such discounts may be pro-competitive. *See id*. at 899. The Ninth Circuit refused to adopt the *LePage's* approach, holding that bundled discounts may not be considered exclusionary conduct under Section 2 unless the discounts resemble predatory pricing behavior. *See id*. at 903.

The Ninth Circuit specifically adopted a discount attribution standard where, when the full amount of the defendant's discount on the bundled offering is allocated to the competitive product, and if the resulting price is above defendant's incremental cost to produce the competitive product (to be precise, its average variable cost), the arrangement is not exclusionary. *See id*. at 906-10. This refinement, although arguably less demanding than the amorphous Third Circuit test, still requires defendants to clear a higher hurdle than merely proving that all sales on average were above cost.

However, the Ninth Circuit also muddied the waters a bit, because it reversed a grant of summary judgment to the defendant on a Section 1 tying claim. The evidence, taken as a whole, presented genuine factual disputes about whether PeaceHealth forced customers (insurers) "either as an implied condition of dealing or as a matter of economic imperative through its bundling discounting" to take some of its services if the insurers wanted other services. *Id*. at 914. The Ninth Circuit did not resolve the question of whether a "no economic option" tying claim would require proof of below-cost pricing. (The Ninth Circuit also did not address bundled discounts involving contractual obligations not to buy from competitors.) As a result, blanket statements to the effect that the legality of price discounting *always* turns on a cost/price analysis should be considered with caution.

*Mr. Ullman is of counsel with Orrick, Herrington & Sutcliffe LLP.*
*hullman@orrick.com*