

EVALUATING BUNDLED DISCOUNTS

Thomas A. Lambert

ABSTRACT: *Bundled discounts—discounts conditioned upon purchasing products from multiple product markets—present a bit of a dilemma for antitrust scholars: on the one hand, they result in lower prices and therefore provide immediate benefits to consumers; on the other hand, even above-cost (i.e., non-predatory) bundled discounts may cause long-run consumer harm by foreclosing competitors that are as efficient as the discounter but do not sell as broad a line of products. Courts therefore need an evaluative approach that would identify and condemn all, but only, those bundled discounts likely to cause long-term consumer harm by driving out efficient rivals. The approach must also be easily administrable so as to avoid chilling procompetitive discounting behavior. This article identifies and critiques five attempts courts and commentators have made at articulating such an evaluative approach and, finding each approach lacking, proposes an alternative evaluative approach. The proposed approach would presume the legality of above-cost bundled discounts but would permit that presumption to be rebutted by a plaintiff that had fully exhausted its competitive options and was, or was likely to become, as efficient as the discounter. The recommended approach would be easily administrable and would include clear safe harbors so as to ensure that procompetitive bundled discounting is not discouraged.*

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INTRODUCTION

A “bundled discount” occurs when a seller offers a collection of different goods for a lower price than the aggregate price for which it would sell the constituent products individually.¹ While such discounts are ubiquitous throughout the economy,² their legality is very much in question. In September 2002, hospital bed maker Hill-Rom Corporation was hit with a \$519 million antitrust judgment for offering bundled discounts on packages of its standard and specialty beds,³ and plaintiffs have recently filed several lawsuits against medical device manufacturers, who have been accused of violating the antitrust laws by

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¹ Other commentators refer to such discounts as “multi-product discounts.” See Daniel A. Crane, *Multi-Product Discounting: A Myth of Non-Price Predation*, 72 U. CHI. L. REV. __ (forthcoming 2005).

² See, e.g., *Make A Bundle Bundling*, HARV. BUS. REV. 18-20 (Nov.-Dec. 1997) (referencing Mercer Management study of “100 companies that use bundling as a major component of their corporate strategy”); Soman & Gourville, *Transaction Decoupling: How Price Bundling Affects the Decision to Consume*, 38 J. MARKETING RES. 30 (2001) (“the practice of price bundling is widespread”); SUCCESS STORIES IN PRODUCT BUNDLING (Corporate Executive Board August 1999), at 7 (“[virtually all industries use product bundling”]; Yadav & Monroe, *How Buyers Perceive Savings in a Bundle Price: An Examination of a Bundle's Transaction Value*, 30 J. MARKETING RES. 350 (1993) (“bundling is ubiquitously applied in both consumer and industrial markets”); Yadav, *How Buyers Evaluate Product Bundles: A Model of Anchoring and Adjustment*, 21 J. CONSUMER RES. 342 (1994); Hanson & Martin, *Optimal Bundle Pricing*, 36 MANAGEMENT SCI. 155 (1990); Harlam et al., *Impact of Bundle Type, Price Framing and Familiarity on Purchase Intention for the Bundle*, 33 J. BUS. RES. 57 (1995); Stremersch & Tellis, *Strategic Bundling of Products and Prices: A New Synthesis for Marketing*, 66 J. MARKETING 55 (2002) (“Bundling is pervasive in today’s markets.”); Johnson, Herrmann, & Bauer, *The Effects of Price Bundling On Consumer Evaluations of Product Offerings*, 16 INT’L J. RES. IN MARKETING 129 (1999).

³ Gary Young, *\$519 Million Antitrust Judgment – Hill-Rom Claims Verdict Will Not Stand*, NAT’L L. J. A9 (October 7, 2002). After threatening to appeal, Hill-Rom settled the case for \$250 million. Sue Reisinger, *Dueling Bed Manufacturers Find Peace in Settlement*, 13 CORP. LEGAL TIMES 58 (April 2003).

granting bundled discounts to hospital buying groups.⁴ The most prominent challenge to the legality of bundled discounts came in *3M Company v. LePage's Inc.*,⁵ in which the *en banc* Third Circuit condemned a bundled discount program, and upheld a \$68 million antitrust judgment against defendant 3M Corporation, even though the discounted prices 3M offered were above its costs and therefore were not predatory.⁶ Not surprisingly, *LePage's* caused quite an uproar in the business community.⁷

The U.S. Supreme Court also seemed troubled by the decision. After 3M petitioned for writ of certiorari, the Court invited the Solicitor General “to file a brief expressing the views of the United States.”⁸ The Solicitor General did so on May 28, 2004, recommending that the Court stay its hand.⁹ That recommendation was not based on a belief that the Third Circuit’s opinion was legally correct; indeed, the Government conceded that the Third Circuit committed significant legal errors.¹⁰ The

⁴ See June 10, 2004 Memorandum of Decision, *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770 MRP (C.D. Cal.) (order denying defendant’s motion for summary judgment) (copy on file with the author); Complaint, *Applied Medical Research Corp. v. Johnson & Johnson, Inc.*, No. 03-CV-1329 (C.D. Cal. filed Sept. 5, 2003) (copy on file with the author); Complaint, *ConMed Corp. v. Johnson & Johnson, Inc.*, No. 03-CV-8800 (S.D.N.Y. filed Nov. 6, 2003) (copy on file with the author).

⁵ 324 F.3d 141 (*en banc* 2003), cert denied, 2004 WL 1459258 (June 30, 2004).

⁶ *Id.* at 147.

⁷ See Mike Meyers, *One Big, Sticky Mess*, MINNEAPOLIS STAR-TRIB. 1D (Nov. 10, 2003) (“Companies nationwide are glued to the case.”). The following businesses and trade groups (represented by, among other well-known attorneys, Kenneth Starr, Robert Bork, and A. Douglas Melamed, former head of the Department of Justice’s Antitrust Division) joined amicus briefs asking the Supreme Court to reverse the decision: BellSouth Corp., Boeing Co., Brunswick Corp., the Business Roundtable, Caterpillar Inc., the Coca-Cola Co., Eastman Kodak Co., Honeywell International Inc., Hormel Foods Corp., Intel Corp., Johnson & Johnson, Kimberly-Clark Corp., Morgan Stanley, the National Association of Manufacturers, Nokia Inc., Northwest Airlines, Inc., the Procter & Gamble Co., Schering-Plough Corp., Staples, Inc., Verizon Communications, and Xerox Corp.

⁸ *3M Co. v. LePage's, Inc.*, 124 S.Ct. 365 (2003).

⁹ *Brief for the United States as Amicus Curiae*, 2004 WL 1205191 (May 28, 2004).

¹⁰ *Id.* at 14 n. 11 (“The Third Circuit declined to apply *Brooke Group* primarily because it thought that nothing in the decision suggests that its discussion of the price-cost test is applicable to a monopolist with its unconstrained market power. But this Court’s language plainly applies to a monopolist.”) (internal alteration, quotation marks, and citation omitted). See generally *Supplemental Brief for Petitioner*, 2004

recommendation was instead based on the Government's view that both the case law and the academic commentary on bundled discounts are underdeveloped and would therefore provide the Court little assistance in determining whether, and under what circumstances, bundled discounts should be illegal.¹¹ The Government observed that "[a]lthough there are references to bundled rebates in the scholarly literature, the theoretical and empirical analysis of that practice as a potentially exclusionary mechanism is relatively recent and sparse,"¹² and it concluded that "the Court would be well served to await further development of the case law, and further insights from academic commentary, before attempting to devise a standard to govern [this] important business practice of currently uncertain exclusionary effect."¹³ The Court was apparently persuaded: on June 30, 2004, it denied 3M's petition for writ of certiorari.¹⁴

This article aims to address, in part, the scholarship deficit noted in the Government's *LePage's* brief. The article analyzes the various frameworks courts and commentators have proposed for evaluating the legality of bundled discounts, and it posits an alternative evaluative approach. Recognizing that bundled discounts that result in above-cost prices ("above-cost bundled discounts")¹⁵ may sometimes cause

WL 1283785 (June 7, 2004), at *2-*3 (cataloguing six errors Government's brief identified in Third Circuit's opinion).

¹¹ *Brief for the United States*, 2004 WL 1205191, at *12 n. 9 (noting that "[t]he practice of bundled rebates has received far less judicial and scholarly scrutiny than predatory pricing," that "[o]nly two other litigated cases . . . have squarely focused on such practices," and that "[a]lthough there are references to bundled rebates in the scholarly literature, the theoretical and empirical analysis of that practice as a potentially exclusionary mechanism is relatively recent and sparse"); *id.* at *14 ("There is insufficient experience with bundled discounts to this point to make a firm judgment about the relative prevalence of exclusionary versus procompetitive bundled discounts."); *id.* at *18 ("[T]he meager case law addressing bundled rebates offers little assistance in determining how alternative standards might work in practice."); *id.* at *19 ("[A]t this juncture, it would be preferable to allow the case law and economic analysis to develop further and to await a case with a record better adapted to development of an appropriate standard.").

¹² *Id.* at *12 n. 9.

¹³ *Id.* at *15-*16.

¹⁴ *3M Co. v. LePage's Inc.*, 2004 WL 1459258 (June 30, 2004).

¹⁵ The term "above-cost bundled discount" is ambiguous. It might signify that the price of the bundle exceeds the bundle's cost (*i.e.*, the sum of the costs of the products within the bundle). *Cf.* 3 P. AREEDA & H. HOVENKAMP, *ANTITRUST LAW* ¶ 749a, at 509-11 (2d ed. 2002) (describing this sort of "above-cost" bundled discount). Alternatively, the term could describe a bundle where *each product* within the bundle is

anticompetitive harm, the proposed approach rejects the view that such discounts should be *per se* legal. At the same time, the approach accounts for the fact that bundled discounts result in lower consumer prices and thus should generally be permitted. The proposed framework attempts to provide an easily administrable legal rule for separating the procompetitive “wheat” from the anticompetitive “chaff.”

The article proceeds as follows: Part I clarifies what bundled discounts are, distinguishing them from single-product purchase target discounts, and sets forth the primary anticompetitive concern such discounts raise. Part II then considers and critiques the five approaches courts and commentators have proposed for determining the legality of above-cost bundled discounts (*i.e.*, those resulting in a bundled price that exceeds the cost of the bundle).¹⁶ Finally, Part III outlines an alternative approach for evaluating such discounts. The proposed approach would presume the legality of the discounts but would permit plaintiffs to rebut that presumption by proving easily ascertainable facts that would ensure that competitive options had been exhausted and would demonstrate that the above-cost bundled discount could exclude a rival that was, or was likely to become, at least as efficient as the discounter.

I. What Are Bundled Discounts, and Why Are They Troubling?

Bundled discounts come in a variety of forms. The simplest form is the “package discount,” in which a seller charges a lower price for a group of disparate goods sold together than for the same collection of goods purchased separately.¹⁷ A more complicated form of bundled discount occurs when a seller charges a lower price on all its products, or pays a rebate on all of a buyer’s purchases from it, if the buyer meets

priced above-cost, even after the entire amount of the discount is attributed to that single product. *See Crane, supra* note 1, at ___ (utilizing the term “above-cost” to indicate that each product is priced above cost when discounted by the entire amount of the bundled discount). This article uses the term in the former sense: A bundled discount is “above-cost” if the discounted price of the bundle exceeds the sum of the costs of the products within the bundle. Bundled discounts where the price of each product is above-cost even after the entire amount of the discount is attributed to that product should be *per se* legal, for the reasons stated by Professor Crane. *See id.* at ___.

¹⁶ *See supra* note 15.

¹⁷ For example, a manufacturer of shampoo and conditioner might charge \$2.00 per bottle of shampoo and \$4.00 per bottle of conditioner, but might sell the two products together for \$5.00. *See infra* notes 25 - 26 and accompanying text.

certain purchase targets (measured by volume, dollar value, or percentage of the buyer's requirements) in multiple product lines. That is the sort of bundled discount at issue in *LePage's*, where defendant 3M Corporation offered sizable discounts on all purchases from it, but only if buyers met purchase targets in several of 3M's varied product lines.¹⁸ It is also the sort of bundled discount that is currently creating antitrust problems for manufacturers of medical devices.¹⁹ The common characteristic of bundled discounts is that they are multi-product, purchase target discounts—*i.e.*, they are conditioned upon purchasing some quantum of goods from multiple product markets.

The term “bundled discount” therefore excludes straightforward volume discounts (what we might call “*single product purchase target discounts*”), pursuant to which a seller offers a reduced price or pays a rebate on all purchases of *a single product* as long as the buyer purchases a certain quantity from the seller.²⁰ From a competitive standpoint, what distinguishes the two types of discounts is their ability to exclude rivals that are at least as efficient as the discounter.²¹ An above-cost single-

¹⁸ See *LePage's*, 324 F.3d at 154. The bundled discounts at issue in *LePage's* are discussed in detail below. See *infra* notes 108 - 112 and accompanying text.

¹⁹ See *supra* note 4 (citing cases in which this sort of bundled discount is being challenged); U.S. GEN. ACCOUNTING OFFICE, GROUP PURCHASING ORGANIZATIONS: USE OF CONTRACTING PROCESS AND STRATEGIES TO AWARD CONTRACTS FOR MEDICAL-SURGICAL PRACTICES (GAO-03-998T) 13-14 (July 16, 2003) (Statement for the Record by Marjorie Kanof).

²⁰ That sort of discount was at issue in *Concord Boat v. Brunswick*, 207 F.3d 1039 (8th Cir. 2000), in which the Eighth Circuit held that Brunswick, a manufacturer of boat motors, did not monopolize the market for inboard and stern driven boat motors by giving boat builders discounts pegged to their purchases of minimum percentages of their requirements. Brunswick offered discounts of approximately 3% off the price to boat builders who purchased at least 70% of their motor needs from Brunswick. It also gave an additional 1% or 2% discount to builders that agreed to maintain those shares for two or three years. *Id.* at 1044. While the discounted prices were above Brunswick's cost, the plaintiffs, a group of boat dealers, claimed that the market share discounts had allowed Brunswick to dominate the market. *Id.* at 1045-46. The Eighth Circuit held that Brunswick's above-cost market share discounts did not violate the antitrust laws. *Id.* at 1062-63. Noting that above-cost discounts enjoy a “strong presumption” of legality, *id.* at 1061, the court distinguished the practices at hand from discounts conditioned on purchases of a bundle of different products. *Id.* at 1062. Thus, the court recognized that single product volume discounts and bundled discounts are different competitive animals.

²¹ 3 P. AREEDA & H. HOVENKAMP, ANTITRUST LAW (2003 Supp.) ¶ 749, at ___ (noting that “multi-product discounts . . . are typically quite distinguishable from single-product discounts or rebates” because “[a]ssuming that the fully discounted price

product volume discount may always be matched by an equally efficient competitor, for if the discounter's final prices are profitable (*i.e.*, above-cost), then any equally or more efficient rival could offer the same price and remain in business.²² Any competitor that would be driven from the market by a rival's single-product volume discount, then, must be a less efficient producer than its discounting rival.²³ The same is not true, though, for *bundled* discounts, which are conditioned on a buyer's purchases of products from different markets. The conventional view is that a multi-product bundled discount, unlike a single-product volume discount, may exclude more efficient rivals that do not produce as broad a product line as the discounter.²⁴

on a single product is profitable to the defendant, an equally efficient rival should always be able to match it").

²² See 3A P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 768b2, at 149 (2d ed. 2002) ("For single item discounts, no matter how measured or aggregated, injury to an equally efficient rival seems implausible.").

²³ As discussed below, *see infra* notes 69 - 78 and accompanying text, a number of commentators have noted that single-product volume discounts may be anticompetitive, even if they cannot exclude equally efficient rivals, because they may *cause* a rival to be less efficient than the discounter by denying the rival economies of scale. See Willard Tom, David Balto, & Neil Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L. J. 615, 627 (2000); Einer Elhauge, *The Exclusion of Competition for Hospital Sales Through Group Purchasing Organizations* (June 25, 2002) (report to U. S. Senate, available at http://www.law.harvard.edu/faculty/elhauge/pdf/gpo_report_june_02.pdf) at 18 ("By denying rivals access to the market share they would need to achieve their minimum efficient scale, exclusionary agreements can thus raise rivals' costs."); *id.* at 24, n. 68 ("Professor Hovenkamp argues that an equally efficient rival can always match the [single-product purchase target] discount . . . , but this is not true if . . . economies of scale exist because the exclusionary scheme will restrict the market share of the rival and thus deprive it of the economies of scale it needs to match the discounted price.").

²⁴ See, e.g., *LePage's*, 324 F.3d at 155 ("The principle anticompetitive effect of bundled rebates . . . 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."); *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1062 (3d Cir. 1978) (holding that defendant's bundled discount on pharmaceutical products violated Sherman Act because plaintiff, which sold a narrower product line, would have to match total dollar value of discount on a much smaller collection of products); *Ortho Diagnostic Systems, Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 463 (S.D.N.Y. 1996) (explaining how above-cost bundled discounts may exclude more efficient rivals); 3 AREEDA & HOVENKAMP (2003 Supp.), *supra* note 21, ¶ 749, at ___ (distinguishing single-product from multi-product purchase target discounts because as long as the former is above-cost "an equally efficient rival should always be able to match it," but with multi-product discounts, "even an equally

To see how this may happen, consider a manufacturer (“A”) that sells both shampoo and conditioner and competes against another manufacturer (“B”) that sells only shampoo.²⁵ B is the more efficient shampoo manufacturer; it can produce shampoo for \$1.25, while it costs A \$1.50 to do so. A’s cost of producing conditioner is \$2.50. If sold separately, A charges \$2 for shampoo and \$4 for conditioner (a total of \$6.00), but if a consumer purchases both shampoo and conditioner, A will sell the combination for \$5.00. That amount is \$1.00 less than the price charged if the products were purchased separately but \$1.00 greater than A’s cost for the two products. Thus, the following situation is presented:

	Manufacturer A		Manufacturer B
	<i>Shampoo</i>	<i>Conditioner</i>	<i>Shampoo</i>
<i>Average Variable Cost</i>	\$1.50	\$2.50	\$1.25
<i>Separate Price</i>	\$2.00	\$4.00	\$2.00
<i>Package Price</i>	\$5.00 (\$1.00 > A’s cost)		No package available. To remain competitive, shampoo price must be ≤ \$1.00.

Under these circumstances, B could stay in the market only if it charged no more than \$1.00 for shampoo (so that a consumer’s total price of B’s shampoo and A’s conditioner would not exceed \$5.00, A’s package price). Of course, B could not do so, given that its average variable cost is \$1.25. Thus, the conventional view asserts, A’s pricing strategy would eliminate B as a competitor *even though B* is the more efficient producer and *even though A* charges more than the average variable cost of its shampoo/conditioner combination.²⁶

efficient rival may find it impossible to compensate for lost discounts on products that it does not produce”).

²⁵ This example is based on a hypothetical discussed in *Ortho Diagnostic*, 920 F. Supp. at 467-68.

²⁶ 3 P. AREEDA & H. HOVENKAMP, ANTITRUST LAW (2004 Supp.) ¶ 749, at 179, offers a more complicated example of how an above-cost multi-product purchase target discount could exclude a rival that was more efficient than the discounter:

The courts that have considered the legality of bundled discounts have recognized that the primary anticompetitive concern they present is that a monopolist who sells in multiple product markets will use the discounts to exclude equally efficient rivals who do not sell as broad a line of products (and thus have fewer products on which to give up margin). So, for example, the court in *SmithKline Corp. v. Eli Lilly & Co.*²⁷ condemned a bundled discount offered by defendant Eli Lilly because the bundle included products not sold by plaintiff SmithKline, who could not compete without offering huge (and presumably below-cost) discounts on its narrower product line.²⁸ Similarly, the *LePage's*

[S]uppose a dominant firm offered products *A*, *B*, and *C* while a smaller rival sold only product *A'*, which is a substitute for *A*. If the dominant firm offered any type of above-cost discount on *A* alone, whether measured by quantity or share of purchases, an equally efficient producer of *A'* would be able to match it. But if the dominant firm carefully tailored a discount program aggregated across its three products, this might not be the case. For example, suppose a particular buyer used equal values of *A*, *B*, and *C* and that a progressive discount aggregated over a year went up by one point for all three products for each additional 1000 units of *A*, *B*, and *C* that the buyer took. The purchaser that took 20,000 units of each product would get the maximum 20 percent discount on all three; but if it took only 10,000 units of *A*, then its discount on *A*, *B*, and *C* would each drop to 10 percent. An equally efficient supplier of *A'* might wish to compete away 10,000 units of the buyer's *A* purchases and could do so as long as the dominant firm's fully discounted *A* price was above cost. But if the retailer made this choice it would also lose 10 percentage points of the discount on *B* and *C*. As a result, the smaller but equally efficient firm would have to offset the buyer's loss of 10 percent on the *A* product with a 30 percent discount in order to compensate the buyer for its total loss aggregated across all three products.

²⁷ 525 F.2d 1056.

²⁸ Defendant Eli Lilly had two cephalosporin products, Keflin and Keflex, on which it faced no competition, and one product, Kefzol, on which it faced competition from plaintiff SmithKline's product, Ancef. *Id.* at 1059. Lilly offered a higher rebate of 3% to companies that purchased specified quantities of any three of Lilly's cephalosporin products—an offer that, practically speaking, required combined purchases of Kefzol, Keflin, and Keflex. *Id.* at 1061-62. Although hospitals were free to purchase SmithKline's Ancef with their orders of Keflin and Keflex from Lilly, the practical effect of that decision would be to deny the Ancef purchaser the 3% bonus rebate on all its cephalosporin products. *Id.* The court reasoned that Lilly's arrangement would force SmithKline to pay rebates on one product equal to rebates paid by Lilly based on sales volume of three products. *Id.* at 1062. Because of Lilly's volume advantage, to offer a rebate of the same net dollar amount as Lilly's,

court reasoned that plaintiff LePage's could not compete with defendant 3M's bundled discounts, which incorporated up to six product lines, without drastically discounting the one product (transparent tape) it sold in competition with 3M.²⁹ And in *Ortho-Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*,³⁰ the court recognized the theoretical possibility that the plaintiff might be a more efficient rival than the defendant discounter but might nevertheless be driven from the market by the defendant's bundled discount, which rewarded purchasers with discounts on products not sold by the plaintiff.³¹

But the fact that bundled discounts may make it difficult for less diversified rivals to compete should not warrant their automatic condemnation. After all, bundled discounts are, first and foremost, *discounts*, which always benefit consumers in the short term. Any legal rule that condemned bundled discounts without a showing that they would exclude rivals that were, or were likely to become, as efficient as the discounter would likely harm consumers by chilling all sorts of procompetitive discounts. What we need, then, is an evaluative approach that will identify anticompetitive bundled discounts (without false positives), and will do so without creating the sort of legal uncertainty that causes understandably cautious firms, fearful of an inappropriately rendered treble damages award, from being overly

SmithKline would have had to offer companies large rebates, ranging from 16% for average size hospitals to 35% for larger volume hospitals, for their purchase of Ancef. *Id.* This would have presumably forced SmithKline to price below its costs.

²⁹ See *infra* notes 108 - 127 and accompanying text (discussing *LePage's*, 324 F.3d 141).

³⁰ 920 F. Supp. 455.

³¹ Plaintiff Ortho manufactured three blood tests that competed with three of five blood tests manufactured by defendant Abbott. *Id.* at 459. Abbott provided a discount on all of a purchaser's blood test purchases if the purchaser would buy at least four types of tests from Abbott, and it offered a higher discount to purchasers who purchased all five of its tests. *Id.* at 460. Ortho complained that the discount policy unfairly disadvantaged it because it could compete with Abbott only by offering the full value of Abbott's five-product discount on its own three-product selection. *Id.* at 461-62. While recognizing that Ortho could have been excluded from the market by Abbott's bundled discounts, even if Ortho were the more efficient competitor, the court refused to hold Abbott liable because Ortho did not demonstrate that Abbott was pricing its package of products below cost or that Ortho was as efficient a producer as Abbott but was unable to compete because of the discounting strategy. *Id.* at 469. *Ortho Diagnostic* and the test articulated therein are discussed in detail below. See *infra* notes 146 - 155 and accompanying text.

conservative with respect to their discounting practices.³² The remainder of this article criticizes the attempts that have been made to construct an approach for evaluating bundled discounts and proposes an alternative evaluative approach.

II. Competing Evaluative Approaches

As the Government noted in its amicus brief urging the Supreme Court to deny certiorari in *LePage's*, the issue of how to evaluate bundled discounts has received scant attention in the case law and scholarly literature.³³ The few courts and commentators that have addressed the issue head on have disagreed as to the showing a plaintiff must make in order to establish a monopolization claim³⁴ based on bundled discounts. So far, five basic approaches have emerged, ranging in terms of restrictiveness from a rule that would deem bundled discounts *per se* legal as long as they result in above-cost pricing,³⁵ to a rule that would condemn even *single product* (i.e., unbundled) above-cost discounts if they would unjustifiably prevent competitors from achieving productive efficiencies.³⁶ Between these poles is an approach

³² See 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 183 (“The difficult question [with regard to bundled discounts] is the formulation of an administrable rule that does not overreach and condemn competitive conduct.”).

³³ *Brief for the United States*, 2004 WL 1205191, at *12 n. 9. See *supra* notes 8 - 13 and accompanying text.

³⁴ The case law has so far analyzed bundled discounts as potential monopolization in violation of Sherman Act Section 2, 15 U.S.C. § 15. See *LePage's*, 324 F.3d 141; *SmithKline*, 575 F.2d 1056; *Ortho Diagnostic*, 920 F. Supp. 455; June 10, 2004 Memorandum of Decision, *Masimo*, No. CV 02-4770 (C.D. Cal.) (copy on file with the author). Because bundled discounts generally involve contracts between buyers and sellers, they might also be deemed to violate Sherman Act Section 1, 15 U.S.C. § 1, which precludes concerted activity that unreasonably restrains trade. Regardless of the particular statutory provision invoked, however, the competitive analysis is likely to be the same. A plaintiff bringing a monopolization action would have to show that the discount amounts to anticompetitive conduct, rather than merely vigorous competition, see *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); a Section 1 plaintiff would have to show that the arrangement “unreasonably” restrains trade, see *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). In either case, the determinative question will be whether the discount ultimately enhances or diminishes competition, and the evaluative approach proposed herein could address that question regardless of whether it was presented in a monopolization claim or as part of a Section 1 action.

³⁵ See *infra* Part II.A.

³⁶ See *infra* Part II.B.

focused on the relative breadth of the parties' product lines,³⁷ and two approaches that would focus on the relative efficiency of the parties and would attempt to condemn only those bundled discounts that could exclude equally or more efficient rivals.³⁸ Examined closely, each of these five approaches proves inadequate.

A. *Per se* Legality

The least restrictive approach to bundled discounts would deem them *per se* legal so long as the discounted price of the bundle exceeds the aggregate cost of the constituent products.³⁹ This is the approach urged by amici that filed briefs in support of the *LePage's* defendant's petition for writ of certiorari.⁴⁰ Advocates of this *per se* legality

³⁷ See *infra* Part II.C

³⁸ See *infra* Parts II.D, E.

³⁹ A less controversial position, with which the author agrees, is that bundled discounts should be *per se* legal when *each product* within the bundle is priced above its cost after the entire amount of the discount is attributed to that product. See Crane, *supra* note 1, at ___. The focus of this article is the more difficult issue of how to evaluate bundled discounts that are above-cost, in the sense that the discounted price of the bundle exceeds the aggregate cost of the products within the bundle, see *supra* note 15, but do not satisfy the condition that each constituent product is priced above-cost when discounted by the entire amount of the discount.

⁴⁰ See *Brief for Amici Morgan Stanley, et al.*, 2003 WL 22428378 (July 28, 2003), at *5 (“This Court has repeatedly recognized that low prices benefit consumers regardless of how those prices are set and that above-cost prices do not threaten competition regardless of the type of antitrust claim involved. The reason is that the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting.”) (internal quotations, alterations, and citations omitted); *id.* at *6-*7 (“As this Court has explained, depriving consumers of the immediate benefits of an above-cost price cut is not sound antitrust policy, even if the ultimate effect of the cut is to induce or reestablish supracompetitive pricing. As long as the price remains above cost, an equally efficient competitor can match the discount and compete with the defendant to the benefit of consumers.”) (internal quotations, alterations, and citations omitted); *Brief for Amicus Curiae the Business Roundtable*, 2003 WL 22428382 (July 28, 2003), at *6 (“This Court, in an unbroken line of cases, has made clear that business are entitled—indeed, encouraged—to engage in above-cost price-cutting without fear that those procompetitive actions will subject them to antitrust liability.”); *id.* at *16-17 (“Any price cut that is above cost is almost certainly moving price in the ‘right’ direction (towards the level that would be set in a competitive marketplace). But even if there were a rare instance in which a price cut would be anticompetitive, courts must always err on the side of no liability. For the

approach maintain that it is compelled by Supreme Court precedent and is desirable as a policy matter.

In support of their claim that Supreme Court precedent mandates their position, advocates of the *per se* legality approach cite a line of decisions, culminating in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,⁴¹ in which the Court indicated that discounts are legal unless they result in below-cost prices. In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,⁴² for example, the Court referred to “cases in which a single firm, having a dominant share of the relevant market, cuts its prices in order to force competitors out of the market, or perhaps to deter potential entrants from coming in.”⁴³ The Court noted that inferring exclusionary conduct in such circumstances is dangerous, because “cutting prices in order to increase business often is the very essence of competition,” and “mistaken inferences” may therefore “chill the very conduct the antitrust laws are designed to protect.”⁴⁴ While it declined to address the issue of whether exclusionary conduct could *ever* result from above-cost discounted prices,⁴⁵ the Court did indicate that predatory pricing claims generally require “pricing below some appropriate measure of cost.”⁴⁶ Similarly, in *Cargill, Inc. v. Monfort*,

consequence of a mistake here is not simply to force a firm to forego legitimate business activity it wishes to pursue; rather, it is to penalize a procompetitive price cut, perhaps the most desirable activity (from an antitrust perspective) that can take place in a concentrated industry where prices typically exceed costs.” (internal quotations, alterations, and citations omitted); *Brief for the Boeing Company, et al., as Amici Curiae in Support of Petitioner*, 2003 WL 22428377 (July 28, 2003), at *13 (“[A]bove-cost pricing practices challenged in any antitrust claim are entitled to an absolute safe harbor, either (i) because such practices allow competition on the merits from equally efficient competitors, or (ii) because relying on costly litigation and lay jurors to identify the occasional anticompetitive above-cost pricing practice involves a risk of error that will chill procompetitive price-cutting practices. Those twin principles apply equally to volume and bundled discounts”) (internal quotations and citations omitted); *Brief of Washington Legal Foundation and National Association of Manufacturers as Amici Curiae in Support of Petitioners*, 2003 WL 22428379 (July 28, 2003), at *19 (encouraging Court to recognize “safe harbor for all above-cost price competition, thereby providing producers with clear guidance regarding how to compete without running afoul of the antitrust laws”).

⁴¹ 509 U.S. 209 (1993).

⁴² 475 U.S. 574 (1986).

⁴³ *Id.* at 585, n. 8.

⁴⁴ *Id.* at 594.

⁴⁵ *Id.* at 585, n. 9.

⁴⁶ *Id.* at 585, n. 8.

Inc.,⁴⁷ the Court noted that it would be a “perverse result” if the antitrust laws were construed to “render illegal any decision by a firm to cut prices in order to increase market share,” for it “is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition.”⁴⁸ And in *Atlantic Richfield Co. v. USA Petroleum Co.*,⁴⁹ the Court reiterated the view that low but above-cost pricing could not give rise to the sort of injury the antitrust laws were designed to preclude,⁵⁰ concluding that “in the context of pricing practices, only predatory pricing has the requisite anticompetitive effect,”⁵¹ and that discounted but above-cost prices cannot be anticompetitive “regardless of how those prices are set.”⁵²

⁴⁷ 479 U.S. 104 (1986).

⁴⁸ *Id.* at 116 (internal quotation marks omitted). The issue in *Cargill* was whether the plaintiff had adequately alleged antitrust injury—*i.e.*, “injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants’ acts unlawful,” *Brunswick Corp. v. Pueblo Bowl-o-mat, Inc.*, 429 U.S. 477, 489 (1977) (holding that antitrust injury is a prerequisite to recovery of damages under the antitrust laws)—where it challenged a potential merger on grounds that the new entity would “lower its prices to some level at or slightly above its costs in order to compete for market share,” thereby cutting into plaintiff’s profits. *Cargill*, 479 U.S. at 114. While the Court recognized that a claim based on below-cost pricing could give rise to antitrust injury, it held that plaintiff had waived any such claim and was instead complaining of above-cost, but discounted, prices, which could not give rise to antitrust injury. *Id.* at 117.

⁴⁹ 495 U.S. 328 (1990).

⁵⁰ Holding that a competitor cannot suffer antitrust injury from a vertical price-fixing scheme that sets prices above costs, the Court explained:

When a firm, or even a group of firms adhering to a vertical agreement, lowers prices but maintains them above predatory levels, the business lost by rivals cannot be viewed as an “anticompetitive” consequence of the claimed violation. A firm complaining of the harm it suffers from nonpredatory price competition is really claiming that it is unable to raise prices. This is not antitrust injury; indeed, cutting prices to increase business often is the very essence of competition.

Id. at 337-38 (internal citation and quotation marks omitted). The Court explained that antitrust injury must arise from an anticompetitive aspect of the defendant’s behavior, *id.* at 339, and that discounted prices cannot be anticompetitive unless they are below-cost, because above-cost pricing cannot exclude equally or more efficient rivals, who could always stay in business by lowering their prices below supracompetitive levels. *Id.* at 337, n. 7 (“Rivals cannot be excluded in the long run by a nonpredatory maximum-price scheme unless they are relatively inefficient.”).

⁵¹ *Id.* at 339.

⁵² *Id.* at 340.

The Court's most direct statement of the rule that discounts must be below cost to create antitrust liability occurred in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*⁵³ The matter before the Court in that case was the legality of defendant Brown & Williamson's sharp rebates on purchases of its generic cigarettes.⁵⁴ Before dissecting the details of the plaintiff's complicated theory of predation (and holding that the plaintiff had failed to establish harm to competition),⁵⁵ the Court addressed generally the subject of predatory pricing. Noting that some of its prior opinions had reserved the question of "whether recovery should *ever* be available when the pricing in question is above some measure of incremental cost,"⁵⁶ the Court decided to put that question to rest once and for all. It rejected "the notion that above-cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws,"⁵⁷ and it stated unequivocally that "a plaintiff seeking to establish competitive injury from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs."⁵⁸ Asserting that above-cost discounting, which generally benefits consumers, "is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting,"⁵⁹ the Court appeared to establish a bright-line rule that courts should not entertain antitrust claims based on low prices unless those prices are below the

⁵³ 509 U.S. 209.

⁵⁴ Plaintiff Liggett maintained that Brown & Williamson had injured competition by offering predatory rebates to wholesale purchasers of its generic cigarettes in an attempt to coerce Liggett into offering similar rebates and thus having to raise the list prices of its generics, thereby shrinking the economy cigarette market relative to the more profitable retail market. *See id.* at 230-31 (summarizing Liggett's theory of predation).

⁵⁵ *Id.* at 230

⁵⁶ *Id.* at 223 (internal alteration omitted; emphasis in orig.) (quoting *Cargill*, 479 U.S. at 117 n. 12).

⁵⁷ *Brooke Group*, 509 U.S. at 223.

⁵⁸ *Id.* at 222. The Supreme Court has never addressed precisely what is "an appropriate measure" of a discounter's costs—*i.e.*, whether the proper metric is marginal cost, average variable cost, or some other measure. Commentators are split on this issue, *see generally* Einer Elhauge, *Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory—And the Implications for Defining Costs and Market Power*, 112 YALE L. J. 681, 704-07 (2003) (describing "the murky and divided nature of the current debate over cost definitions"), and the matter is beyond the purview of this article.

⁵⁹ *Id.* at 223.

discounter's cost and could therefore drive out of business firms that are as efficient as the discounter but do not possess deep enough pockets to sustain below-cost pricing.

Applying *Brooke Group* to bundled discounts, the *per se* legality advocates contend, represents sound antitrust policy because any rule that attempted to condemn some above-cost bundled discounts (*i.e.*, those that could exclude equally efficient competitors) would inject antitrust law with a measure of uncertainty that would discourage pro-consumer, non-exclusionary discounts.⁶⁰ Such a perverse result is likely, *per se* legality advocates argue, because the antitrust laws provide for treble damages,⁶¹ and antitrust tribunals are largely incapable of making the fine economic distinctions necessary to distinguish anticompetitive from procompetitive conduct.⁶² Rather than risk a potential judgment requiring payment of treble damages, firms would be reluctant to offer discounts involving multiple products, even where those discounts were not at all exclusionary.⁶³ In order to avoid such a chilling effect, *per se* legality advocates contend, courts should recognize the safe harbor announced in *Brooke Group* and should refuse to condemn above-cost bundled discounts. *Brooke Group*'s safe harbor for above-cost pricing is based not on the fact that above-cost discounted pricing can never be

⁶⁰ *Brief for Amici Curiae BellSouth Corp., et al.*, 2003 WL 22428381 (July 28, 2003), at *6 (“The need for easily administered rules is particularly acute in this context because bundled pricing policies are characterized by fast-pace, trial-and-error experimentation, and firms cannot easily apply an indeterminate, multi-factor antitrust analysis every time they tweak a pricing policy to accommodate rapidly shifting market realities.”).

⁶¹ 15 U.S.C. § 15 (permitting antitrust plaintiff to recover “threefold the damages by him sustained”).

⁶² *See* *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (2nd Cir. 1983) (Breyer, J.) (“[U]nlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counterproductive, undercutting the very economic ends they seek to serve.”).

⁶³ *See Business Roundtable Amicus Brief, supra* note 40, at 14 (“Rather than take the risk that a jury might condemn such practices with treble damages, and rather than hire a cadre of lawyers and economic consultants to attempt to justify every new proposed pricing scheme, firms will simply continue not to grant such discounts and not to bundle products at all. The result will be higher prices and economic inefficiencies, to the consumer’s ultimate detriment—precisely what the antitrust laws seek to avoid.”).

anticompetitive,⁶⁴ but rather on grounds of judicial administrability: Any consumer benefit created by a rule that permitted inquiry into above-cost single-product discounts and allowed judicial condemnation of those deemed legitimately exclusionary would likely be outweighed by the consumer harm occasioned by over-detering non-exclusionary discounts.⁶⁵ Similarly, the *per se* legality advocates warn, a legal rule that permitted judicial condemnation of *some* above-cost bundled discounts would likely cause more harm than good.

In essence, the *per se* legality advocates are contending that the total costs of a more restrictive rule (*i.e.*, the administrative costs plus the costs resulting from wrong decisions and from deterrence of procompetitive behavior) exceed the total benefits of such a rule (*i.e.*, the benefits resulting from elimination of anticompetitive bundled discounts). But that is ultimately an empirical claim for which the *per se* legality advocates have offered no evidence. Advocates appear to assume either: (1) that above-cost bundled discounts are so unlikely to exclude equally or more efficient competitors that the search for exclusionary bundled discounts is not worth the effort, or (2) that there is no alternative evaluative approach that is easily administrable and is unlikely to over-deter pro-consumer discounts. Both of those assumptions are probably untrue. First, it is easy to imagine instances of

⁶⁴ An abundance of relatively non-controversial economic scholarship shows that strategic single-product pricing can be anticompetitive even at prices above cost. See Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 312 (2001) (summarizing literature regarding possible anticompetitive effects of above-cost but discounted pricing). For example, businesses may use above-cost discounts to discourage entry, either by engaging in “limit” pricing or by building excess capacity and holding out the threat of dramatic price reductions. See *In re DuPont (titanium dioxide)*, 96 F.T.C. 653 (1980); FREDERIC M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 356-66, 405-06 (3d ed. 1990); Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L. J. 284 (1977); Steven C. Salop, *Strategic Entry Deterrence*, 69 AM. ECON. REV. 335 (1979); David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894-1912*, 102 J. POL. ECON. 103 (1994). Alternatively, businesses might set low but above-cost prices so as to signal false information about costs, thus deterring rivals who cannot meet the apparent costs of the dominant firm, see J. TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* 367-74 (1992), or to reduce the cost of acquiring rivals. See Malcolm R. Burns, *Predatory Pricing and the Acquisition Cost of Competitors*, 94 J. POL. ECON. 266 (1986).

⁶⁵ Cf. *Barry Wright*, 724 F.2d at 234 (“[W]e must be concerned lest a rule or precedent that authorizes a search for particular type of undesirable pricing behavior end up by discouraging legitimate price competition.”).

bundled discounts by monopolists that could be used to expand or maintain monopoly power,⁶⁶ so it is not likely that exclusionary bundled discounts are so rare that they're not worth looking for. Second, as Part III explains, there is an alternative evaluative regime that is both easily administrable and unlikely to over-deter pro-consumer discounts and is therefore worth adopting.

B. Exclusionary if Rivals' Costs Are Raised Unjustifiably

A second approach to bundled discounts would focus on whether the discounts unjustifiably increase the costs of the discounter's rivals.⁶⁷ This "raising rivals' costs" approach lies at the opposite end of the spectrum from the *per se* legality approach, for it would go so far as to condemn certain above-cost, *single-product* purchase target discounts.⁶⁸ Advocates of this restrictive approach reason that discounts conditioned upon purchasing a bundle, or even a specified amount of a single product, may foreclose marketing opportunities for the discounter's rivals, thereby raising the rivals' costs by denying them economies of scale.⁶⁹

To see how even a single-product purchase target discount might raise rivals' costs, consider a manufacturer whose well-established brand enjoys such an inelastic consumer demand that retailers must carry about 60% of their requirements of the product in that firm's brand.⁷⁰ Suppose that, in order to achieve the economies of scale and other efficiencies necessary to be a viable producer of this product, a competing

⁶⁶ See *supra* notes 25 - 26 and accompanying text.

⁶⁷ See Einer Elhauge, *Antitrust Analysis of GPO Exclusionary Agreements* (hereinafter, "Elhauge, *GPO Agreement Analysis*"), Statement for DOJ/FTC Hearing on Group Purchasing Organizations (September 26, 2003), at 38 (avail. at http://www.law.harvard.edu/faculty/elhauge/pdf/statement_ftdoj.pdf); Einer Elhauge, *Defining Better Monopolization Standards* (hereinafter, "Elhauge, *Monopolization Standards*"), 56 STAN. L. REV. 253, 315 (2003); Tom, et al., *supra* note 23, at 636-68.

⁶⁸ As noted above, see *supra* notes 20 - 23 and accompanying text, the prevailing view is that such discounts are legal, for they can always be matched by an equally efficient competitor and will therefore tend to exclude only relatively inefficient rivals. See, e.g., *Concord Boat*, 207 F.3d at 1061; 3A AREEDA & HOVENKAMP, *supra* note 22, ¶ 768b2, at 149 ("For single item discounts, no matter how measured or aggregated, injury to an equally efficient rival seems implausible.").

⁶⁹ See Tom et al., *supra* note 23 at 622-27; Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 3-10.

⁷⁰ This example is taken from Tom, et. al, *supra* note 23, at 627.

manufacturer needs to maintain about a 35% market share. Assume that the current market share of the dominant brand is 60% (reflective of consumer demand) and the competitor's share is 40%. Now, suppose that the dominant manufacturer offers a 6% discount (going back to the first purchase) to retailers who buy at least 70% of their requirements from the firm, and suppose that the discounted price is still above cost. Even this apparently modest market share discount would have a strong tendency to shift purchases because receipt of the entire dollar value of the discount will depend on the retailers' decisions to purchase the incremental units between 60 and 70 percent of requirements.⁷¹ The buyer will face a "tax" or penalty in the form of the loss of *all cumulative discounts* if it takes a single unit from the alternative supplier beyond 30% of its needs. Thus, to compete with the dominant seller's 6% discount, the rival seller would have to give a discount on its smaller market share that was equal in absolute dollar value to the 6% discount the dominant supplier would provide on 70% of the purchaser's requirements. If prices were set close to marginal cost, the non-dominant seller would not be able to provide such a discount, and his market share would probably fall below 30%, a level beneath the "minimum efficient scale" of 35%.⁷² Thus, advocates of the restrictive approach assert, any discount structured to usurp business from rivals—even an above-cost single-product purchase target discount—may be used to raise rivals' costs and should therefore be subject to condemnation (if not justified).⁷³

Professor Elhauge, perhaps the leading proponent of this restrictive approach, has identified a number of ways above-cost purchase target discounts may raise rivals' costs.⁷⁴ As the example above illustrates, purchase target discounts that result in foreclosure may bar rivals from marketing outlets needed to sustain minimum efficient scale.⁷⁵ Even when alternative marketing outlets are available, rivals'

⁷¹ *Id.* at 627. I am assuming, of course, that retailers carry 60% of their requirements in the dominant firm's brand, reflecting overall consumer demand.

⁷² *See id.* at 627-28.

⁷³ As explained below, the commentators recommending a raising rivals' costs approach have disagreed as to how to spot a discount that raises rival's costs but should nonetheless be legal because it is justified. *See infra* notes 80 - 84 and accompanying text.

⁷⁴ *See* Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 4-10; Elhauge, *Monopolization Standards*, *supra* note 67, at 256, 283, 320-23.

⁷⁵ *Id.* at 4; Elhauge, *Monopolization Standards*, *supra* note 67, at 321 ("In most industries, there are economies of scale at low output levels, so that firms can lower

costs will be raised (and their efficiency reduced) if those alternative means of distribution are less cost-effective.⁷⁶ Moreover, to the extent marketing opportunities are foreclosed, rivals will find it more difficult to raise capital for research and development, for capital markets will provide less funding where expected payoffs are lower, and such payoffs will obviously be lower when available marketing opportunities are foreclosed.⁷⁷ In addition, purchase target discounts may decrease the efficiency of the discounter's rivals in industries where there are "network effects" (*i.e.*, where the value to a consumer of a particular product brand increases as more consumers purchase that brand); in such industries, discounts that take market share from rivals impair those rivals by decreasing the value of their product to consumers.⁷⁸

So what does all this theorizing imply for the law governing bundled discounts? Should the law simply preclude discounts that win away market share from the discounter's rivals? Surely not, for

their costs by expanding until they reach the output level that minimizes their costs, which is called the minimum efficient scale. If foreclosure prevents a competitive number of rivals from achieving this scale, or from expanding their operations to reach it, then it impairs their efficiency." Cf. *LePage's*, 324 F.3d at 161 ("As a result [of defendant's bundled discounts, which expanded its market share], LePage's manufacturing process became less efficient and its profit margins declined. In transparent tape manufacturing, large volume consumers are essential to achieving economies of scale.").

⁷⁶ Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 5 ("Even if other means of distribution remain open . . . , foreclosing rivals from the means of distribution that are most cost effective will increase rivals' costs and thus their prices, hampering their ability to compete."); Elhauge, *Monopolization Standards*, *supra* note 67, at 321. Cf. HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* 431 (2d ed. 1999) (noting that "foreclosure theories of exclusive dealing become more robust if" based on "raising rivals' costs by relegating them to inferior distribution channels"); *LePage's*, 324 F.3d at 160 n. 14 ("In the transparent tape market, superstores like Kmart and Wal-Mart provide a crucial facility to any manufacturer—they supply high volume sales with concomitant substantially reduced distribution costs. By wielding its monopoly power in transparent tape and its vast array of product lines, 3M foreclosed LePage's from that critical bridge to consumers that superstores provide, namely, cheap, high volume supply lines.").

⁷⁷ Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 7; Elhauge, *Monopolization Standards*, *supra* note 67, at 322 ("If firms are foreclosed from a significant share of the market, then successful innovations will have a smaller payoff than they otherwise would have, which will discourage efficient investments in research and innovation.").

⁷⁸ Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 6. "Network effects" exist when a "seller's product is more valuable to buyers the more that other buyers have purchased the same good from that seller." *Id.*

practically *all* discounts do that. Indeed, Professor Elhauge acknowledges that any price-decreasing or product-improving innovation will permit the innovator to usurp business from rivals and thus might have the effect of raising rivals' costs, and he recognizes that antitrust law should not discourage such innovations.⁷⁹ Thus, antitrust law needs some means of separating procompetitive from anticompetitive bundled discounts.

Former Federal Trade Commission ("FTC") officials Willard Tom, David Balto, and Neil Averitt, advocates of the "raising rivals' costs" approach, have recommended that antitrust tribunals engage in case-by-case analysis to determine whether above-cost purchase target discounts are legal.⁸⁰ Such an approach, the former regulators contend, "would let counselors and enforcers concentrate instead on the core questions that have long been central to antitrust—whether the restraints at issue tend to create or facilitate horizontal problems of collusion or exclusion" and would "focus[] on effect rather than on formalistic line drawing."⁸¹ The problem with this open-ended approach, of course, is that it offers virtually no guidance to businesses. In practice, it would require antitrust counselors to predict whether a judge (or, worse yet, a jury) would conclude that an above-cost structured discount was merely "competition on the merits" or was likely to be so successful (*i.e.*, to win so much business from rivals) that it would harm competition by reducing rivals' efficiencies. The crystal ball nature of this inquiry, coupled with the fact that a mistaken prediction could result in treble damages, would likely overdeter pro-consumer structured discounts.

⁷⁹ Elhauge, *Monopolization Standards*, *supra* note 67, at 265 ("[P]erfectly desirable competitive behavior can 'foreclose competition' and 'destroy a competitor,' such as when a firm figures out how to make a better or cheaper product and thus takes away market sales from rivals and drives them out of the market.").

⁸⁰ Tom, et al., *supra* note 23, at 638 ("Where the pricing structure, rather than the price level, is used to secure an anticompetitive result, the cost test of predatory pricing does not automatically apply. Instead, one must conduct a case-by-case analysis of the actual effects of the particular practice to determine whether anticompetitive outcomes are likely.") When their article was published, Tom, Balto, and Averitt were, respectively, the Deputy Director of the FTC's Bureau of Competition, the bureau's Assistant Director for Policy and Evaluation, and an attorney within the bureau.

⁸¹ *Id.* at 638-39.

Recognizing the danger inherent in a case-by-case balancing of competitive effects,⁸² Professor Elhauge has proposed a more structured inquiry. Under his suggested approach, the antitrust tribunal would ask whether the discounting behavior would enhance the discounter's market power regardless of whether it enhanced the discounter's efficiency.⁸³ If so, then the discount is anticompetitively exclusionary, and there is no need to weigh its procompetitive benefits; if not (*i.e.*, if the discounting behavior could not enhance the discounter's market power without creating some efficiencies for the discounter), then the discounting behavior is procompetitive and should be deemed legal *per se*, even if the discounting did cause some foreclosure of marketing opportunities for rivals.⁸⁴

Under Professor Elhauge's approach, a purchase target discount that had the effect of decreasing the market share of the discounter's rivals and thereby increasing their costs would be legal *only if* selling the product as a bundle (in the case of a bundled discount) or in the quantities required to earn a volume discount (in the case of a single-product purchase target discount) created efficiencies for the discounter.

⁸² Under an approach that determines the legality of structured discounts (or other conduct) on the basis of an open-ended case-by-case inquiry into whether the conduct is exclusionary,

firms must operate under the risk that the actual criteria by which their conduct will be judged will depend largely on the happenstance of which judge and jurors will be selected in a trial a great number of years later that will retroactively decide whether to assess multimillion or even multibillion dollar treble damages. Further, firms run the risk that different judges or juries will reach inconsistent conclusions about the legality of their conduct based on different implicit normative criteria. These sorts of risks cannot help but chill investments to create product offerings with a sufficient quality or cost advantage over preexisting market options

Elhauge, *Monopolization Standards*, *supra* note 67, at 266-67.

⁸³ *Id.* at 315.

⁸⁴ *Id.* at 315-16. Professor Elhauge maintains that antitrust law should eschew "an open-ended rule of reason balancing test" and should instead

employ[] two rules to sort out when to condemn conduct that helps acquire or maintain monopoly power. One rule makes such conduct *per se* legal if its exclusionary effect on rivals depends on enhancing the defendant's efficiency. The other rule makes such conduct *per se* illegal if its exclusionary effect on rivals will enhance monopoly power regardless of any improvement in defendant efficiency.

Id. at 330.

Moreover, the discount could presumably be no greater than required to attain those efficiencies, for any incremental discount in excess of that amount would effectively be raising rivals' costs and enhancing the discounter's market power "regardless of any improvement in [the discounter's] efficiency."⁸⁵ So, for example, a firm with a 70% market share, charging supracompetitive prices, could not offer volume discounts if all available economies of scale could be exploited at a level of production equal to 50% of the market and there were no distributional efficiencies created by selling the larger volume. Nor could a firm that could obtain productive or distributional efficiencies by increasing total production or the size of individual orders offer a discount greater than that necessary to induce the increased demand needed to achieve the growth in production or order size. Consider, for example, a firm that currently operates its factories at 70% capacity and could reduce its per unit costs from \$.10/unit to \$.09/unit by running the factories at 85% capacity. Running the factories above 85% capacity, however, would produce no net efficiency gain, for any incremental economies of scale would be offset by diseconomies occasioned by, for example, excessive wear and tear. Suppose that the firm could expand demand for its product sufficiently to warrant production at 85% capacity by paying a 10% rebate on purchases over 1,000 units. Under Professor Elhauge's approach, the firm would be allowed to offer that rebate, but it could not offer a higher rebate (say, 12%) even if the post-rebate price was well above cost. The 2% excess discount would tend to reduce rivals' market shares, raise their costs, and enhance the discounter's market power regardless of whether it provided an efficiency gain. Thus, the excess discount would be "exclusionary," even if it resulted in above-cost pricing.

Put simply, Professor Elhauge's view seems to be that bundled discounts will be deemed exclusionary if they raise rivals' costs "unjustifiably," where "justifiable" means "as a byproduct of a gain in productive or distributional efficiency." Thus, in evaluating a purchase-target or bundled discount, the antitrust tribunal would ask, "Is selling the product in this fashion somehow making the discounter more efficient, or is the discounter merely giving up margin?" If the latter, the discount would be illegal. If the former, the tribunal must ask a follow-up question: "Could the efficiencies be achieved by giving a smaller discount (or by structuring the discount in some other fashion that would win less business from rivals)?" If so, the "excess discount" (or the part

⁸⁵ *Id.*

of the structured discount whose efficiency-enhancing ends could be achieved in a manner that would raise rivals' costs less) would be anticompetitively exclusionary.

Both versions of the "raising rivals' costs" approach (both the case-by-case approach advocated by the former FTC officials and Professor Elhauge's more focused approach) are problematic. As an initial matter, the claim that single-product purchase target discounts pose the same sort of competitive threat posed by bundled discounts seems wrong. As explained above, the majority view is that an above-cost, single-product purchase target discount may be met by any equally efficient rival.⁸⁶ Professor Elhauge and the former FTC officials maintain that this argument misses the point, for such discounts may actually *cause* rivals to be less efficient by denying them the business needed to achieve all available economies of scale.⁸⁷ But any potentially efficient rival willing to engage in vigorous competition could maintain the market share necessary to achieve economies of scale and thus need not be excluded by an above-cost, single-product purchase target discount.

To see this point, consider again the situation where the discounter has a larger market share than its rival, is able to offer an above-cost purchase target discount whose total dollar value the rival could not meet (given its smaller market share) without pricing below cost, and is thus able to win enough market share from the rival to prevent it from obtaining all available economies of scale.⁸⁸ Professor

⁸⁶ See *supra* notes 20 - 23 and accompanying text.

⁸⁷ See Elhauge, *supra* note 23, at 24 n. 68 ("Professor Hovenkamp argues that an equally efficient rival can always match the discount . . . , but this is not true if . . . economies of scale exist because the exclusionary scheme will restrict the market share of the rival and thus deprive it of the economies of scale it needs to match the discounted price."); Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 33-34 ("[T]he claim that rivals can avoid foreclosure by just matching the exclusionary discount assumes away the very anticompetitive harm of interest. For one reason that equally efficient rivals cannot match the discounts is that the marketwide foreclosure has impaired their efficiency."); Tom, et al., *supra* note 23, at 621-23, 636-38.

⁸⁸ Recall the example offered by the former FTC officials: A has a 60% market share; B has a 40% market share; the market share required to attain all available scale efficiencies is 35%; A offers a 6% discount on all purchases conditioned on the buyer taking at least 70% of its requirements from A; B, therefore, would have to meet that total dollar discount on its smaller (40%) market share; B could not do this without pricing below cost and will therefore lose enough market share to fall below minimum efficient scale. See *supra* notes 70 - 73 and accompanying text (discussing example presented by Tom *et al.*, *supra* note 23, at 627).

Elhaug and the former FTC officials assume that the rival is stuck and has no way of competing with the discounter. But that's not true. A rival firm that produced a product of equal or better quality and could, after achieving all available economies of scale, do so as cheaply as the discounter could raise the capital necessary to meet (or beat) the discount so as to expand its market share to the point at which all available economies of scale were achievable.

As the old saying goes, one must spend money to make money. Every business makes investments to achieve the market share required to obtain minimum efficient scale. Businesses must, for example, build productive facilities of the requisite size, produce marketing and advertising materials, give away free samples to generate consumer interest, and incur all sorts of other start-up costs. Start-ups finance these expenditures, of course, by convincing investors and lenders that their product is superior to competing products and will eventually command enough consumer loyalty to warrant production at the level required to attain all available economies of scale. When they in fact have a "better mousetrap" and plausible plans for efficiently producing that mousetrap, they generally have little trouble raising start-up funds.

Just as a business has to incur costs early on in order to establish the market share required to achieve minimum efficient scale, it might—if its margins were not great enough to fund a competitive discount—have to incur similar costs in order to recover market share from a discounting rival and thereby protect or enhance productive efficiencies. But the fact that it has to incur such costs does not mean it is being "excluded" from the market. If the disadvantaged rival's product offering were as good as the discounter's and could be produced as cheaply at minimum efficient scale, the rival should be able to raise enough capital to fund any discount necessary to grow its market share to the point necessary to achieve minimum efficient scale.⁸⁹ Its below-cost pricing for the period required to achieve such a scale would not amount to predation because there would be no likelihood of recoupment via

⁸⁹ See 2A P. AREEDA, H. HOVENKAMP, & J. SOLOW, ANTITRUST LAW ¶ 421b, at 67 (2d ed. 2002) ("If capital markets are working well, new investment will be made in any market earning anything above competitive returns—which is defined to include sufficient profit to attract new capital—regardless of the absolute cost of entry."); Harold Demsetz, *Barriers to Entry*, 72 AM. ECON. REV. 47 (1982); Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J. L. & ECON. 1 (1973); GEORGE STIGLER, *THE ORGANIZATION OF INDUSTRY* 67 (1968).

supracompetitive pricing.⁹⁰ Were a rival unable to achieve minimum efficient scale by pricing just below the discounter's above-cost discounted price and thereby winning business from the discounter, it would be because the capital markets perceived the rival's product to be inferior to the discounter's, and the rival's loss of business would thus be deserved.⁹¹ Accordingly, any above-cost, single-product purchase target discount should be deemed *per se* legal.

The focus of this article, though, is bundled discounts (*i.e.*, multi-product purchase target discounts). Thus, the important question to consider is how the approaches advocated by the "raising rivals' costs" theorists fare at separating procompetitive from anticompetitive discounts. As noted above, and as recognized by Professor Elhauge, an evaluative approach involving an open-ended case-by-case balancing of competitive effects is undesirable because it offers little guidance for businesses, subjects them to the possibility of inappropriate treble damages judgments, and is therefore likely to overdeter pro-consumer bundled discounts.⁹² But what about Professor Elhauge's more focused approach? That approach is similarly deficient, for at least three reasons.

First, the approach, which would "make[] [any] conduct *per se* illegal if its exclusionary effect on rivals will enhance monopoly power regardless of any improvement in defendant efficiency,"⁹³ would have the perverse effect of preventing price-cutting by any monopolist that had achieved all available economies of scale and was unable to achieve additional distributional efficiencies by discounting. Consider, for example, a widget monopolist that commands a 70% market share and sells widgets for \$2.00, a 100% mark-up over its per unit cost of \$1.00. Suppose all available economies of scale are achievable at a production level reflecting a 50% market share and that there are no distributional efficiencies to be gained by a straight price cut. If the monopolist decided to cut its price to \$1.75, it would sell more widgets, impairing its

⁹⁰ See *Brooke Group*, 509 U.S. at 222 (positing likelihood of recoupment via future monopoly pricing as pre-requisite to valid predation claim).

⁹¹ The point here is that any equally efficient—or *potentially* equally efficient—rival could procure the financing necessary to temporarily price below cost in order to win market share from the discounter and achieve economies of scale. "Expenditures" on a period of below-cost pricing to win market share are just like an investment in a factory, or research and development, or introductory marketing materials, or other start-up costs.

⁹² See *supra* note 82 and accompanying text.

⁹³ Elhauge, *Monopolization Standards*, *supra* note 67, at 330.

rivals' efficiencies. That price cut would therefore enhance the widget seller's monopoly power even without improving its efficiency and would, under Professor Elhauge's test, be exclusionary and illegal. A rule that precludes monopolists from cutting their supracompetitive prices, unless such price cuts are necessary to achieve productive efficiencies, is inconsistent with the very goal of antitrust law, which is to protect consumers from supracompetitive prices.⁹⁴

In addition, the approach is fundamentally inconsistent with the Supreme Court's *Brooke Group* decision, which held that an antitrust violation could not arise from a price cut that leads to above-cost pricing.⁹⁵ There is obviously great debate as to whether *Brooke Group* reaches structured discounts—either single-product market share discounts or bundled discounts.⁹⁶ But there can be no question that the case reaches a straightforward price cut; if such a price cut results in a price above cost, the price cut is legal *per se*. Professor Elhauge's approach would condemn above-cost price cuts that increased the price-cutter's market share (and thus reduced rivals' efficiencies) without also increasing the price-cutter's efficiency.⁹⁷ *Brooke Group* would not countenance that result.

Finally, even if the approach were consistent with antitrust policy and precedent, the approach would still be deficient because it is difficult to administer, would require factfinders to engage in rather sophisticated economic analysis, fails to offer discounters a reliable safe harbor, and is thus likely to chill pro-consumer discounting. As noted, Professor Elhauge's approach would require a factfinder to determine whether a

⁹⁴ See ROBERT H. BORK, THE ANTITRUST PARADOX 22 (1978) ("In the Supreme Court's first substantive Sherman Act decisions, Justice Peckham . . . chose consumer welfare as the law's guiding policy . . ."). But see Robert H. Lande, *Wealth Transfers as the Immediate and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L. J. 65, 68-69 (1982) (suggesting that original goals of antitrust laws included distributional objectives).

⁹⁵ 509 U.S. at 222-23.

⁹⁶ Compare *LePage's*, 324 F.3d at 147 (rejecting view that *Brooke Group's* holding regarding prerequisites to liability for predatory pricing applies to bundled discounts) with *Morgan Stanley Amicus Brief*, *supra* note 40, at 10 ("Because the bundled rebates did not rise to the level of an illegal tie or otherwise violate Section 1, whether they would harm competition by unjustifiably excluding even equally efficient rivals from the market had to be determined in accordance with the pricing principles most recently articulated in *Brooke Group*"); *Business Roundtable Amicus Brief*, *supra* note 40, at 9-10 (arguing that *Brooke Group's* below-cost pricing requirement applies to bundled discounts).

⁹⁷ See *supra* notes 83 - 85 and accompanying text.

discounting policy was increasing the efficiency of the discounter *and* whether the policy somehow went beyond what was necessary to achieve those efficiency benefits.⁹⁸ Thus, any business that offered a bundled discount would risk a jury's concluding either that the discounting program did not create productive or distributional efficiencies *or* that the efficiencies that were created could have been achieved by offering a smaller discount or by requiring fewer purchases to qualify for the discount. A jury could award treble damages if convinced that the defendant was giving up surplus (to consumers, incidentally) not because doing so was necessary to achieve some productive or distributional efficiencies but because doing so would win market share from rivals, thereby reducing their efficiencies. The possibility of an adverse (treble damages) judgment, and the lack of any reliable safe harbor, would likely deter pro-consumer bundled discounts⁹⁹ and would limit the size of bundled discounts that were offered.¹⁰⁰

In sum, an evaluative approach that determines the legality of bundled discounts based on whether rivals' costs have been raised unjustifiably is unworkable. The problem with the approach is that much (perhaps most) procompetitive conduct raises rivals' costs,¹⁰¹ and it is difficult to provide an easily administrable, but not overly proscriptive, means of determining when such cost-raising is "justifiable." If the justifiability of raising rivals' costs is determined on a case-by-case basis, as suggested by Tom, Balto, and Averitt, then business planners

⁹⁸ See *supra* note 85 and accompanying text.

⁹⁹ See *infra* notes 133 - 140 and accompanying text (discussing efficiency benefits of bundling and bundled discounts).

¹⁰⁰ It is not an adequate response to say that the plaintiff would bear the burden of proving that the entire discount was not necessary to achieve productive or distributional efficiencies. Practically any plaintiff could produce an expert who could question whether a defendant's bundled discount—or some portion of thereof—actually produced productive or distributional efficiencies. Thus, discounters would inevitably have to defend their discounting behavior by proving that the discounts did, in fact, result in such efficiencies and did not simply represent a transfer of surplus to consumers.

¹⁰¹ RICHARD A. POSNER, *ANTITRUST LAW* 196 (2d ed. 2001) (noting that "[o]ne way of raising a rival's costs is to be so much more efficient than the rival that the latter is unable to reach a level of output at which to exploit the available economies of scale . . ."); Frank H. Easterbrook, *When Is It Worthwhile to Use Courts to Search for Exclusionary Conduct?*, 2003 *COLUM. BUS. L. REV.* 345, 346-47 (raising rivals' costs "can be mistaken for any other element of doing business. General Motors does not sell engines to Ford, and this may raise Ford's costs; but the separation is also essential to rivalry . . .").

will be left with no definitive guidelines or safe harbors and will therefore be deterred in their discounting by the prospects of a treble damages award based on a mistaken jury finding.¹⁰² If justifiability is determined, as Professor Elhauge suggests, by asking whether the discounting creates productive or distributional efficiencies for the discounter, then the approach (in addition to being excessively difficult to administer)¹⁰³ will be overly proscriptive, for it will condemn desirable pricing practices that have been expressly approved by the Supreme Court.¹⁰⁴ Perhaps it would be possible to articulate an easily administrable, and not overly proscriptive, test for determining whether rivals' costs are being raised "unjustifiably," but the approaches articulated so far are deficient.

C. Exclusionary if Bundled Discounts Cover Products Not Sold By Rivals, and the Discounter Fails to Prove an Adequate Business Justification for the Discounting

A third approach for evaluating bundled discounts—the approach followed in several recently litigated cases—focuses on the extent to which the discounter bundles products not sold by its rivals.¹⁰⁵ As discussed above, the primary concern with bundled discounts is that a discounter that bundles multiple products and funds the total discount by giving up some margin on each of those products may be able to usurp business from an equally or more efficient rival that does not sell as broad a product line, has fewer products on which to give up margin, and thus must provide the entire value of the bundled discount on its narrower product offering.¹⁰⁶ Accordingly, some courts have reasoned that a discounter engages in exclusionary conduct when, without an

¹⁰² See *supra* notes 80 - 82 and accompanying text.

¹⁰³ See *supra* notes 98 - 99 and accompanying text.

¹⁰⁴ See *supra* notes 93 - 96 and accompanying text.

¹⁰⁵ See *LePage's*, 324 F.3d at 155; June 10, 2004 Memorandum of Decision, *Masimo*, No. CV 02-4770 MRP (C.D. Cal.) (copy on file with the author). Cf. Complaint, *Applied Medical Research Corp. v. Johnson & Johnson, Inc.*, No. 03-CV-1329 (C.D. Cal. filed Sept. 5, 2003) (copy on file with the author); Complaint, *ConMed Corp. v. Johnson & Johnson, Inc.* No. 03-CV-8800 (S.D.N.Y. filed Nov. 6, 2003) (copy on file with the author).

¹⁰⁶ See *supra* notes 24 to 31 and accompanying text.

adequate business justification, it offers a bundled discount that covers products not sold by its rivals.¹⁰⁷

Consider, for example, the *en banc* decision in *LePage's*.¹⁰⁸ Plaintiff *LePage's* was a manufacturer of transparent tape, which it sold as “private label” tape (*i.e.*, tape that retailers such as Wal-Mart and Office Max labeled with their own brand name).¹⁰⁹ Defendant 3M manufactured “Scotch” brand transparent tape—by far the leading brand—as well as private label tape, “Post-It Notes,” and other packaging, home care, and leisure products.¹¹⁰ Beginning in 1993, 3M began rebate programs that would reward retailers for purchasing packages of 3M products.¹¹¹ The size of available rebates was dependent upon the number of product lines in which customers met specified purchase targets, and the rebates covered purchases from all 3M’s product lines.¹¹² *LePage's* sued, contending that 3M, which admittedly

¹⁰⁷ See *LePage's*, 324 F.3d at 155 (“The principal anticompetitive effect of bundled rebates . . . 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.”); June 10, 2004 Memorandum of Decision, *Masimo*, No. CV 02-4770 MRP (C.D. Cal.) (copy on file with the author), at 17 (relying on *LePage's* in denying defendant’s summary judgment motion where defendant “bundled its oximetry products with non-oximetry markets, thereby creating an inducement to buy from [defendant] that [plaintiff] could not match because [plaintiff] only offers oximetry”). Cf. *SmithKline*, 575 F.2d at 1065 (condemning bundled discount because defendant linked a product on which it faced competition from plaintiff with products plaintiff did not sell) (*see supra* note 28).

¹⁰⁸ 324 F.3d 141.

¹⁰⁹ *Id.* at 144.

¹¹⁰ *Id.* at 144, 154.

¹¹¹ *Id.* at 154.

¹¹² *Id.* The evidence at trial focused on three different rebate programs. Under the first, the Executive Growth Fund (“EGF”), 3M negotiated volume and growth targets for each customer’s purchases from six 3M consumer product divisions. A customer that met the target in three or more divisions earned a volume rebate of between 0.2% and 1.25% of total sales. See *id.* at 170 (Greenberg, J., dissenting). Beginning in 1995, 3M ended the EGF program and instituted the Partnership Growth Fund (“PGF”) for the same six 3M consumer product divisions. See *id.* at 171. Under PGF, 3M established uniform growth targets applicable to all participants. Customers who increased their purchases from at least two divisions by at least \$1.00, and increased their total purchases by at least 12% over the previous year, qualified for the rebate, which ranged from 0.5% to 2%, depending on the number of divisions (between two and five) in which the customer increased its purchases, and the total volume of purchases. See *id.* In 1996 and 1997, 3M offered price incentives called Brand Mix Rebates to two tape customers, Office Depot and Staples, to increase purchases of Scotch brand tape. See *id.* 3M imposed a minimum purchase level for tape set at the

possessed monopoly power in the transparent tape market,¹¹³ was monopolizing that market because customers could not meet 3M's growth targets without eliminating LePage's as a supplier.¹¹⁴ The jury found for LePage's on its monopolization claim.¹¹⁵ On appeal, a divided panel of the Third Circuit reversed the jury's monopolization verdict, holding that LePage's had failed to present proof of anticompetitive conduct.¹¹⁶ The majority based its holding on the fact that LePage's "did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled rebates."¹¹⁷ The Third Circuit vacated the panel opinion and granted rehearing *en banc*.¹¹⁸ On rehearing, the court rejected the panel's reasoning and conclusion and upheld the jury's determination that 3M's structured discounts amounted to anticompetitive conduct.¹¹⁹

Of interest here is the evaluative approach the *en banc* court used in considering the legality of 3M's bundled discounts.¹²⁰ The court first emphasized that the principal anticompetitive harm in bundled discounts is that they can be used to disadvantage competitors that sell narrower product lines and therefore must offer, across a smaller range of products, discounts that are at least equal in absolute dollar value to the

level of Office Depot's and Staples's purchases the previous year, with "growth" factored in. To obtain a higher rebate, these two customers could increase their percentage of Scotch purchases relative to certain lower-priced orders. *See id.*

¹¹³ *Id.* at 146.

¹¹⁴ *Id.* at 160-61.

¹¹⁵ *Id.* at 145.

¹¹⁶ *LePage's, Inc. v. 3M Corp.*, 2002 WL 46961, at *9 (3d Cir. Jan. 14, 2002), vacated, 277 F.3d 365 (Feb. 25, 2002), on reh'g, 324 F.3d 141, cert denied 2004 WL 1459258 (June 30, 2004).

¹¹⁷ *Id.*

¹¹⁸ *LePage's, Inc. v. 3M*, 277 F.3d 365 (3d Cir. 2002).

¹¹⁹ *LePage's*, 324 F.3d at 163-64. In upholding the verdict, the *en banc* court rejected outright any suggestion that *Brooke Group* might insulate 3M's pricing structure, which resulted in above-cost pricing, from Section 2 liability. *See id.* at 147 (rejecting 3M's theory "that after *Brooke Group* no conduct by a monopolist who sells its product above cost—no matter how exclusionary the conduct—can constitute monopolization in violation of Section 2 of the Sherman Act").

¹²⁰ I am using the term "bundled discounts" to include rebates conditioned upon purchasing the constituent parts of a bundle. The complained of conduct in *LePage's* consisted of bundled rebates. Rebates, of course, are nothing more than discounts provided after the purchase requirements are met.

discounter's total discounts across all products.¹²¹ The court did not require, however, that LePage's prove that it could not meet the discount without pricing below cost.¹²² Nor did the court require LePage's to prove that it produced transparent tape as efficiently as 3M.¹²³ All LePage's was required to prove was that the bundle 3M's customers had to buy to secure the discounts included products that LePage's did not sell,¹²⁴ and that this fact made it difficult for LePage's to compete with 3M.¹²⁵ Once LePage's made that showing, the burden shifted to 3M to prove that its bundled discounts were "justified" by cost-savings of some sort.¹²⁶ Because 3M failed to present proof that selling its products in a

¹²¹ *LePage's*, 324 F.3d at 155 ("The principle 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.").

¹²² The dissent recognized this point in distinguishing the majority's reasoning from that employed in *SmithKline*, 575 F.2d at 1065:

SmithKline showed that it could not compete by explaining how much it would have had to lower prices for both small and big customers to do so. *SmithKline* ascertained the rebates that Lilly was giving to customers on all three products and calculated how much it would have had to lower the price of its product if the rebates were all attributed to the one competitive product. In contrast, LePage's did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled rebates, and thus its brief does not point to evidence along such lines.

LePage's, 324 F.3d at 175 (Greenberg, J., dissenting).

¹²³ The dissent recognized this point in distinguishing the majority's reasoning from that employed in *Ortho Diagnostic*, 920 F. Supp. at 469. Whereas the *Ortho Diagnostic* court had required the plaintiff to show "either that (a) the [defendant] monopolist has priced below average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant's pricing makes it unprofitable to continue to produce," *id.* at 177 (quoting *Ortho Diagnostic*, 920 F. Supp. at 469), plaintiff LePage's "d[id] not contend that 3M priced its products below average variable cost," and "LePage's' economist conceded that LePage's is not as efficient a tape producer as 3M." *LePage's*, 324 F.3d at 177 (Greenberg, J., dissenting).

¹²⁴ *Id.* at 155-57.

¹²⁵ *Id.* at 159-63 (documenting the "anticompetitive effect" of 3M's bundled discount).

¹²⁶ *Id.* at 163 ("It remains to consider whether defendant's actions were carried out for 'valid business reasons,' the only recognized justification for monopolizing."); *id.* at 164 ("The defendant bears the burden of persuading the jury that its conduct was justified by any normal business purpose.") (internal quotation and alteration omitted).

bundled fashion reduced costs by an amount equal to or exceeding the amount of the total bundled discount, its bundled discounts were deemed unjustified and thus exclusionary.¹²⁷ Accordingly, *LePage's* appears to hold (1) that bundled discounts are presumptively exclusionary if the discounter is bundling products not sold by its rivals and is winning business from those rivals, but (2) that that presumption may be rebutted if the discounter proves a “business reasons justification” for the bundled discounts, meaning that the bundling saves costs approaching the amount of the total discount.¹²⁸

The *LePage's* approach is problematic for at least two reasons. First, the approach may force consumers to subsidize less efficient competitors and thus runs counter to a policy of vigorous competition in which firms succeed or fail based solely on their relative efficiencies. Given that the *LePage's* approach eschews consideration of the relative efficiency of the plaintiff (or any other rival)¹²⁹ and instead focuses on product line breadth, any plaintiff could successfully challenge a bundled discount simply by showing that its product line does not include products within the discounter's bundle. The plaintiff could enjoin the bundled discounts, and receive treble damages, even if it were a less efficient producer of whatever product(s) it sells in competition with the discounter.¹³⁰ Thus, the *LePage's* approach may essentially force

¹²⁷ *Id.* at 164 (“Although 3M alludes to its customers’ desire to have single invoices and single shipments in defense of its bundled rebates, 3M cites to no testimony or evidence in the 55 volume appendix that would support any actual economic efficiencies in having single invoices and/or single shipments. It is highly unlikely that 3M shipped transparent tape along with retail auto products or home improvement products to customers such as Staples or that, if it did, the savings stemming from the joint shipment approaches the millions of dollars 3M returned to customers in bundled rebates.”).

¹²⁸ There appears to be substantial momentum in the direction of the evaluative approach employed in *LePage's*. Other courts have adopted the approach, *see* June 10, 2004 Memorandum of Decision, *Masimo*, No. CV 02-4770 MRP (C.D. Cal.) (copy on file with the author), and plaintiffs have recently filed lawsuits claiming exclusion from the market by virtue of the fact that defendants offered bundled discounts covering products plaintiff did not sell. *See* Complaint, *Applied Medical Research Corp. v. Johnson & Johnson, Inc.*, No. 03-CV-1329 (C.D. Cal. filed Sept. 5, 2003) (copy on file with the author); Complaint, *ConMed Corp. v. Johnson & Johnson, Inc.*, No. 03-CV-8800 (S.D.N.Y. filed Nov. 6, 2003) (copy on file with the author).

¹²⁹ *See LePage's*, 324 F.3d at 177 (Greenberg, J., dissenting) (criticizing majority opinion for not requiring proof of equivalent efficiency).

¹³⁰ Consider, for example, our hypothetical shampoo manufacturers (discussed *supra* at notes 25 - 26 and accompanying text), but this time assume that the bundled discounter is the more efficient producer. The discounter produces shampoo at a cost

consumers to “subsidize” less efficient competitors by foregoing discounts that otherwise would be available.¹³¹

Indeed, one needn’t manufacture hypotheticals to demonstrate this possibility, for this is precisely what happened in *LePage’s*. As the dissent emphasized, *LePage’s* conceded (through its expert) that it was a less efficient producer of transparent tape than 3M.¹³² Thus, 3M was punished for charging lower prices to consumers, and was ordered to stop doing so, in order to ensure that an admittedly less efficient competitor could stay in business. *LePage’s* itself therefore shows that the evaluative approach adopted in the decision may ultimately prop up less efficient rivals at the expense of consumers.

A second problem with the *LePage’s* approach is that its focus on product line breadth threatens to chill bundling, a business practice that frequently creates efficiencies and provides benefits to consumers. On the sellers’ side, bundling and bundled discounts may reduce costs by creating economies of scope¹³³ (*i.e.*, decreases in the per unit costs of

of \$1.25/bottle and conditioner at a cost of \$2.50/bottle, sells the shampoo and conditioner separately for \$2.00 and \$4.00, respectively, and sells the package for \$5.00. The plaintiff rival sells only shampoo, which costs it \$1.50/bottle to produce. Under these facts, the plaintiff would obviously be “excluded” by the above-cost, \$5.00 price (representing a \$1.00 bundled discount), for it would have to lower its shampoo price to \$1.00/bottle—well below its cost—in order to compete. Thus, under the *LePage’s* approach, the defendant’s bundled discount would be presumptively exclusionary, and the defendant could avoid liability (and treble damages) only by showing that its \$1.00 effective price cut was justified by cost-savings occasioned by selling the products in a package. If the defendant were worried about making that showing—or, more likely, were concerned that a factfinder might not be persuaded by its evidence of cost-savings—it would likely forego, or at least reduce the size of, the discount. Thus, the *LePage’s* rule would discourage discounts whose only effect (besides lowering prices for consumers) would be to make it difficult for a less efficient rival to compete.

¹³¹ See 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 183 (“Requiring the defendant’s pricing policies to protect the trade of higher-cost rivals is overly solicitous of small firms and denies customers the benefits of the defendant’s lower costs.”).

¹³² *LePage’s*, 324 F.3d at 177 (Greenberg, J., dissenting) (noting that *LePage’s* “d[id] not contend that 3M priced its products below average variable cost,” and that “*LePage’s*’ economist conceded that *LePage’s* is not as efficient a tape producer as 3M”).

¹³³ See, e.g., THOMAS T. NAGLE & REED K. HOLDEN, THE STRATEGY AND TACTICS OF PRICING: A GUIDE TO PROFITABLE DECISION MAKING 306-07 (3d ed. 2002); Yannis Bakos & Erik Brynjolfsson, *Bundling Information Goods in Pricing, Profits, and Efficiency*, 45 MGMT. SCI. 1613, 1619 (Dec. 1999) (“Bundling can create significant

two or more products due to producing or marketing them together instead of separately)¹³⁴ or by facilitating output increases so as to achieve economies of scale.¹³⁵ The practices may also lower costs by reducing uncertainty about aggregate demand,¹³⁶ reduce overhead and marketing expenses by economizing on the quality-signaling benefits of well-known brands,¹³⁷ and facilitate efficiency-enhancing differential pricing.¹³⁸ On the buyers' side, bundled discounts reduce supracompetitive prices, at least in the short-run, and buyers (especially retailers) frequently prefer purchasing in bundles because doing so reduces the number of vendors with whom they must deal.¹³⁹ For both buyers and sellers, pre-announced bundled discounts reduce the

economies of scope even in the absence of technological economies in production, distribution or consumption.”); Stefan Stremersch & Gerald J. Tellis, *Strategic Bundling of Products and Prices: A New Synthesis for Marketing*, 66 J. MKTG. 55, 68 (2002).

¹³⁴ Stremersch & Tellis, *supra* note 133, at 68.

¹³⁵ See, e.g., Asim Ansari, S. Siddarth & Charles B. Weinberg, *Pricing a Bundle of Products or Services: The Case of Nonprofits*, J. MKTG. RES. 86-93 (Feb. 1996); NAGLE & HOLDEN, *supra* note 133, at 3.

¹³⁶ Yannis Bakos & Erik Brynjolfsson, *Bundling and Competition on the Internet*, 19 MKTG. SCI. 63 (2002).

¹³⁷ See, e.g., Michael A. Salinger, *A Graphical Analysis of Bundling*, 68 J. OF BUS. 85 (1995).

¹³⁸ See NAGLE & HOLDEN, *supra* note 133, at 246 (“Rather than cutting prices to price-sensitive customers, the value-added bundler instead offers them an additional value of a kind that less price-sensitive buyers do not want. With that strategy, a company can attract price-sensitive buyers without reducing prices to those who are relatively price insensitive.”); see also William J. Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 J.L. & ECON. 49, 65-67 & n. 17 (1996) (noting circumstances in which economic efficiency requires the use of differential pricing).

¹³⁹ See, e.g., Robert J. Vokurka, *Supplier Partnerships: A Case Study*, 39 PROD’N & INVENTORY MGT. J. 30 (Jan. 1, 1998); Philip B. Evans & Thomas S. Wurster, *Strategy and the New Economics of Information*, HARV. BUS. REV. (Sept./Oct. 1997). In competing for the business of retailers, multi-product vendors increasingly find it necessary to offer pro-consumer bundled product discounts. See, e.g., Chun-Hsiung Liao & Yair Tauman, *The Role of Bundling in Price Competition*, 20 INT’L J. OF INDUS. ORG. 365 (Mar. 2002); Gary D. Eppen, Ward A. Hanson & R. Kipp Martin, *Bundling – New Products, New Markets, Low Risks*, SLOAN MGT. REV. 7 (Summer 1991); Stremersch & Tellis, *supra* note 133, at 70 (“We find that product bundling of existing products may be optimal because it creates added value for consumers, saves costs, and creates differentiation in highly competitive markets.”); *Make a Bundle Bundling*, *supra* note 2, at 20 (quoting the author of one study of 100 companies for the proposition that bundling reduces information and transaction costs for consumers: “When done correctly, bundling provides customers with simplicity and order in an otherwise chaotic world.”).

transaction costs associated with negotiating multi-product purchases.¹⁴⁰ In short, there are many procompetitive reasons for bundling and thus for offering (and accepting) bundled discounts. The *LePage's* approach would discourage such discounts, for any firm offering one would be subject to antitrust suits by competitors that sell some, but not all, of the bundled products.

An advocate of the *LePage's* approach would contend, of course, that the approach will not inhibit procompetitive bundled discounting because discounters are afforded the opportunity to justify their behavior by proving that their bundled discounts generate cost-savings.¹⁴¹ But that argument ignores the real-world effect of placing the burden of justification on the discounter. Any business considering whether to offer a bundled discount covering products not sold by some rivals would have to ensure in advance that it could convince a jury that the discount created cost-savings at least equal to the amount of profit sacrificed.¹⁴² A discounter that could not prove an adequate quantum of cost-savings would risk a treble damages judgment.

This burden seems misplaced. Given that an above-cost bundled discount *always* provides some procompetitive benefit (in that it drives prices closer to the level of costs, which is where they would be in perfect competition)¹⁴³ and *always* provides some immediate consumer

¹⁴⁰ See NAGLE & HOLDEN, *supra* note 133, at 245.

¹⁴¹ Under *LePage's*, once a plaintiff established that the defendant was offering discounts on bundles that included products its rivals did not sell, the defendant's bundled discount would be deemed exclusionary *unless* the defendant could prove, to the satisfaction of a jury, that the amount of the discount did not exceed the efficiency benefits created by selling the products in a bundle. See *supra* notes 126 - 127 and accompanying text.

¹⁴² See *LePage's*, 324 F.3d at 164 (rejecting 3M's business reasons justification because 3M did not prove that "the savings stemming from [selling the products in a bundled fashion] approach[ed] the millions of dollars 3M returned to customers in bundled rebates"). The group of firms dissuaded from offering bundled discounts would include almost all monopolists, for a monopolized product generally would not be sold by rivals competing with the monopolist in other markets. Thus, a result of the *LePage's* approach is that no monopolist could offer a discount on a bundle that included its monopolized product, unless it could prove that the amount of the discount was exceeded by cost-savings occasioned by the bundling. See *id.* Such a rule would, of course, greatly discourage monopolists from offering any bundled discounts including their monopolized product—the very product for which the monopolist is most likely to charge supracompetitive prices.

¹⁴³ Cf. 2A AREEDA, HOVENKAMP, & SOLOW, *supra* note 89, ¶ 402b2, at 6 (noting that in perfect competition, price will be driven to the level of marginal cost); 10 P.

benefit (lower prices), it seems perverse to burden the defendant with “justifying” its discount. The law ought instead to require the *plaintiff* to prove that the discounting scheme is designed to be exclusionary rather than procompetitive. Part III explains how the law could do this without requiring the plaintiff to produce, and the judicial tribunal to evaluate, amorphous “intent” evidence.

D. Exclusionary if Actual Plaintiff Is Equally Efficient and Is Unable to Compete

As noted, an evaluative approach focused on the relative breadth of the discounter’s bundle vis-à-vis its rivals’ product lines may condemn discounts that would exclude only less efficient rivals and may, as in *LePage’s* itself, force consumers to subsidize rivals that are less efficient than the discounter.¹⁴⁴ Accordingly, some courts have reasoned that a competitor complaining of an above-cost bundled discount should have to prove that it is at least as efficient a producer of the competitive product as the discounter.¹⁴⁵ Requiring such proof would, of course, prevent less efficient competitors from using the law to create a “price umbrella” that would shield them from vigorous price competition.

This approach is best exemplified by the *Ortho Diagnostic* opinion.¹⁴⁶ The issue before the court in that case was whether defendant Abbott, which sold five types of (non-interchangeable) blood tests, had violated Sherman Act Section 2 by providing discounts on packages of its different types of blood tests.¹⁴⁷ The plaintiff, Ortho, manufactured blood tests that competed with three of Abbott’s five tests.¹⁴⁸ Abbott provided a discount on all of a purchaser’s blood test purchases if the purchaser bought at least four types of tests from Abbott, and it offered a higher discount to purchasers who bought all five of its tests.¹⁴⁹ Ortho complained that the discount policy unfairly

AREEDA, H. HOVENKAMP, & E. ELHAUGE, *ANTITRUST LAW* ¶ 1758f, at 334 (2d ed. 2004) (noting that a package discount “brings that price closer to the competitive level and increases output in both the tying and tied product.”).

¹⁴⁴ See *supra* notes 130 - 132 and accompanying text.

¹⁴⁵ See *LePage’s*, 2002 WL 46961, at *9-*10 (original panel majority opinion); *Ortho Diagnostic*, 920 F. Supp. at 469.

¹⁴⁶ 920 F. Supp. 455.

¹⁴⁷ *Id.* at 458.

¹⁴⁸ *Id.* at 459.

¹⁴⁹ *Id.* at 460.

disadvantaged it because it could compete with Abbott only by offering the full value of Abbott's five-product discount on its own three-product selection.¹⁵⁰ Ortho did not demonstrate that Abbott was pricing its discounted package below cost or that Ortho was as efficient a producer as Abbott but was unable to compete because of the discounting strategy.¹⁵¹

The court rejected Abbott's claim that its discounting should be deemed *per se* legal because it resulted in above-cost prices. The court first observed that the "below-cost" requirement for predatory pricing "is a vehicle designed to identify cases in which the defendant has priced its product at a level that creates the risk of depriving consumers of the benefits of competition from firms at least as efficient as the defendant."¹⁵² The court then concluded that the below-cost test might be underinclusive when bundled discounts are at issue, for even above-cost bundled discounts may have exclusionary effects where the discounter participates in more product markets than its competitors and is therefore able to spread the total discount over all those product lines and to force competitors to provide the entire dollar amount of the discount on a smaller collection of products.¹⁵³

Having rejected the *per se* legality approach, the court did not ask whether the discounter's conduct unjustifiably "raised rivals' costs," nor did it presumptively condemn the bundled discounts simply because the bundle included products the plaintiff did not sell. Instead, the court attempted to articulate a test that would condemn only those bundled discounts that would exclude a plaintiff that was as efficient as the discounter. Recognizing that discounting is usually procompetitive, the court held that a plaintiff complaining of bundled discounts must show that the pricing strategy somehow threatens equally or more efficient firms.¹⁵⁴ To do so, the plaintiff must demonstrate either that the

¹⁵⁰ *Id.* at 461-62. In other words, Ortho would have had to discount each of its products more than Abbott did in order to offer a competitive discount to consumers.

¹⁵¹ *Id.* at 469.

¹⁵² *Id.* at 466 (also noting that "below-cost pricing, unlike pricing at or above that level, carries with it the threat that the party so engaged will drive equally efficient competitors out of business, thus setting the stage for recoupment at the expense of consumers").

¹⁵³ *Id.* at 467-68. To illustrate this point, the court offered a version of the shampoo/conditioner example discussed above. *See supra* notes 25 - 26 and accompanying text.

¹⁵⁴ *Id.* at 469.

discounted bundled price is below the average variable cost of the bundle *or* that the plaintiff is at least as efficient a producer of the competitive product as the defendant but cannot charge prices high enough to turn a profit because of the defendant's pricing.¹⁵⁵ In its ultimately-vacated opinion, the panel majority in *LePage's* appeared to adopt a similar approach for evaluating bundled discounts.¹⁵⁶

While the *Ortho Diagnostic* approach avoids forcing purchasers to subsidize less efficient competitors by foregoing discounts, the approach creates serious administrability difficulties.¹⁵⁷ Under the approach, a plaintiff would have to prove, and a judicial tribunal would have to determine, what the plaintiff's per unit production and distribution costs are and how those costs compare to the defendant's per unit costs. Ascertaining costs is notoriously difficult,¹⁵⁸ and proving

¹⁵⁵ *Id.* Specifically, the court held that:

a Section 2 plaintiff in . . . a case in which a monopolist (1) faces competition on only part of a complementary group of products, (2) offers the products both as a package and individually, and (3) effectively forces its competitors to absorb the differential between the bundled and unbundled prices of the product in which the monopolist has market power – must allege and prove either that (a) the monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant's pricing makes it unprofitable for the plaintiff to continue to produce.

Id.

¹⁵⁶ *LePage's*, 2002 WL 46961, at *9. On rehearing, of course, the *en banc* majority rejected the approach. See *LePage's*, 324 F.3d at 175-77 (Greenberg, J., dissenting) (noting that *en banc* court had lowered quantum of proof required to establish exclusionary conduct).

¹⁵⁷ On the need for antitrust standards to be easily administrable, see Hovenkamp, *supra* note 64, at 269, 272-73; Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. CHI. L. REV. __, __ (forthcoming 2005) (“A workable definition of exclusionary conduct under Section 2 of the Sherman Act . . . must be administrable by a court, perhaps in a jury trial.”); Fred S. McChesney, *Talking ‘Bout My Antitrust Generation: Competition for and in the Field of Competition Law*, 52 EMORY L. J. 1401, 1414 (2003) (“Optimal minimization of error requires not just rules that are substantively sound, but also ones relatively easy for courts to apply correctly.”); *Town of Concord, Mass. v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, J.) (“[A]ntitrust rules are court-administered rules. They must be clear enough for lawyers to explain them to clients. They must be administratively workable and therefore cannot always take account of every complex economic circumstance or qualification.”).

¹⁵⁸ See 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 740, at 423-40; Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why Aspen*

another party's costs is even more difficult, given that the relevant evidence is in that other party's control.

Of course, the difficulty of proving another's costs cannot, by itself, doom the *Ortho Diagnostic* approach, for well-established doctrine requires predatory pricing plaintiffs to make precisely such a showing.¹⁵⁹ But the burden the *Ortho Diagnostic* approach places on plaintiffs and judicial tribunals exceeds the burden in run-of-the-mill predatory pricing cases. First, the approach requires the plaintiff to make (and the tribunal to evaluate) two cost showings: the plaintiff must prove its own per unit costs in addition to the defendant's. In a predatory pricing case, by contrast, the defendant's cost is compared to price, which is easily ascertainable. Second, determining the defendant's cost in a bundled discount case will likely be particularly complicated because there will always be joint costs—*i.e.*, costs pertaining to two different products.¹⁶⁰ Joint costs are inevitable in this context because every bundled discounter, unlike every predatory pricing defendant, produces multiple products and sells them together. Thus, the bundled discounter incurs, at a minimum, common marketing costs. Moreover, the discounter will generally incur common costs related to manufacturing, packaging, transportation, invoicing, and overhead. Determining how to allocate these common costs among the competitive product and the other products for which the costs were incurred (some of which might not even be included within the bundle) can be exceedingly difficult—arbitrary, in fact.¹⁶¹ Proving a discounter's costs will therefore be particularly difficult when bundled discounts are involved. Thus, the *Ortho Diagnostic* approach, while properly focusing on whether an equally efficient rival is being excluded by a bundled discount, creates intractable difficulties in terms of administrability and is likely to underdeter truly exclusionary bundled pricing, for plaintiffs will find it difficult to make the showing necessary to establish illegality.

and Kodak Are Misguided, 68 ANTITRUST L. J. 659, 664-65 (2001) (“[I]t is well-known that calculating marginal costs from accounting data is difficult.”).

¹⁵⁹ *Brooke Group*, 509 U.S. at 222 (“[A] plaintiff seeking to establish competitive injury from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs.”).

¹⁶⁰ 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 182 n. 35.

¹⁶¹ *See generally* 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 742, at 757-68 (discussing difficulty of allocating joint costs); 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 143, ¶ 1758f, at 335 (“Proving costs is always difficult and tracing them to particular products is even more difficult. Indeed, allocating joint costs among the products in a package is arbitrary even in theory.”).

Moreover, if the plaintiff happens not to be the discounter's most efficient rival, it is possible that the plaintiff's legal challenge will not prevail (because the plaintiff is not an equally efficient rival) but that there are, or could in the future be, equally efficient rivals who would be excluded by the defendant's bundled discounts. Thus, the *Ortho Diagnostic* approach may require multiple lawsuits where the plaintiff is not the rival best able to match the discounter's productive efficiencies.

E. Exclusionary if Hypothetical Equally Efficient Rival Would Be Unjustifiably Excluded

In light of the difficulties associated with *Ortho Diagnostic*'s evaluative approach, the leading antitrust treatise ("*Antitrust Law*"),¹⁶² has suggested an alternative approach that similarly seeks to ensure that only equally (or more) efficient rivals are protected but that would be easier to administer and less likely to underdeter or to require multiple lawsuits. Under the *Antitrust Law* approach, a court deciding whether an above-cost bundled discount is exclusionary¹⁶³ would not ask whether *the particular* plaintiff is as efficient as the discounter but would instead ask whether the discount would, without reasonable justification, exclude a *hypothetical* equally efficient rival.¹⁶⁴ Thus, in the *LePage's* case, the approach "would not have required LePage's to provide evidence that *it* could not compete against 3M's multi-product discounts; rather, [the approach] would [have] require[d] it to show that a hypothetical equally efficient firm making only one of the products subject to the bundled

¹⁶² The *Antitrust Law* treatise is so extensively relied on by antitrust lawyers and judges that U.S. Supreme Court Justice Stephen Breyer once remarked that most lawyers would prefer to have on their side "two paragraphs of Areeda on antitrust than four Courts of Appeals and three Supreme Court Justices." *Langdell's West Wing Renamed in Honor of Areeda*, HARV. GAZETTE (Apr. 25, 1996) (avail. at <http://www.news.harvard.edu/gazette/1996/04.25/LangdellsWestWi.html>) (last visited July 15, 2004).

¹⁶³ A bundled discount resulting in a package price below the cost of the package would presumably be adjudged under the straightforward predatory pricing principles announced in *Brooke Group*, 509 U.S. at 222. See 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 509-11.

¹⁶⁴ 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 182 ("The relevant question is not necessarily whether a particular plaintiff was equally efficient, but whether the challenged bundling practices would have excluded an equally efficient rival, without reasonable justification.").

rebate could not have competed successfully.”¹⁶⁵ The treatise maintains that “a requirement that the bundling practice be sufficiently severe to exclude an equally efficient single-product rival, and without an adequate business justification, seems to strike about the right balance between permitting aggressive pricing while prohibiting conduct that can only be characterized as anticompetitive.”¹⁶⁶

Antitrust Law’s proposed approach would avoid several of the difficulties inherent in the *Ortho Diagnostic* approach. First, the recommended approach would be easier to administer because ascertaining whether an equally efficient rival would be excluded is simpler than determining whether the plaintiff itself is as efficient a producer of the competitive product as the bundled discounter.¹⁶⁷ In addition, the approach would avoid *Ortho Diagnostic*’s problems of underdeterrence and multiple lawsuits. Relieved of the difficult burden of proving their equal efficiency, plaintiffs would be more likely to sue over truly exclusionary bundled discounts, and plaintiffs who turned out not to be as efficient as the discounter could still stop truly exclusionary discounts, thereby eliminating the need for others to sue, by proving that some other (actual or hypothetical) equally efficient rival would be excluded by the discounts.

But the *Antitrust Law* approach is not without difficulties. As an initial matter, the approach conflicts with the treatise’s treatment of package pricing (which is, of course, a form of bundled discounting).¹⁶⁸ Recognizing that discounts on packages of disparate products are usually

¹⁶⁵ 3 AREEDA & HOVENKAMP (2003 Supp.), *supra* note 21, ¶ 749, at ___ (emphasis in original).

¹⁶⁶ 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 182-83. The treatise explains:

Requiring the defendant’s pricing policies to protect the trade of higher-cost rivals is overly solicitous of small firms and denies customers the benefits of the defendant’s lower costs. Further, if the practice will exclude an equally efficient rival, then it will exclude whether or not the rival is equally efficient in fact.

Id. at 183.

¹⁶⁷ *Id.* at 182 (contending that proposed approach is preferable on grounds of administrability because, while “proving whether a hypothetical equally efficient rival is excluded by a multi-product discount is typically quite manageable . . . , proof that a plaintiff is equally efficient can be quite difficult, particularly in cases where the defendant produces a larger product line than the plaintiff and there are joint costs”).

¹⁶⁸ See *supra* note 17 and accompanying text.

procompetitive because they reflect cost savings¹⁶⁹ and/or move supracompetitive prices toward costs,¹⁷⁰ the treatise suggests that challenges to package pricing ought to be difficult to mount.¹⁷¹ Package pricing should not be condemned as predatory pricing, the treatise contends, as long as the price of the package exceeds the package's total cost.¹⁷² In other words, a tribunal should not attribute the total amount of any package discount to a single product within the package and ask whether that product, as discounted, is priced below cost; instead, it should ask whether the package price exceeds the sum of the costs of the products within the package.¹⁷³ If so, then the package pricing should be deemed legal as long as it does not amount to *de facto* tying.¹⁷⁴ Whether package pricing amounts to *de facto* tying, then, depends on whether the package discount has an effect similar to an outright refusal to sell the packaged products separately.¹⁷⁵ That question, the treatise maintains,

¹⁶⁹ 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 143, at ¶ 1758d1 (noting that “[p]ackaging two products together often reduces costs” and that “[f]ailure to legitimize cost savings hospitably would overdeter the common, often procompetitive, and seldom anticompetitive package discount”).

¹⁷⁰ *Id.* at ¶ 1758f (“[T]he package discount brings that price closer to the competitive level and increases output in both the tying and tied products.”).

¹⁷¹ *See generally id.* at ¶ 1758.

¹⁷² *Id.* ¶ 1758f, at 334 (“[W]e do not find predatory pricing so long as the package price exceeds the total relevant cost of the package.”); 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 509-10 (contending that “[c]ourts should not entertain claims that while a defendant's overall price is remunerative, the separate ‘price’ for one particular component is predatory” and criticizing *Multistate Legal Studies v. Harcourt Brace Jovanovich*, 63 F.3d 1540, 1549 & n. 7 (10th Cir. 1995), for finding predation by attributing total amount of package discount to single product within package and asking whether that product, as discounted, was priced below cost).

¹⁷³ 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 510 (“[I]t is difficult to think of a more anticompetitive antitrust rule than one requiring that the full cost of each product improvement or increment must be accompanied by a price increase fully offsetting the costs.”).

¹⁷⁴ 11 H. HOVENKAMP (2004 Supp.), ANTITRUST LAW ¶ 1807c, at 285 (noting that if package price is above the cost of the package, there can be no predatory pricing and that “[t]he real competitive harm, if any, comes from tying via a package discount of two or more different products”).

¹⁷⁵ 10 AREEDA, ELHAUGE, & HOVENKAMP, *supra* note 142, ¶ 1758a, at 323 (noting that whether there is *de facto* tying depends on “whether the discount has an effect similar to an outright refusal to sell tying product A separately”). *Antitrust Law* “reject[s], as have most courts, the two polar positions that every package discount proves a tie or that separate availability negates a tie.” *Id.* ¶ 1758b, at 325. Deeming every package discount an illegal tie is improper because “package discounts might promote competition by bringing some package cost savings to consumers, by

should be answered by focusing on the “proportion of separate purchases”—*i.e.*, the percentage of purchases of “tied” product *B*, by purchasers who buy both the defendant’s “tying” product *A* and any seller’s product *B*, that are outside the defendant’s package.¹⁷⁶ The treatise suggests that if separate purchases exceed 10 percent, there should be no illegal tie.¹⁷⁷ In addition, the treatise posits three “safe harbors” where a tie should not be found *even if* separate purchases are less than 10 percent.¹⁷⁸ The upshot of this analysis is that a plaintiff

accommodating heterogeneous buyer preferences, or by helping undermine supracompetitive prices in the tying or tied market.” *Id.* Conversely, deeming voluntary package discounts to be *per se* not a tie “would eviscerate tying scrutiny . . . for any seller could tie with impunity simply by setting a sufficiently large package discount.” *Id.* at 326. A number of courts have similarly recognized that a sufficiently large package discount may constitute a *de facto* tie. *See, e.g., United Shoe Machinery Corp. v. United States*, 258 U.S. 451, 464 (1922) (noting that package discount might have an “effect . . . so onerous as to compel” the buyer to take the package but finding conflict in testimony about whether such effect was present); *American Mfrs. Mut. Ins. Co. v. American Broadcasting-Paramount Theatres*, 388 F.2d 272, 284 (2d Cir. 1967) (observing that allowing defendant to avoid tying claim “merely by setting a pre-established price for each individual item—even if that price is rarely if ever charged and is, in relation to the package price, fanciful and unjustified by cost—would mean that the antitrust laws could be flouted at will”); *Virtual Maintenance, Inc. v. Prime Computer*, 957 F.2d 1318 (6th Cir.), vacated on other grounds, 113 S. Ct. 314 (1992) (package discount a tie); *In re Data General Corp. Antitrust Litig.*, 490 F. Supp. 1089, 1110-11 (N.D. Cal. 1980) (same); *Ways & Means v. IVAC Corp.*, 506 F. Supp. 697, 701 (N.D. Cal. 1979), *aff’d*, 638 F.2d 143 (9th Cir. 1980) (“separate availability will not preclude antitrust liability where a defendant has established its pricing policy in such a way that the only viable economic option is to purchase the tying and tied products in a single package”); *Nobel Scientific Indus. v. Beckman Instruments*, 670 F. Supp. 1313, 1324 (D. Md. 1986), *aff’d*, 831 F.2d 537 (4th Cir. 1987) (same, quoting *Ways & Means*); *see also Robert’s Waikiki U-Drive v. Budget Rent-a-Car*, 491 F. Supp. 1199, 1208 (D. Haw. 1980), *aff’d*, 732 F.2d 1403 (9th Cir. 1984) (package discount might be a tie if no one would buy the tying product separately).

¹⁷⁶ 10 AREEDA, ELHAUGE, & HOVENKAMP, *supra* note 143, ¶ 1758b, at 325-28. For example, if there are 100 purchasers who buy tying product *A* from the defendant and tied product *B* from anyone (the defendant or anyone else), and 60 of those purchasers take *B* as well as *A* from the defendant, the “proportion of separate purchases” is 40 percent.

¹⁷⁷ *Id.* ¶ 1758b, at 328; ¶ 1756b2, at 300.

¹⁷⁸ *See id.* ¶ 1758e, at 332-33. Given that the concern of tying law is “that the price for the tying product separately has been so artificially inflated that it is not realistically available separately,” *id.* at 332, the treatise maintains that courts should decline to find a tie when either (1) the separate price of tying product *A* is less than or equal to the market price of *A*, *id.*; (2) the package price of tied product *B* (*i.e.*, the price of the package less the separate price of tying product *A*) exceeds or equals the market price of *B*, *id.* at 332-33; or (3) the package price of *B* exceeds or equals the marginal

attacking package pricing must prove either (1) that the package price is less than the sum of the costs of the products within the package (in which case the package pricing is predatory), or (2) that the “proportion of separate purchases” is less than 10 percent and none of the three safe harbors applies (in which case the package pricing constitutes *de facto* tying).

In contrast, *Antitrust Law*’s approach to bundled discounting would require a plaintiff to show merely that “the challenged bundling practices would have excluded an equally efficient rival.”¹⁷⁹ A plaintiff could do so by showing that attributing the entire amount of the bundled discount to the competitive product results in an effective price for that product that is below the defendant’s cost, so that an equally efficient single-product seller could not match, and thus would be excluded by, the bundled discount. That, however, is *precisely* the showing the treatise says is insufficient to prove that package pricing is predatory.¹⁸⁰ Moreover, there is no requirement that the plaintiff establish tying (actual or *de facto*), which the treatise elsewhere says is the “real competitive harm” occasioned by package pricing.¹⁸¹

To see the tension in the treatise’s disparate treatment of package pricing¹⁸² and bundled discounts,¹⁸³ consider a situation where a defendant offers a discount on a package consisting of products A and B,

cost of rivals’ B, *id.* at 333. (noting that “[t]his excess means that any inducement to take the defendant’s package results from his rivals’ insistence on charging supracompetitive prices for the tied product”). In the first two situations, there can be no legitimate concern that the defendant has jacked up the separate price of tying product A in order to induce buyers to purchase the package. In the third, there is no injury to competition because the defendants’ rivals could compete by reducing their prices to competitive levels. *Id.* at 332-33.

¹⁷⁹ 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 182. This exclusionary effect must occur, according to the treatise, “without reasonable justification.” *Id.* Presumably, that means that the defendant would be permitted to show some efficiency justification for the bundled discounting. As explained above, *see supra* notes 141 - 143 and accompanying text, this rebuttal opportunity would not be sufficient to prevent the chilling of procompetitive bundled discounting.

¹⁸⁰ *See supra* notes 172 - 174 and accompanying text.

¹⁸¹ 11 HOVENKAMP (2004 Supp.), *supra* note 174, ¶ 1807c, at 285. *Cf.* 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 510 (“Of course, the bundling of the car and the stereo may foreclose rival stereo makers, but that concern results from tying and not from predatory pricing.”).

¹⁸² *See generally* 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 143, ¶ 1758; 11 HOVENKAMP (2004 Supp.), *supra* note 174, ¶ 1807c (2004 Supp.).

¹⁸³ *See generally* 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749.

and its rival (the plaintiff) sells product *A* but not product *B*. Suppose that, when the total amount of the discount is allocated to product *A*, that product is priced below the defendant's cost, but that the discounted price of the *A-B* package exceeds the sum of the defendant's costs of *A* and *B*. Suppose further that 70 percent of purchasers who buy both *A* and *B*, and buy at least one of them from the defendant, partake of the discount by also buying the other product from the defendant.¹⁸⁴ If viewed as package pricing, the treatise would approve this scheme, for it is neither predatory pricing (because the package cost does not exceed the package price)¹⁸⁵ nor tying (because the "proportion of separate purchases" exceeds 10%).¹⁸⁶ If viewed as a bundled discount, however, the treatise would presumptively condemn the scheme, for a hypothetical competitor that was equally as efficient as the defendant but sold only product *A* could not stay in business.¹⁸⁷ Thus, *Antitrust Law*'s approach to bundled discounting is inconsistent with its treatment of package pricing—which is really the same thing.

A more significant difficulty with the *Antitrust Law* approach is that it would prevent multi-product sellers from "cross-subsidizing" discounts (*i.e.*, from funding a discount on one product by giving up margin on other supracompetitively priced products) and would thereby reduce consumer welfare. Suppose, for example, that the defendant discounter sells products *A*, *B*, and *C* in concentrated markets that are subject to oligopolistic pricing but are not actually cartelized (*i.e.*, there are no actual agreements regarding price).¹⁸⁸ Assume that the plaintiff competes with the defendant in the market for product *A* but does not sell either product *B* or *C*. The defendant's cost of producing each of

¹⁸⁴ Put differently, the "proportion of separate purchases" is 30 percent. *See supra* note 176.

¹⁸⁵ *See* 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 509-11; 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 143, ¶ 1758, at 334-35; 11 HOVENKAMP (2004 Supp.), *supra* note 174, ¶ 1807c, at 285.

¹⁸⁶ *See* 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 143, ¶ 1758b, at 328; ¶ 1756b2, at 300.

¹⁸⁷ *See* 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 182 (proposing that the legality of a bundled discount turn on "whether the challenged bundling practices would have excluded an equally efficient rival, without reasonable justification").

¹⁸⁸ Pricing in oligopolistic markets (*i.e.*, markets in which a few large sellers account for the bulk of the output) tends to depart from the competitive norm of prices equal to marginal cost, even without actual price agreements among sellers. *See* 2A AREEDA, HOVENKAMP, & SOLOW, *supra* note 89, ¶ 404b, at 10-14.

products *A*, *B*, and *C* is \$4 per unit. Sold separately, the defendant charges \$5 per unit for each of *A*, *B*, and *C*, but it sells the *A-B-C* package for \$13.50. This package pricing more closely aligns the defendant's prices and costs and will tend to destabilize the coordinated supracompetitive pricing in each of the *A*, *B*, and *C* markets.¹⁸⁹ From the standpoint of consumers and competition, this is a good thing: prices have been pushed toward costs (where they would be in a perfectly competitive market), oligopolistic pricing has been disrupted (and non-discounting rivals are likely to respond with discounts of their own), and

¹⁸⁹ Ironically, the *Antitrust Law* treatise elsewhere recognizes these benefits of permitting the sort of discount cross-subsidization that its approach to bundled discounting would forbid. With respect to the "pushing prices toward costs" benefit, the treatise explains:

When the package price exceeds its costs but pushes the tied product's price within the package below its own costs, the defendant's separate price for the tying product must exceed the relevant costs of making the tying product. Thus, the tying product's price must be supracompetitive, and the package discount brings that price closer to the competitive level and increases output in both the tying and tied products. Because of rising output in both products, this is not a case of "monopoly profit" in the tying product allegedly funding predatory pricing in the tied product. Unlike standard predatory pricing, moreover, the expansion in output need not be temporary; nor is there any loss that needs to be recouped by future monopoly pricing. Tying market rivals can hardly demand that antitrust law protect their supracompetitive prices.

10 AREEDA, ELHAUGE, & HOVENKAMP, *supra* note 143, ¶ 1758, at 334-35. With respect to the "destabilizing oligopolistic pricing" benefit, the treatise states:

[S]uch indirect price-cutting on the tying product [*i.e.*, giving up margin on one (or more) product(s) in the bundle to subsidize the other bundled product(s)] has a special potential for disrupting oligopolistic coordination. Rival oligopolists may be uncertain whether the price cut is on the tying or tied product. They may also not know whether the defendant is "cheating" or merely passing on a package cost saving. Moreover, they may not retaliate because the price cut will be limited to those purchasers of the tying product who want the tied product and choose the package. In addition, such a selective price cut is less expensive for the defendant than an across-the-board price cut on all tying product sales. For all these reasons, the defendant may attempt the price cut. Not only does the defendant's price cut benefit buyers, it can weaken oligopolistic collaboration more widely.

Id. at 335.

consumers are paying less.¹⁹⁰ The *Antitrust Law* approach, however, would condemn this arrangement because a hypothetical A seller whose per unit cost is \$4 would have to lower its A price to \$3.50 in order to compete and would thus be driven out of business. The approach may therefore condemn cross-subsidization that would be good for consumers and competition in the long run.

Finally, the *Antitrust Law* approach is troubling because its lax requirements for imposing liability would allow plaintiffs to condemn even bundled discounts that likely could not exacerbate monopolistic pricing. The approach does not require plaintiffs to demonstrate that they could not match the bundled discount by entering the markets in which they do not currently participate. Neither does it require them to prove that the market in which they do participate is structurally susceptible to monopolistic pricing. Absent such proof, plaintiffs cannot establish any genuine likelihood of consumer harm, and they should not be permitted to thwart immediate consumer benefits (*i.e.*, lower prices) without proving such a likelihood.

The *Antitrust Law* approach would impose liability based upon a mere “show[ing] that a hypothetical equally efficient firm making only one of the products subject to the bundled rebate could not have competed successfully.”¹⁹¹ This test could provide undue protection for firms that are inefficient with respect to scope (*i.e.*, that do not produce an optimal mix of products), for in many cases a single-product rival could feasibly begin selling the other products in the bundle. Where entry into the other product markets is easy, the law should not condemn bundled discounts just so that rivals will not have to enter those markets. Entry would increase competition in those markets to the benefit of consumers and should be encouraged. Thus, a plaintiff challenging a bundled discount should have to show that entry barriers¹⁹² would preclude the “hypothetical equally efficient firm making only one of the

¹⁹⁰ Indeed, the *Antitrust Law* treatise elsewhere acknowledges that it would be poor antitrust policy to require the full cost of any “increment” to be accompanied by a price increase fully offsetting that cost. 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 510. The treatise’s treatment of bundled discounts, though, would require that the cost of each bundled “increment” be accompanied by a fully offsetting price increase.

¹⁹¹ 3 AREEDA & HOVENKAMP (2003 Supp.), *supra* note 21, ¶ 749, at ___.

¹⁹² An “entry barrier” or “barrier to entry” is “any factor that makes entry into a market unprofitable, even as profits are being earned there.” 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 729a, at 345.

products subject to the bundled rebate” from expanding its scope so as to compete with the bundle.

The plaintiff should also have to show entry barriers in the market for the competitive product (*i.e.*, the product already sold by the hypothetical equally efficient rival), for the absence of such barriers would preclude future supracompetitive pricing by the discounter and would thus destroy the rationale for condemning a present discount.¹⁹³ Suppose that allocating the entire amount of the discount to the competitive product results in below-cost pricing so that a hypothetical equally efficient single-product rival would be excluded. Suppose further that there are low barriers to entry in the market for the competitive product. In such circumstances, even if the discounter were to drive out all competitors, it would not have the power to raise prices above competitive levels because other rivals would respond to the supracompetitive pricing by entering the market.¹⁹⁴ Thus, the *Antitrust Law* approach is deficient in that it fails to require proof of some possibility of recoupment through monopolistic pricing.¹⁹⁵ Before being allowed to enjoin a consumer-friendly discount, a plaintiff should have to demonstrate the likelihood of future supracompetitive pricing by showing that there are barriers to entry in the market for the competitive product.

III. An Alternative Proposal: Above-Cost Bundled Discounts Are Presumptively Legal, But a Plaintiff May Rebut the Presumption By Proving Facts that Demonstrate Genuine Exclusion of a Competitive Rival.

It seems, then, that each of the thus far articulated approaches to bundled discounts is problematic; each approach would either over- or

¹⁹³ Condemning a present discount is warranted only if the discount is likely to cause future supracompetitive pricing (after it successfully drives rivals from the market).

¹⁹⁴ See Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 2 (1984) (“Monopoly is self-destructive. Monopoly prices eventually attract entry.”); *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) (“[I]t is not enough simply to achieve monopoly power, as monopoly pricing may breed quick entry by new competitors eager to share in the excess profits.”).

¹⁹⁵ *Cf. Brooke Group*, 509 U.S. at 222 (holding that below-cost prices that would exclude rivals are not, by themselves, sufficient to establish anticompetitive harm; there must also be a likelihood of recoupment).

under-deter and/or is overly difficult to administer.¹⁹⁶ What we need is an evaluative approach that (1) will condemn those bundled discounts that are ultimately likely to harm consumer welfare, (2) will not chill bundled discounts that are not likely to cause long-run consumer harm, and (3) is easily administrable.¹⁹⁷ An approach that presumes the legality of above-cost bundled discounts, but would allow a plaintiff to rebut that presumption by proving certain easily ascertainable facts indicating genuine exclusion of an efficient rival, would meet these criteria.

A. Objectives of the Alternative Approach

Let's begin with the assumption that the ultimate goal of our evaluative approach is to promote consumer welfare by achieving the highest output and lowest price possible.¹⁹⁸ Given that goal, the

¹⁹⁶ To review, the *per se* legality approach fails adequately to account for the ability of above-cost bundled discounts to drive out equally efficient rivals and is justified only if there is no administrable means of distinguishing between pro- and anticompetitive above-cost bundled discounts. *See supra* notes 61 - 66 and accompanying text. The “raising rivals’ costs” theory fails because much procompetitive conduct raises rivals’ costs, and there is no easily administrable test that will identify when raising rivals’ costs is unjustifiable and will not chill procompetitive behavior. *See supra* notes 92 - 104 and accompanying text. The *LePage’s* approach may force consumers to forego lower prices in order to protect less efficient rivals (such as *LePage’s* itself) and will discourage even procompetitive bundled discounting by improperly burdening discounters with having to justify their reduced prices by pointing to adequate cost-savings. *See supra* notes 129 - 143 and accompanying text. The *Ortho Diagnostic* approach is difficult to administer, may lead to underdeterrence because the burden on plaintiffs is too great, and may require multiple lawsuits if the “right” plaintiff (*i.e.*, the one best able to match the discounter’s efficiency) does not bring the lawsuit. *See supra* notes 157 - 161 and accompanying text. And the *Antitrust Law* approach would preclude discount cross-subsidization, which will frequently be procompetitive and beneficial to consumers, and would deter bundled discounts that could not lead to future supracompetitive pricing. *See supra* notes 188 - 195 and accompanying text.

¹⁹⁷ As the *Antitrust Law* treatise puts it, “The difficult question [with respect to bundled discounts] is the formulation of an administrable rule that does not overreach and condemn competitive conduct.” 3 AREEDA & HOVENKAMP (2004 Supp.), *supra* note 26, ¶ 749, at 183.

¹⁹⁸ *See, e.g.*, Thomas A. Piraino, *The Antitrust Analysis of Network Joint Ventures*, 47 HASTINGS L. J. 5, 6 n. 7 (1995) (“[T]he federal courts make it clear that the goal of the antitrust laws is to enhance consumer welfare by ensuring competitive markets that provide consumers with the maximum possible output of goods and services at the lowest possible prices.”); *State Oil v. Kahn*, 522 U.S. 3, 15 (1997) (noting that “the

approach should condemn bundled discounts that would drive out of business those rivals that are more efficient producers than the discounter, for those rivals would be able to produce, and thus to sell, their products more cheaply than the discounter. In addition, the approach should condemn bundled discounts that would drive out rivals that are *as* efficient as the perpetrator, for by reducing the number of such rivals, the perpetrator's conduct would reduce the competition that increases output and drives down prices. Finally (and more controversially), we might want the approach to condemn bundled discounts that would exclude rivals that currently are not as efficient as the perpetrator but would likely become so if given the opportunity to develop economies of scale.¹⁹⁹ If we use the term "competitive rivals" to refer to rivals that are, or are likely to become, as efficient as the discounter,²⁰⁰ then our approach should aim to condemn bundled discounts that would drive competitive rivals out of business.²⁰¹

primary purpose of the antitrust laws is to protect interbrand competition," which frequently consists of "cutting prices to increase business") (quoting *Matsushita*, 475 U.S. at 594); *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 366 (Powell, J., dissenting) ("As we have noted, the antitrust laws are a 'consumer welfare prescription.'") (quoting *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979)).

¹⁹⁹ *Compare, e.g.,* Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 33-34 (arguing that antitrust law should seek to prevent exclusion of even less efficient rivals where the exclusionary tactic is preventing the rivals from attaining efficiencies), *with* POSNER, *supra* note 101, at 194-95 (defining the exclusionary conduct the antitrust laws should police as conduct that is "likely in the circumstances to exclude from the defendant's market an equally or more efficient competitor"). *See generally* Hovenkamp, *supra* note 157, at ___ (discussing debate over whether less efficient rivals should receive protection).

²⁰⁰ Rivals unlikely to achieve efficiencies equal to or greater than the discounter would be "non-competitive rivals," much the way the number 100 ranked tennis player in the world is a non-competitive rival of the top-ranked player. The number four ranked player, by contrast, is a competitive rival, even though she is currently less "efficient" than the top player.

²⁰¹ A goal of protecting those rivals that are as efficient as the bundled discounter *or* are likely to become that efficient if afforded the opportunity to grow is largely consistent with the various competing views on what constitutes "exclusionary" unilateral conduct. Professor Hovenkamp has identified four such views. *See* Hovenkamp, *supra* note 157, at ___-___. One view, espoused by Judge Posner, identifies exclusionary conduct as conduct that is "likely in the circumstances to exclude from the defendant's market an equally or more efficient competitor." *Id.* at ___ (quoting POSNER, *supra* note 101, at 194-95). The goal set forth here is largely consistent with that definition of exclusionary conduct, though it would call for condemnation of conduct that would exclude rivals not yet as efficient as the discounter but likely to become so if given the opportunity to grow. A second definition of exclusionary

Designing our evaluative approach to condemn bundled discounts that would exclude competitive rivals is only part of the objective, however. We should also ensure that the approach does not improperly chill procompetitive bundled discounts. The approach should therefore be easy to administer (*i.e.*, it should not require an amorphous and unpredictable “balancing” by a factfinder) and should include clearly defined safe harbors for bundled discounts that could not exclude competitive rivals.²⁰² Such safe harbors—like the safe harbor that exempts above-cost single-product price cuts from predatory pricing challenges²⁰³—will permit businesses to engage in approved forms of bundled discounting without fear of treble antitrust damages.

conduct is espoused by the so-called “post-Chicago” school and maintains that conduct is exclusionary if it renders the perpetrator’s rivals less efficient. *See* Hovenkamp, *supra* note 157, at ___ (citing Thomas Krattenmaker & Steven Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L. J. 209 (1996); Steven C. Salop & David T. Scheffman, *Raising Rivals’ Costs*, 73 AM. ECON. REV. 267 (1993)). The goal proposed above is largely consistent with this “raising rivals’ costs” theory, for that theory cannot ultimately be concerned with protecting *every* rival, but only those likely to achieve comparable efficiency. A third definition of exclusionary conduct focuses on whether the defendant has sacrificed short-run revenues or profits in exchange for larger revenues anticipated to materialize later when the defendant’s monopoly power has been created or strengthened. *See* Hovenkamp, *supra* note 157, at ___. This “sacrifice-based” theory is largely consistent with the goal stated above because the ultimate point of the sacrifice test is to ensure that rivals that are equally efficient—or are likely to become so—are not driven from the market. Preventing the sacrifice of current profits is not an end in itself; rather, it is a means of determining whether a firm is engaging in conduct that could drive out rivals society would like to have remaining in the market. *See* Crane, *supra* note 1, at ___. Finally, the exclusionary conduct test stated in the *Antitrust Law* treatise asks whether the practice at issue (1) is reasonably capable of excluding rivals, (2) fails to provide adequate consumer benefit, and (3) can be easily identified and condemned by a judicial tribunal. *See* Hovenkamp, *supra* note 157, at ___ (discussing the exclusionary conduct test set forth in 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 651a, at 72). The goal here is largely consistent with that definition because only discounts that would exclude equally efficient rivals, or those rivals likely to become so, would meet all three criteria.

²⁰² *Cf.* Hovenkamp, *supra* note 157, at ___ (“A workable definition of exclusionary conduct under Section 2 of the Sherman Act must satisfy two criteria: first, it must define anticompetitive exclusionary conduct with tolerable accuracy, in particular, without excessive false positives. Second, it must be administrable by a court, perhaps in a jury trial.”).

²⁰³ *Brooke Group*, 509 U.S. at 222 (requiring, for predatory pricing liability, that “the prices complained of [be] below an appropriate measure of [the defendant’s] costs”).

B. The Alternative Approach

The following evaluative approach would achieve each of our objectives: As long as a bundled discount results in a price that exceeds the bundle's cost, the discount is legal *unless* the plaintiff shows—

- 1) that there are barriers to entry (a) in the product market(s) in which the plaintiff does not participate and (b) in the market for the competitive product;
- 2) that it is impossible for the plaintiff to coordinate with other producers to create a competing bundle; and
- 3) that the plaintiff made a good faith offer to become a supplier to the discounter but was rebuffed.

If the plaintiff proves each of these facts, the defendant may nonetheless escape liability by showing that it rejected the plaintiff's offer to become a supplier because either (a) the price the plaintiff would have charged exceeded the defendant's cost of producing the product, or (b) the quality of the plaintiff's product was inferior to that of the defendant's product.

As explained below, this approach would identify and condemn bundled discounts that could actually drive a competitive rival out of business, but it would preclude liability for discounts that could not exclude a competitive rival. Moreover, it would provide a trustworthy safe harbor for firms that wish to offer procompetitive bundled discounts: those firms would be assured of no liability as long as (1) the discounted price of the package is above the package's cost, and (2) the discounter accepts any mutually beneficial supplier offers extended by its rivals.

1. The Plaintiff's Required Showing

Before a judicial tribunal thwarts a bundled discount (which provides immediate consumer benefit), the complaining plaintiff should be required to prove that it has done all it can do to compete with the discounter by matching the discounter's offer. The conventional wisdom, of course, is that a rival with a less complete product line simply can't compete with a bundled discount,²⁰⁴ unless it can lower the

²⁰⁴ See, e.g., 3 AREEDA & HOVENKAMP (2003 Supp.), *supra* note 21, ¶ 749, at ___ (“Depending on the number of products that are aggregated and the customer's relative purchases of each, even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce.”).

price of its competitive product(s) by the total amount of the bundled discount.²⁰⁵ Indeed, the *LePage's* court asserted that the “principle anticompetitive effect” of bundled discounts is that “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.”²⁰⁶

But this reasoning incorrectly assumes that a rival “who does not manufacture an equally diverse group of products” “cannot make a comparable offer.” In actuality, there are at least three ways a plaintiff facing a competitor’s bundled discount could “make a comparable offer” and thus stay in business: It might be able to (1) match the bundle itself by entering the product markets in which it doesn’t currently participate and offering its own competing bundle; (2) collaborate with other sellers in the markets in which it doesn’t participate to provide a competing bundle; or (3) become a supplier of the bundled discounter, thus effectively offering a competitive bundle consisting of its product and those of the discounter. A determined rival would pursue each of these options before giving up the ghost, and the law should require such self-help before permitting judicial intervention to thwart immediate lower prices. The approach articulated above provides courts with a mechanism for ensuring that judicial intervention is a last resort that is employed only after the plaintiff has established that it has no viable means of staying in business by competing more vigorously.

a. Barriers to Entry in Other Product Markets and in the Market in Which Plaintiff Participates

A determined rival’s most obvious option for competing with a bundled discount that exceeds the rival’s total margin on the products it sells in competition with the bundle²⁰⁷ is to expand its scope by entering the market(s) for the bundled product(s) it does not sell. For example, if

²⁰⁵ If the total amount of the bundled discount is less than the rival’s margin on the product or products it sells in competition with the bundle, then the rival could stay in business by simply lowering the price of its competitive product or products by the amount of the bundled discount. See Crane, *supra* note 1, at ____.

²⁰⁶ *LePage's*, 324 F.3d at 155.

²⁰⁷ For a bundled discount whose total amount could be attributed to each bundled product without driving the price of that product below cost, a competitive rival’s most obvious option would be to lower the price of its product by the amount of the bundled discount. See *supra* note 205. Since this response could only benefit consumers, this sort of bundled discount should be *per se* legal. See Crane, *supra* note 1, at ____.

a diversified medical supply company were offering discounts on bundles of trocars (devices used in endoscopic surgery) and sutures (stitches),²⁰⁸ a trocar manufacturer might be able to enter the sutures market and offer its own competitive bundle. Of course, such entry might be difficult for a host of reasons—*e.g.*, the existence of sutures patents, regulatory hurdles, long-term contracts, or natural monopoly.²⁰⁹ Indeed, most monopolization cases based on bundled discounting would presumably involve a monopolist cross-subsidizing its discount on the competitive products by giving up margin on the monopoly product.²¹⁰ The mere presence of such monopoly profits would indicate that entry into the “other” market was difficult.²¹¹ One can imagine, though, bundled discount cases where the markets in which the challenger does not participate are not monopolized markets; indeed, *LePage’s* was such a case.²¹² Thus, the plaintiff should have to show that barriers to entry would prevent it from expanding its scope so as to replicate the challenged bundle. In most cases, plaintiffs would probably have little trouble making this showing, but requiring them to do so would prevent a plaintiff from being able to avoid procompetitive scope expansion when such expansion is feasible.

²⁰⁸ See, *e.g.*, Complaint, *ConMed v. Johnson & Johnson*, No. 03-CV-8800 (S.D.N.Y. filed Nov. 6, 2003) (copy on file with the author); Complaint, *Applied Medical v. Johnson & Johnson*, No. 03-CV-1329 (C.D. Cal. filed Sept. 5, 2003) (copy on file with the author).

²⁰⁹ Importantly, the need to amass a large amount of capital to finance scope expansion is *not* generally a barrier to entry. See 2A AREEDA, HOVENKAMP, & SOLOW, *supra* note 89, ¶ 421b, at 67 (“If capital markets are working well, new investment will be made in any market earning anything above competitive returns—which is defined to include sufficient profit to attract new capital—regardless of the absolute cost of entry. . . . [W]e assume that capital markets are efficient in assembling groups of investors. At any rate, the plaintiff wishing to show that the absolute cost of entry serves as an effective barrier should be required to provide evidence that financing entry is very difficult or impossible, notwithstanding good prospects that entry, once it occurs, will be sufficiently profitable to pay investors a competitive rate of return.”).

²¹⁰ This is plaintiffs’ theory in the *Johnson & Johnson* cases, *see supra* note 208. In each case, the plaintiff claims that *Johnson & Johnson* uses its supracompetitive profits in the sutures market to fund a discount on trocars, the product the plaintiff sells in competition with *Johnson & Johnson*.

²¹¹ See 2A AREEDA, HOVENKAMP, & SOLOW, *supra* note 89, ¶ 420a, at 57-58 (noting that entry barriers are the reason for supracompetitive profits and that such profits cannot exist absent entry barriers).

²¹² 3M was a monopolist in the transparent tape market—the market in which *LePage’s* participated. See *LePage’s*, 324 F.3d at 146 (“3M concedes it possesses monopoly power in the United States transparent tape market, with a 90% market share.”). There is no indication that 3M had monopoly power in the other markets.

The plaintiff should also be required to show barriers to entry in the market in which it participates. This showing, unlike the one above (and the others required by the proposed approach), is not designed to prove that the plaintiff has taken all steps to compete on the merits but instead seeks to ensure that the market in which the plaintiff participates (and which the defendant is purportedly attempting to monopolize) is actually susceptible to monopolization. The law should not preclude a bundled discount, which provides a concrete and immediate consumer benefit, in order to “preserve competition” in a market that is structurally incapable of being monopolized.²¹³ Because barriers to entry are necessary for monopolization of a market,²¹⁴ a plaintiff should be required to show that the market in which it competes is subject to such barriers.

b. Collaborative Bundle Impossible

A determined rival that was unable, because of barriers to entry, to offer its own competitive bundle would seek to collaborate with other firms to create a competitive bundle.²¹⁵ For example, if a firm selling products *A*, *B*, and *C* offered a reduced price on a bundle of those products, its rival that sold only product *A* could collaborate with sellers of products *B* and *C* to collectively offer a competitive bundled

²¹³ Moreover, where entry barriers in the market for the competitive product are low, the bundled discount likely reflects efficiencies achieved by the bundling. The discounter would not include the competitive product within the bundle in order to cross-subsidize a discount on another product, for the product would be competitively priced (given that entry is easy) and the discounter would have no “margin to give” on that product. Nor would the discounter bundle the product just because consumers prefer the products bundled together, for if that were the case, no discount would be necessary to market the bundle. Thus, a discount on a bundle including a product sold in a market with low entry barriers is likely occasioned by cost-savings created by that bundle and thus ought not to be condemned.

²¹⁴ See 2A AREEDA, HOVENKAMP, & SOLOW, *supra* note 89, ¶ 420a, at 58 (noting that absent barriers to entry, “the equilibrium price will be at long-run marginal cost, the competitive level, no matter how concentrated the market” and “no firm within [the] market can sustain monopolistic pricing.”).

²¹⁵ Such “cross-seller bundling” is quite common. A recent trip to a Target store revealed (among many others) the following cross-seller bundles: an Olympus digital voice recorder bundled with Duracell batteries, Suave-for-Men body wash bundled with a Schick Xtreme 3 razor, Almay mascara bundled with Bausch & Lomb Renu contact lens cleanser, Colgate Simply White Night Plus teeth-whitening cream bundled with a disposable Konica camera, a First-Alert smoke detector bundled with Energizer batteries, and Soft Lips lip balm bundled with an Apple i-Tunes music download.

discount.²¹⁶ The sellers of products *B* and *C* would presumably be willing to collaborate with the seller of *A*, for they likewise would find themselves disadvantaged by the bundled discount and would be seeking a competitive offer.²¹⁷ Assuming that the rival sellers were as efficient as the discounter or would likely become so if they expanded their scale,²¹⁸ they should be able to allocate the total value of the bundled discount among themselves and to offer a competitive bundle. Thus, a plaintiff challenging a bundled discount should have to prove—prior to securing an order enjoining the discounts (or awarding treble damages)—that it could not have collaborated with sellers of products within the other product markets to offer a competitive bundle. The plaintiff could discharge this burden by proving either that there were no sellers in the other markets with whom it could collaborate *or* that it made a good faith collaboration offer to those sellers, including an offer to reduce revenue on its product to the level of its average variable cost,²¹⁹ but was rebuffed by the other product sellers. Requiring such

²¹⁶ Consider, for example, a bundled discount on premium gin and vodka. As of late 1999, Diageo PLC's Tanqueray brand gin commanded a more than 50 percent market share in the "imported premium gin" market. Regulatory News Service, *Diageo PLC Final Results – Part I* (Sept. 16, 1999). Diageo also sells a premium vodka called Tanqueray Sterling. See Adam Jones, *The Art of Killing a Name Softly*, FIN. TIMES 13 (July 15, 2004). Suppose Diageo sought to grow its somewhat obscure Tanqueray vodka by offering a discount on bundled purchases of Tanqueray gin and vodka. Given the popularity of Tanqueray gin, competing vodka sellers would likely find this discount troubling; after all, purchasers that decided to buy less Tanqueray vodka and more of another premium vodka brand would find themselves losing a discount on popular Tanqueray gin. Those vodka sellers, though, would not be without recourse: they could collaborate with sellers of other brands of premium gin (*e.g.*, Bombay or Beefeater) to offer a competitive bundle. It is highly unlikely, then, that the vodka sellers would be "excluded" by Diageo's gin/vodka bundle.

²¹⁷ Amici in the *LePage's* case recognized this possibility for single-product competitors. See *Brief for Amici Boeing, et al.*, *supra* note 40, at *18 ("LePage's should have the opportunity to team up with 3M's rivals in the other product markets to offer their own joint package deals to large retailers (after all, sellers in other product areas presumably do not wish to lose sales to 3M any more than LePage's does).").

²¹⁸ Given efficient capital markets, rivals that are not currently as efficient as the discounter but probably could become so if their market share were expanded could likely obtain the financing necessary to fund a below-cost discount for long enough to expand market share enough to achieve the productive efficiencies necessary to drive costs below price. See *supra* note 89 and accompanying text.

²¹⁹ Proof of an offer price at this level should be required because a competitor willing to exhaust all competitive options would lower its revenue demands to this point—a point that would permit it to stay in business but not to earn supracompetitive profits.

proof would ensure that the plaintiff had earnestly pursued procompetitive collaborations with sellers in the other product markets covered by the bundle, so that judicial condemnation of the discount was a last resort.

c. Good Faith Offer to Sell to Discounter

A determined rival who could neither enter the other product markets to offer its own competitive bundle nor collaborate with other sellers to do so would still have one option for staying in the market: it could become a supplier to the bundled discounter. If the rival were at least as efficient as the bundled discounter, or would likely become so by expanding its scale,²²⁰ it could offer to supply the discounter for a price the discounter would find attractive (*i.e.*, a price at or below the discounter's own cost of producing and distributing the product). Thus, any bundled discounter that was not in reality utilizing its discounts as a means of excluding rivals would be willing to accept a "competitive rival's"²²¹ offer to become a supplier.²²² A rival attacking a bundled discount should therefore be required to prove that it made a good faith offer to become a supplier of the discounter but was rebuffed. The discounter's rejection of the supplier offer would provide *prima facie* (albeit rebuttable, as explained below)²²³ evidence that the discount was being used to exclude a competitive rival.

To see how a rival disadvantaged by a bundled discount may remain in the market by offering to supply the discounter, consider what has happened with the small regional airlines that in recent years have found themselves unable to compete with the major carriers. A significant impediment to these smaller airlines is the major carriers'

²²⁰ If the rival were not yet as efficient a producer as the discounter but would likely become so if its scale were expanded, it could probably secure the financing necessary to fund a below-cost discount for long enough to expand its scale so as to achieve the productive efficiencies that would drive its costs below price. *See supra* note 89 and accompanying text.

²²¹ *See supra* notes 199 - 201 and accompanying text (defining "competitive rival").

²²² *Cf.* E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 184 (1994) (noting that "greater efficiency is an ideal way to overcome an 'entry barrier,'" for the more efficient, but foreclosed, rival may begin supplying the competitor responsible for the foreclosure); ROGER D. BLAIR & DAVID L. KASERMAN, ANTITRUST ECONOMICS 403-04 (1985) (observing that monopolist engaged in tying would purchase tied product from more efficient rivals).

²²³ *See infra* Part III.B.2.

ability to offer a type of bundled discount—a price for a “bundle” of flights going from departure point to hub to destination that is significantly lower than the sum of the prices of two flights, one from departure point to hub and the other from hub to destination.²²⁴ A smaller carrier that wanted to compete with this discount but flew only one leg of the journey (*i.e.*, either between departure point and hub city or between hub city and destination, but not both) would have to absorb the entire amount of the package discount on the single leg it offered.²²⁵ This requirement would frequently require the regional airline to price below its cost. The regional airlines, however, have not been driven out of business by the major carriers’ bundled discounts but have instead remained in business (and have thrived, in fact) by becoming suppliers to the major carriers.²²⁶ Similarly, single-product producers finding themselves hampered by a bundled discount may be able to stay in business, and thrive, by becoming suppliers of the discounter. At a minimum, they should be required to prove that they gave that option a try.

2. *The Discounter’s Rebuttal Opportunity*

The first part of the proposed evaluative approach (the plaintiff’s *prima facie* case) is designed to ensure that a judicial order thwarting a bundled discount is a last resort pursued only after the complaining plaintiff has exhausted all means of competing on the merits. It thus prevents judicial orders that would allow plaintiffs to shirk the difficulties of pro-consumer competition. But a plaintiff’s diligence in pursuing competitive options is not, by itself, sufficient to entitle that plaintiff to a court order precluding a bundled discount. As in any

²²⁴ For example, a United Airlines flight from St. Louis to Chicago (United’s hub) to Green Bay, Wisconsin might cost \$200, whereas purchasing separate flights from St. Louis to Chicago and then from Chicago to Green Bay would cost a total of \$300 (\$125 for the St. Louis to Chicago leg and \$175 for the Chicago to Green Bay leg). This is, in effect, a bundled discount of \$100.

²²⁵ For example, a regional airline flying between Chicago and the major cities in Wisconsin (but not to St. Louis) would have to discount its Chicago to Green Bay flight to \$75 in order to remain competitive with United’s bundled discount.

²²⁶ See Eric Wieffering, *Airlines: Fighting for Survival*, MINNEAPOLIS STAR TRIB. 1D (May 11, 2003) (documenting successful supply relationships between small regional and major air carriers and noting that “Northwest [Airlines] and most other major network carriers experienced a decline in traffic in 2002, but traffic on most regional carriers soared”).

competition, trying is not enough; even those that try very hard sometimes deserve to lose. To permit a diligent but less talented competitor to be defeated is not to sanction anything anticompetitive. Indeed, vigorous competition implies that there will be losers—that less efficient firms will not be artificially propped up but will be driven out of business by those that are more efficient. We thus need some means of identifying, within the class of firms that have pursued all competitive options, those rivals that are competitive with the discounter—*i.e.*, that are, or are likely to become, as efficient as the discounter.²²⁷ The proposed evaluative approach would accomplish this “weeding” via the defendant’s rebuttal opportunity.

If a plaintiff proves that it cannot compete with the bundled discount because (1) there are high entry barriers into the other product markets, (2) a collaborative bundle is impossible, and (3) the discounter rejected a good faith offer by the plaintiff to become a supplier, the discounter should still be able to avoid liability by proving that the plaintiff’s best “supplier offer”—which would presumably reflect the maximum efficiencies the plaintiff could attain after reaching minimum efficient scale²²⁸—was not good enough. Specifically, the discounter could avoid liability by showing either that its costs were less than the price demanded by the plaintiff or that the plaintiff’s product was inferior. If the discounter could make either showing, it could rebut the contention that the bundled discount was excluding a rival that was, or was likely to become,²²⁹ equally efficient.

The proposed approach thus ultimately involves comparing the cost structures of the complaining rival and the discounter. In that sense, the approach resembles the *Ortho Diagnostic* approach, which required a plaintiff challenging a bundled discount to prove that it is as efficient a producer of the competitive product as the discounter.²³⁰ But the

²²⁷ See *supra* notes 198 - 201 and accompanying text.

²²⁸ A plaintiff that could achieve productive efficiencies by expanding its scale would take account of those efficiencies in determining its offer price. The price offered might thus be below the plaintiff’s current costs, but, given efficient capital markets, the plaintiff should be able to obtain financing to sustain a temporary below-cost price if such pricing would permit it to expand its scale to achieve productive efficiencies that would push its costs below the price offered. See *supra* note 89 and accompanying text.

²²⁹ See *supra* notes 218, 220.

²³⁰ *Ortho Diagnostic*, 920 F. Supp. at 469. See *supra* notes 145 - 155 and accompanying text.

proposed approach is superior to the *Ortho Diagnostic* approach in terms of administrability and reliability. The plaintiff's achievable cost²³¹ would be established not by potentially self-serving testimony from the plaintiff's own witnesses, but by the plaintiff's actual supplier offer—*i.e.*, the lowest price for which the plaintiff would sell its products to the discounter. Presumably, the offer price would be neither below the plaintiff's actual cost (because the discounter might accept the offer, and the plaintiff would have to perform) nor above it (because an inflated offer price might exceed the discounter's costs, permitting the discounter to refuse the offer with impunity). Thus, the proposed evaluative approach would force the plaintiff to reveal its true cost and would likely generate a more accurate cost figure than the *Ortho Diagnostic* approach, which would determine plaintiff's cost on the basis of possibly self-serving testimony from plaintiff's witnesses. In addition, the discounter's cost information would be produced more cheaply and reliably, for the burden to produce that information would be on the discounter itself, not on the plaintiff. As noted, ascertaining another party's costs is difficult,²³² the defendant discounter is in a much better position to produce evidence regarding its costs. Thus, the proposed approach, while resembling *Ortho Diagnostic* in terms of its ultimate focus (*i.e.*, the relative efficiencies of the discounter and complaining rivals), is superior in terms of administrability.

In the end, the proposed evaluative approach would achieve each of the goals we initially set for ourselves.²³³ The approach would condemn bundled discounts that would exclude competitors that had competed vigorously by pursuing all competitive options, and were, or were likely to become, as efficient as the discounter. The approach would *not* condemn bundled discounts if the complainant had not pursued all competitive options or was not likely to be able to match the discounter's efficiency. Moreover, the approach would facilitate procompetitive bundled discounting by providing a clear safe harbor: A bundled discounter could avoid antitrust liability by ensuring that it accepted any supplier offer where the price offered was less than the discounter's own cost (an offer that would be in its economic interest to

²³¹ There is, of course, a difference here in that the proposed approach focuses on the plaintiff's *achievable* cost—*i.e.*, its expected cost after achieving anticipated economies of scale—rather than actual current cost, the focus of the *Ortho Diagnostic* approach.

²³² See *supra* notes 158 - 161 and accompanying text.

²³³ See *supra* Part III.A (setting goals for evaluative approach).

accept). Finally, the approach would be easily administrable, for the relevant facts are relatively easy to ascertain, and proof burdens are allocated so that the party with the burden of proof on a matter is most likely to have access to the relevant evidence.

C. Possible Shortcomings: “Phony Discounts” and Collusion Between Discounters and Supplier Rivals

There are, however, a couple of potential shortcomings that merit consideration. First, firms engaging in other types of potentially anticompetitive pricing practices might exploit the proposed evaluative approach in order to increase the difficulty of successfully challenging the practices. Recognizing that above-cost bundled discounts are usually beneficial to consumers, the proposed evaluative approach presumes their legality and places a somewhat heavy proof burden on rivals asserting legal challenges. Professor Elhauge has argued that affording special protection to bundled discounts may simply encourage creative firms to insulate anticompetitive bundling or tying practices by artificially inflating prices and then offering phony “discounts” off those higher prices.²³⁴ For example, a firm could engage in *de facto* tying by artificially increasing the separate price of the tied products and then offering a substantial bundled “discount” off that higher price.²³⁵ Under

²³⁴ Professor Elhauge writes:

[A]nything called a “discount” for agreeing to the loyalty or bundling condition could equally be called a “penalty” on those who refuse to conform to that condition. The higher price charged to those who violate the loyalty or bundling condition may be inflated artificially. If one accepted the proposition that no discount for agreeing to an exclusionary condition could ever be challenged unless the discounted price were below cost, “then any firm could immunize its exclusive-dealing agreements from antitrust scrutiny by the simple expedient of inflating the price and then offering a rebate conditioned on exclusivity.” Thus, the mere existence of a discount proves nothing.

Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 31 (quoting Elhauge, *supra* note 58, at 698 n. 53).

²³⁵ While some courts have held that tying cannot occur if the tied products are available separately, *see* *SmithKline Corp. v. Eli Lilly & Co.*, 427 F. Supp. 1089, 1112, 1114 (E.D. Pa. 1976) *aff’d* on other grounds, 575 F.2d 1065, 1061 n. 3 (3d Cir. 1978); *Datagate v. Hewlett-Packard Co.*, 1994-2 TRADE CAS. ¶ 70,827 (N.D. Cal. 1993); *Shop & Save Food Markets v. Pneumo Corp.*, 683 F.2d 27, 31 (2d Cir. 1982), the majority view is that a sufficiently large discount for buying the products together may constitute *de facto* tying if it has coercive effects. 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra*

the proposed evaluative approach, a challenger would bear a heavier proof burden (because there is a bundled “discount”) than would a plaintiff challenging *de facto* tying that had not been made to resemble a discount.²³⁶ Accordingly, Professor Elhauge concludes, it would be unwise to provide special protection (*e.g.*, a presumption of legality) to a pricing practice merely because it is labeled a bundled discount.

The possibility of phony discounts need not create concern, however, for the strategy, where plausible, could be easily identified. A phony discount could be accomplished by either artificially hiking prices prior to the discount, precluding prices from falling following the occurrence of some notable event that should have caused their decrease, or precluding prices from naturally falling in a slow and steady fashion. The first situation, a pre-discount price hike, would be easy enough to demonstrate by pointing to historical price data. If prices were not actually increased prior to the discount but were instead artificially precluded from falling,²³⁷ the plaintiff could show that there was no actual discount by producing evidence of whatever factor should have caused a notable decrease in prices (*e.g.*, an abrupt reduction in the cost of an input). Absent both a pre-discount price hike and a notable occurrence that should have caused a price decrease, artificial price inflation could occur only if the defendant artificially sustained the price above its profit-maximizing level for an extended time period (*i.e.*, long enough for the difference between the actual price and the diminishing “natural” price level to grow to the amount of the discount). A rational seller would sacrifice profits in this manner²³⁸ only if it believed it could

note 143, ¶ 1758, at 323 (“[W]e join most courts in asking whether the discount has an effect similar to an outright refusal to sell tying product *A* separately.”).

²³⁶ A plaintiff alleging *de facto* tying would have to prove a low proportion of separate sales. *See supra* notes 174 - 178 and accompanying text (discussing test described in 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 143, ¶ 1758).

²³⁷ Professor Elhauge contends that one cannot merely look to historical prices (*i.e.*, to whether there was a pre-discount price hike) to determine whether prices have been artificially inflated, for the inflation may have been accomplished by stalling price reductions that otherwise would have occurred. He explains:

Nor does history provide a good baseline for determining whether a loyalty or bundled discount has really lowered prices. Prices may be declining for unrelated reasons, including changes in costs and demand, but have that decline dampened by the marketwide foreclosure produced by exclusionary conditions.

Elhauge, *GPO Agreement Analysis*, *supra* note 67, at 31-32.

²³⁸ Holding price constant when marginal cost has fallen will lower the seller’s immediate profit. “[S]ince the profit-maximizing price is determined by the

later offer a phony bundled discount, drive its rivals out of business, and recoup its losses by charging supracompetitive prices. The tactic would therefore require a good bit of faith on the part of a seller and is unlikely to be pursued. Thus, the strategic behavior with which Professor Elhauge is concerned either would be easy to identify (in the first two circumstances discussed above) or is implausible (in the third).

A second potential problem with the proposed evaluative approach is that it might not prevent consumer harm, even if it prevents foreclosure of competitive rivals, because it might lead to collusive output reduction. Consider, for example, a situation where the bundled discounter accepts its single-product rivals' offers to become suppliers (so the rivals are not foreclosed) but then cuts its own production and charges a supracompetitive price for the products supplied by its rivals. The proposed evaluative approach would not condemn the bundled discount that motivated the rivals to become suppliers; yet, consumers would be harmed by the discounter's conduct.

But the proposed evaluative approach would not sanction this sort of consumer harm. As long as the supplier rivals are free to sell directly to the discounter's customers, their continued presence in the market should prevent the discounter from being able to cut its own production and raise prices above competitive levels. Should the discounter attempt that tack, its supplier rivals would increase their production and offer prices lower than the discounter's.²³⁹ But what if the discounter cut a deal with the rivals, offering to share its supracompetitive profits (*e.g.*, to make some sort of side-payment) if the rivals would not undersell it? That, of course, would be a price-fixing agreement that is *per se* illegal under Sherman Act Section 1.²⁴⁰ It would also be rather easy to identify, for output would fall, price would rise,

intersection of the marginal revenue and marginal cost curves, any reduction in marginal costs shows up as a lower profit-maximizing price." 1 P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 103, at 44 n. 21 (2d ed. 2002). Hence, during the period in which a seller artificially held price constant in the face of decreasing costs, its profits would be reduced.

²³⁹ See generally Christopher S. Yoo, *Vertical Integration and Media Regulation in the New Economy*, 19 YALE J. REG. 171, 209 (2002) (noting that "any attempt to increase price can often induce existing players to expand output as well as attract entry by new firms"); Easterbrook, *supra* note 194, at 2 ("Monopoly prices eventually attract entry.").

²⁴⁰ *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (agreement among competitors to reduce output, like agreement to fix prices, is *per se* illegal under Sherman Act Section 1, 15 U.S.C. § 1).

and the seller would be unable to articulate a valid reason for its decision to cut production. Antitrust liability should attach to this agreement, once materialized, but there is no compelling reason to impose antitrust liability in anticipation of such an agreement.²⁴¹

CONCLUSION

Bundled discounts present a classic example of what Judge Easterbrook calls “the puzzle of exclusionary conduct.”²⁴² That puzzle exists because “competitive and exclusionary conduct look alike,”²⁴³ and it is often difficult for courts to condemn the latter without discouraging the former. With respect to bundled discounts, it can be difficult to tell which are procompetitive (*i.e.*, which ones reflect efficiencies and/or represent a whittling away of supracompetitive prices) and which are likely to injure consumers in the long-run by driving out those rivals we want to remain in the market. The “puzzle,” then, is to develop an easily administrable evaluative approach that will identify and condemn all, *but only*, those bundled discounts that could injure consumers by excluding rivals that are, or are likely to become, as efficient as the discounter.

This article has sought to solve that puzzle. The proposed evaluative approach would presume the legality of above-cost bundled discounts but would allow that presumption to be rebutted by a plaintiff that had exhausted all viable options for offering a competitive discount and was, or was likely to become, as efficient as the discounter. Specifically, the plaintiff would have to show that it could not stay in business by either lowering its price(s) on the competitive product(s), entering new markets to create its own bundle, collaborating with other sellers to offer a competitive bundled discount, or becoming a supplier to the discounter. If the plaintiff made such a showing, the discounter could still avoid liability by proving that it rejected the plaintiff’s supplier offer because the offer simply wasn’t good enough (*i.e.*, because the plaintiff couldn’t produce the competitive product as efficiently as the discounter). When a plaintiff made the required *prima facie* showing

²⁴¹ Cf. Easterbrook, *supra* note 101, at 347 (“Instead of making predictions that are impossible to test—and will injure consumers if wrong—wait to see what happens. If monopolistic prices happen later, prosecute then.”)

²⁴² *Id.* at 345.

²⁴³ *Id.* See also Frank H. Easterbrook, *Workable Antitrust Policy*, 84 MICH. L. REV. 1696, 1710 (1986) (“[I]t is almost impossible to distinguish exclusion from hard competition.”).

and the defendant failed to justify its rejection of the plaintiff's supplier offer, a court would be justified in concluding that the bundled discounting would exclude competitive rivals²⁴⁴ and was therefore anticompetitive on balance. When a plaintiff failed to make its *prima facie* showing (and thus failed to prove it had exhausted competitive options) *or* the defendant proved that acceptance of the plaintiff's supplier offer would have been a bad business decision for the defendant (and thus established that the plaintiff was a less efficient producer), a court would not be justified in forcing consumers to forego the defendant's discounts in order to protect the plaintiff. Puzzle solved.

²⁴⁴ See *supra* notes 199 - 201 and accompanying text (defining "competitive rival").

