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CARROTS & STICKS: IN DEFENSE OF A DIFFERENTIATED APPROACH TO BUNDLED DISCOUNTS & TYING

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I. INTRODUCTION

Bundled discounts and tying are both practices used by sellers to increase sales, achieve transaction cost and other efficiencies, and encourage loyalty on the part of their customers. In their simplest forms, the two practices can be considered as bookends of a continuum of conduct – ranging from procompetitive arrangements that reduce prices by providing incentives for consumers to purchase the bundle ("carrots"), to anticompetitive arrangements that coerce buyers into purchasing products they otherwise would chose to obtain from competitive sources ("sticks").

Some commentators have advanced the view that the difference between bundling and tying is chiefly one of the degree of competitive foreclosure that they produce. As a result, some have advanced the position that the most appropriate mode of analysis for the two practices is a unified one, in which all forms of bundled sales are judged under a full-blown rule of reason approach, weighing the anticompetitive foreclosure produced by the practice against any procompetitive efficiency benefits that might accrue.

In this paper, we set forth the approaches taken by courts and enforcement authorities in the U.S. and Europe to various forms of tying and bundling arrangements. We then evaluate the arguments for and against a uniform approach to the analysis of such practices, and conclude that a differentiated approach based on the type of bundling/tying conduct at issue is more consistent with well-settled economic principles, legal and business practicalities, and the underlying goals of antitrust law and policy.

II. TYING: THE STICK

Tying is among the classic forms of conduct condemned by the antitrust laws. The analytical framework under which such conduct is assessed has changed markedly over time, as the "[Supreme] Court's strong disapproval of tying arrangements has substantially diminished,"[2] but it is possible to argue that the analysis remains relatively strict under U.S. law – and is far stricter as applied in Europe.

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2 *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28, 35 (2006).

Even as tying analysis has changed from a strict *per se* analysis with several threshold prerequisites to one that incorporates at least some elements of a rule of reason inquiry, the analysis clearly presumes to disfavor conduct deemed to constitute tying. This presumption has developed from a long history of observations by the courts that tying behavior more often involves forcing a buyer to do something against its interests ("coercion") rather than providing tangible benefits to consumers, such as lower prices in the case of bundled discounts.

A. The Classic *Per Se* Approach

In its classic form, tying is "an agreement by a party to sell one product only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[3] In so doing, the seller harnesses market power he has over the "tying" product to prevent competition for sales of the "tied" product, and "[w]here such conditions are successfully exacted competition on the merits with respect to the tied product is inevitably curbed."[4]

Tying harms consumers by 1) inducing more sales at higher prices of the tied product than the seller would make in a fully competitive market, 2) "deny[ing] competitors free access to the market for the tied product," and 3) forcing buyers "to forego their free choice between competing products."[5]

Classic tying analysis is based on strong presumptions against the legality of the practice, which the Supreme Court articulated in its 1947 decision in *Standard Oil Co. v. United States*: "[T]ying agreements serve hardly any purpose beyond the suppression of competition."[6] Because of the strength of this presumption, "tying agreements fare harshly under the laws preventing restraints of trade."[7] In fact, conduct meeting all elements of the test was historically condemned *per se*.[8]

Tying arrangements have traditionally been evaluated under Section 1 of the Sherman Act as agreements in restraint of trade. The first element of the test requires that there be "two separate product markets [that] have been linked."[9] This element is designed to exclude the possibility that the two products are of a type that *should* be sold together because of efficiencies inherent in the tied offering.

Second, the tie must involve the element of "coercion," or "conditioning." As the Supreme Court explained in *Jefferson Parish*,

> . . . the essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms. When such "forcing" is present, competition on the merits in the market for the tied item is restrained and the Sherman Act is violated.[10]

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3 *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5-6 (1958).
4 *Id.* at 6.
5 *Id.*
6 *Standard Oil Co. v. United States*, 337 U.S. 293, 305 (1949).
7 *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 606 (1953).
8 *See, e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 9-10 (1984).
9 *Id.* at 21.
10 *Id.* at 12.

Courts have considered a variety of different types of conduct to constitute coercion in alleged cases of tying. An "express refusal" to sell the tied products separately, often in the form of a clear contractual requirement that two products be purchased together, has consistently been accepted by courts as evidence of coercion.[11] Short of an explicit contract, some courts have accepted threats by sales personnel to withhold the tying product as evidence of coercion,[12] but generally have not accepted that mere sales pressure to accept both products involves a sufficient level of coercion.[13] More recently, courts have evaluated "technological" or "technical" tying, in which the "tied good [is] physically and technologically integrated with the tied good."[14] However, treatment of technological tying is particularly controversial. Some U.S. courts have applied a rule of reason analysis to technological ties for fear of chilling potentially cognizable procompetitive benefits of such ties.[15] By contrast, the European Commission's recent Guidance reflects a belief that technological ties pose greater risks to competition than do other forms of tying, because they are "costly to reverse" and "reduce[] the opportunities for resale of individual components."[16]

Some courts have explored more quantitative evidence about the purchasing behavior of buyers, refusing to find coercion where a significant number of buyers purchased the tied products from other sellers or separately.[17] And several courts have explicitly considered price manipulation (offering the elements of a tied offering singly only at higher prices) as a form of coercion, something that will be discussed further in this paper.[18]

Third, to constitute a tying violation, a seller must have "some special ability – usually called 'market power' – to force a purchaser to do something that he would not do in a competitive market."[19] The Court in *Jefferson Parish* clarified that this market power could be shown "when the seller's share of the market is high . . . or when the seller offers a unique product that competitors are not able to offer."[20]

Finally, tying behavior must affect "a 'not insubstantial' amount of interstate commerce,"[21] a *de minimis* test that requires only that foreclosure affect more than a tiny *absolute* amount of business.[22] The "not insubstantial" element does not incorporate any real or practical economic analysis of competitive effects.[23]

The traditional tying test thus operates as a short-form analysis that imposes *per se* liability categorically on all conduct that satisfies the requisite elements: separate products, coercion and market power. The elements of the test operate as "screens" to weed out cases in which the strong presumption against tying might not be warranted. For instance, the "separate products" test seeks to identify cases in which tying two products together could have efficiencies, a circumstance that has recently been attributed to tying in the software

11 *Amerinet, Inc. v. Xerox Corp.*, 972 F.2d 1483, 1500 (8th Cir. 1992); *see also N. Pac. Ry. Co.*, 356 U.S. 1 (1958).
12 *DataGate, Inc. v. Hewlett-Packard Co.*, 60 F.3d 1421, 1426-27 (9th Cir. 1995).
13 *Bob Maxfield, Inc. v. Am. Motors Corp.*, 637 F.2d 1033, 1037 (5th Cir. 1981) ("cajolery to the point of obnoxiousness" falls short of required coercion).
14 *United States v. Microsoft Corp.*, 253 F.3d 34, 90-92 (D.C. Cir. 2001).
15 *Id.* at 92-94.
16 *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, ¶ 53, COM (2009) 864 final (Feb. 9, 2009).
17 *E.g.*, *Paladin Assocs. Inc. v. Montana Power Co.*, 328 F.3d 1145, 1160 (9th Cir. 2003).
18 *Amerinet, Inc. v. Xerox Corp.*, 972 F.2d 1483, 1500 (8th Cir. 1992); *see also Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1216-17 (9th Cir. 1977).
19 *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-14 (1984) (internal citations omitted).
20 *Id.* at 17 (internal citations omitted).
21 *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 6 (1958).
22 *Telerate Sys., Inc. v. Caro*, 689 F. Supp. 221, 234 (S.D.N.Y. 1988).
23 *Id.* (citing cases where courts have held amounts as little as approximately $60,000 to be "not insubstantial").

industry.[24] Likewise, the market power screen excludes cases in which the seller likely would be unsuccessful in foreclosing competition because consumers would ignore its tied offering unless it were priced competitively.

Most significantly, the "coercion" test screens for cases in which anticompetitive foreclosure is unlikely because consumers really do have the ability to choose feasible alternatives. The test assumes that in cases in which the other prerequisites are met, the existence of a clear, hard "tie" in the form of an overt or contractual refusal to sell separately presumptively results in a "forcing" of consumer choices that excludes competition in the tied product with intolerable anticompetitive consequences.

B. The *Per Se* "Plus" Approach

The traditional test for tying amounts to "condemnation without inquiry into actual market conditions," omits any analysis of the actual foreclosure effects of the alleged tying conduct.[25] In its most recent decisions laying out the classical tying test, *Eastman Kodak Co. v. Image Technical Servs.* and *Jefferson Parish*, the Supreme Court did not prescribe any opportunity for defendants, under the *per se* rule, to argue that any procompetitive benefits their tying conduct might provide would outweigh its anticompetitive effects – where all of the elements of the tying standard have been met.[26]

However, the Supreme Court has articulated a role for competitive effects analysis that can be applied to cases of alleged tying that do not satisfy all of the "screens" for *per se* condemnation.[27] This mechanism allows plaintiffs to offer additional proof with respect to the actual competitive consequences of the complained-of conduct where they do not meet the higher burden required for *per se* treatment.

Lower courts have begun to incorporate some elements of competitive effects analysis into the tying standard, although the Supreme Court has not explicitly ratified such an approach. In *United States v. Microsoft*, the D.C. Circuit considered whether combining the Windows operating system with the Internet Explorer browser constituted an illegal tie.[28] The court found that although the conduct in question satisfied the elements of the traditional tying test, it would be inappropriate to find it *per se* illegal because there could be "a number of efficiencies that, although very real, have been ignored in the calculations underlying the adoption of a per se rule for tying."[29] The court found that while some of these concerns could be dealt with through the "separate products" element of the tying test (ostensibly, a tie manifesting significant efficiencies would be seen as a single product rather than two separate products), it decided that "the separate products test is a poor proxy for net efficiency from newly integrated products," and that a full rule of reason analysis would be a more appropriate analytical tool to explore such efficiencies.[30] While the *Microsoft* court went to great lengths to limit its concern to high-technology markets with which courts have little experience, it is easy to imagine such concerns regarding potential efficiencies in other tied markets.

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24 *United States v. Microsoft*, 253 F.3d 34, 90-92 (D.C. Cir. 2001); "But not all ties are bad. Bundling obviously saves distribution and consumer transaction costs. PHILLIP E. AREEDA & HERBERT HOVENKAMP, *in* ANTITRUST LAW, ¶ 1703g2, at 51-52 (1991). This is likely to be true, to take some examples from the computer industry, with the integration of math co-processors and memory into microprocessor chips and the inclusion of spell checkers in word processors." *Id.* at 87. "Indeed, if there were no efficiencies from a tie (including economizing on consumer transaction costs such as the time and effort involved in choice), we would expect distinct consumer demand for each individual component of every good." *Id.*

25 *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 15 (1984).

26 *Eastman Kodak Co. v. Image Technical Servs, Inc.*, 504 U.S. 451, 479 (1992); *Jefferson Parish*, 466 U.S. at 16-17.

27 *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 104 (1984).

28 253 F.3d 34 (D.C. Cir. 2001).

29 *Id.* at 94.

30 *Id.* at 92.

Other courts have acknowledged this potential, leading them to import effects analysis as a fairly standard component of the tying test. As the Eleventh Circuit found in *U.S. Philips Corp. v. International Trade Commission*, "[i]n order to show that a tying arrangement is per se unlawful, a complaining party must demonstrate that it links two separate products *and has an anticompetitive effect in the market for the second product*."[31]

C. The European Approach

Similar to the traditional U.S. approach, courts in the EU have been reflexively hostile to tying practices, generally condemning them *per se*.[32] In *Tetra Pak v. Commission*, for example, the European Court of First Instance ("CFI") found against a manufacturer of equipment for packaging food in cartons that required buyers purchasing its packaging machines also to purchase all packaging cartons used with those machines from Tetra Pak.[33] The Commission successfully met the threshold predicates for establishing an unlawful tie, including that Tetra Pak had market power in the markets for the tying products (in this case, separate markets for non-aseptic and aseptic packaging machines) and in the market for the tied products (packaging for those machines).[34] The CFI also accepted the Commission's allegation that the machines and packaging materials should be considered separate products, rejecting various technical and public safety arguments advanced by Tetra Pak that the two products are essentially separate.[35] That Tetra Pak's sales agreements involved a high degree of coercion was accepted as obvious from the face of its agreements, which specifically provided that all packaging had to be purchased from Tetra Pak.[36]

Having established the basic threshold elements for a tying case, the *Tetra Pak* court deemed the tying conduct to be "abusive" and therefore a violation of Article 82. The decision involves no real effects analysis at all: while it considers and rejects "objective justifications" advanced by Tetra Pak for its policies, these were found to amount to no more than public policy reasons (having to do with food safety) advanced by Tetra Pak for wanting to tie the two products together. The court did not consider harm to competition other than to say that other packaging manufacturers are necessarily excluded by Tetra Pak's conduct, and it did not consider any procompetitive effects the conduct might have.

In more recent cases, European courts have applied the thresholds tests for tying, but have been more receptive to a fuller effects analysis, at least in theory. In *Microsoft v. Commission*, in which the Commission alleged illegal tying of Microsoft's Windows Media Player (WMP) to the Windows operating system, the Commission established all of the elements of an illegal tie as set forth in *Tetra Pak.* However, the CFI noted that a presumption of competitive effects from the mere existence of the tying elements would not be appropriate:

> There are . . . circumstances relating to the tying of [Windows Media Player] which warrant a closer examination of the effects that tying has on competition in this case. While in classical tying cases, the Commission and the Courts considered the foreclosure effect for competing vendors to be demonstrated by the bundling of a separate

31 *U.S. Philips Corp. v. Int'l Trade Comm'n*, 424 F.3d 1179, 1193-94 (Fed. Cir. 2005) (emphasis added).
32 *See, e.g.*, Case T-30/89, *Hilti AG v. Comm'n*, [1991] ECR II-01439.
33 Case T-83/91, *Tetra Pak v. Commission*, [1994] ECR II-00755; *aff'd* Case C-333/94, *Tetra Pak v. Commission,* [1996] ECR I-5951.
34 *Tetra Pak*, [1994] ECR II-00755 at ¶ 42-78.
35 *Id.* at ¶ 79-81.
36 *Id.* at ¶ 12.

> product with the dominant product, in the case at issue, users can and do to a certain extent obtain third party media players through the Internet, sometimes [free of charge]. There are therefore indeed good reasons not to assume without further analysis that tying [Windows Media Player] constitutes conduct which by its very nature is liable to foreclose competition.[37]

However, in the final analysis, the CFI accepted the Commission's argument that Microsoft's conduct resulted in anticompetitive foreclosure, with a very limited analysis that focused more on Microsoft's distribution advantages and implied disadvantages for rivals and consumers than on direct analysis of the competitive effects these parties would suffer.[38] Nowhere does the Commission consider evidence of competitive effects such as prices to consumers, an analysis which might have led to a different result, given that media players were generally priced at zero at the time the action was brought.

The European Commission's recent Guidance on the application of Article 82 suggests a modern approach similar to that taken to tying cases in the U.S.:

> The Commission will normally take action under Article 82 where an undertaking is dominant in the tying market and where, in addition, the following conditions are fulfilled: (i) the tying and tied products are distinct products, and (ii) the tying practice is likely to lead to anticompetitive foreclosure.[39]

The Commission notes a number of circumstances in which it presumes that tying conduct is likely to be harmful to competition, including longer-term tying arrangements, such as those in which the two products are technically integrated into a whole, regulated markets, and markets in which the two tied products are both substitutable inputs into a manufacturing process.[40] Notably, the Commission's presumption that "technological" tying is likely to be more harmful than contractual tying or tying based on price incentives is directly at odds with the American presumption, which ascribes potential efficiencies to technological tying and treats this practice as worthy of more deference.[41] This can be interpreted as a judgment by the Commission that technological tying is more coercive than contractual tying, whereas U.S. courts tend to come to the opposite conclusion.

The Commission does account for efficiencies in its general formulation of the tying test, in accordance with the trend in modern U.S. case law. It will consider "claims by dominant undertakings that their tying and bundling practices may lead to savings in production or distribution that would benefit customers."[42]

It is also important to note that the threshold for dominance under EU law is significantly lower than it is in the United States, which may lead to the result that similar

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37 Case T-201/04, *Microsoft Corp. v. Comm'n*, [2007] ECR II-3601, ¶ 977 (*quoting* Case COMP/C-3/37.792 Microsoft at ¶ 841).

38 *Id.* at ¶ 1054.

39 *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, ¶ 50, COM (2009) 864 final (Feb. 9, 2009).

40 *Id.* at ¶¶ 53-57.

41 *Microsoft*, [2007] ECR II-3601, ¶ 293.

42 *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, ¶ 62, COM (2009) 864 final (Feb. 9, 2009).

rules may have significantly broader application as applied by the European Commission and courts.[43]

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The traditional tying analysis began as a relatively blunt instrument, efficient in its application but imprecise in its results, condemning absolutely a relatively narrow category of conduct. More recently, both in the U.S. and Europe, it has developed a more nuanced formulation, taking into account more sophisticated arguments regarding the separate products and coercion elements, and softening the poleax of *per se* treatment with some consideration of competitive effects. These developments retain the relative efficiency of the presumption against tying conduct, while preventing false positives at the margins where conduct is less coercive or results in more procompetitive efficiencies.

III. BUNDLED DISCOUNTING: THE CARROT

Analysis of bundled discounting is a relatively newer field than is analysis of tying, and as such is less settled. A "bundled discount" can come in any number of forms, but, like tying, it involves a seller offering two or more products for a single price. In one product ("Product A"), the seller has market power, and in another ("Product B"), it does not. The seller encourages buyers to purchase both Product A and Product B by offering a discount on the two products when they are purchased together.

Bundled discounting arrangements differ from tying because, in theory, customers receive something in return for their purchase of both products from the seller: lower prices in the form of a discount. By contrast, purchasers of tied products receive nothing – they simply do not have the option to buy the tying product without also purchasing the tied product.

U.S. antitrust laws favor lower prices,[44] and courts analyzing bundled discounting have generally shaped their analysis around the assumption that "[b]undled discounts generally benefit buyers because the discounts allow the buyer to get more for less."[45] As many commentators have noted, sellers may offer bundled discounts for a number of reasons, including "to save costs in distribution and packaging, to reduce transaction costs for themselves and their customers, and to increase reliability for customers."[46] Recognition of the potential efficiencies of bundled discounting, and of the potential benefits to consumers, are recognized, to a greater or lesser degree, in the two principal modes of analysis by U.S. courts.

On the one hand, some courts have applied an "anticompetitive foreclosure" test to bundled discounting.[47] This approach is exemplified by the Third Circuit's decision in *LePage's Inc. v. 3M*.[48] The foreclosure analysis stands in sharp contrast to the "discount

43 *See, e.g.*, Case T-30/89, *Hilti AG v. Comm'n*, [1991] ECR II-1439 (finding 55% market share as dominant); Case C-62/86, *AKZO v Comm'n*, [1991] ECR I-03359 (finding 50% market share as dominant); Case 85/76, *Hoffmann-La Roche & Co.* v *Comm'n*, [1979] ECR 461 (finding 47% market share as dominant). "The Commission's experience suggests that dominance is not likely if the undertaking's market share is below 40% in the relevant market." *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, ¶ 14, COM (2009) 864 final (Feb. 9, 2009).

44 *See Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

45 *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 895 (9th Cir. 2008).

46 Antitrust Modernization Commission Report and Recommendations, at 95 (2007).

47 *See, e.g., SmithKline Corp. v. Eli Lilly & Co.,* 427 F. Supp. 1089 (E.D. Pa. 1976), *aff'd,* 575 F.2d 1056 (3d Cir. 1978), *cert. denied,* 439 U.S. 838 (1978).

48 324 F.3d 141 (2003).

attribution" test developed by the district court in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, and refined and extended by the Ninth Circuit in *Cascade Health Solutions v. PeaceHealth*.[49]

A. The Foreclosure Standard

The anticompetitive foreclosure test evaluates whether the bundled discount arrangement impermissibly excludes competition in the market for the competitive product. In the classic situation, the seller has market power in Product A and faces competition in the market for Product B. The seller's bundled discount harms competition for sales of Product B by making it difficult, if not impossible, for competitors of Product B to successfully compete with the bundled package price. Employing a rule of reason-type approach, this anticompetitive effect must not be outweighed by the procompetitive business justifications offered by the seller.

The decision handed down by the Third Circuit in *LePage's* illustrates the application, and shortcomings, of the anticompetitive foreclosure approach. In *LePage's*, defendant 3M was deemed to have market power in the market for transparent tape (particularly Scotch brand tape), but faced competition from plaintiff LePage's in the market for "second brand" and "private label" tape. Among other things, 3M offered bundled discounts in the form of tiered rebates that increased for customers who bought multiple categories of 3M products. LePage's alleged that this discounting behavior foreclosed it from being able to sell second brand and private label tape to key retail accounts, thus protecting not only 3M's position in transparent tape but also in second brand and private label tape.[50]

The Third Circuit upheld a jury verdict in LePage's favor. It found that 3M "concedes it possesses monopoly power in the United States transparent tape market, with a 90% market share."[51] It also found that "the jury could have reasonably found that 3M's exclusionary conduct cut LePage's off from key retail pipelines necessary to permit it to compete profitably,"[52] specifically finding that "3M foreclosed LePage's from that critical bridge to consumers that [office] superstores provide, namely, cheap, high volume supply lines."[53]

The Third Circuit specifically credited evidence that LePage's retail customers would have suffered the loss of large rebates from 3M if they had purchased LePage's products in significant quantities, and evidence that LePage's profits and market share declined after 3M began to implement its bundled discounting program, as support for LePage's contention that 3M's program harmed competition. Further, the court pointed to evidence that 3M could later recoup some of the money spent on rebates if it was successful in driving LePage's from the market, citing evidence of barriers to entry to

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49 *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996); *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008). Note that several other courts have considered bundled discounting and reached decisions that have formed the backdrop for *PeaceHealth*, but none have undertaken as full an analysis as did the Ninth Circuit. *See, e.g.*, *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770, 2006 WL 1236666 (C.D. Cal. Mar. 23, 2006) (finding that plaintiffs failed to allege sufficient facts to make out a case based on bundling conduct, and rejecting *LePage's*); *Invacare Corp. v. Respironics, Inc.*, No. 1:04 CV 1580, 2006 WL 3022968 (N.D. Ohio Oct. 23, 2006) (disposing of plaintiff's bundling claim because "unlike in *SmithKline* or *LePage's,* Plaintiff manufactures the same products and can match the product bundles offered by Defendant"); *J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, Nos. 1:01-CV-704 & 1:03-CV-781, 2005 WL 1396940 (S.D. Ohio Jun. 13, 2005), *reh'g and reh'g en banc denied*, 485 F.3d 880 (6th Cir. 2007) (granting summary judgment against a plaintiff alleging anticompetitive discounting and specifically declining to apply *LePage's*).

50 *LePage's Inc. v. 3M*, 324 F.3d 141, 160 (3d Cir. 2002).

51 *Id.* at 146.

52 *Id.* at 160.

53 *Id.* at 160 n.14.

show that no other competition likely would restrain 3M.[54] Finally, the Third Circuit dismissed the argument that 3M's discounting conduct was based on efficiencies that 3M would pass on to consumers, holding that 3M had introduced no record evidence to support such arguments.[55]

The *LePage's* decision has been widely criticized, however, for focusing on the impact of 3M's conduct on LePage's itself, rather than on the impact on competition generally or on consumer welfare.[56] The court did not address the possibility that LePage's was unable to compete with 3M because it is a less efficient or effective competitor than 3M. The court explicitly rejected 3M's contention that the antitrust laws do not condemn pricing practices unless they involve some form of below cost pricing, which 3M's discounts did not.[57] As the Antitrust Modernization Commission observed, "[l]ower prices may harm a rival but benefit consumers," and the court in *LePage's* did not apply an objective standard to segregate conduct that harms less efficient rivals from conduct that harms competition itself.[58] As such, the decision "is therefore likely to chill welfare-enhancing bundled discounts or rebates."[59]

B. The Price-Cost Test

The decision in *LePage's* marked a distinct departure from a nascent view of bundled discounting taken by the district court in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc*.[60] In that court's early articulation of a bundled discounting analysis, it applied a type of price-cost test known as a discount attribution standard to condemn pricing that fell below the seller's average cost of goods sold after the total amount of discounts for the entire bundle were attributed to the competitive good. However, the court left open the possibility that above-cost pricing could also be anticompetitive.[61] As the *Ortho* court laid out its test, pricing could be deemed anticompetitive where either "(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 . . . the defendant's pricing makes it unprofitable for the plaintiff to continue to produce."[62]

More than a decade later in the *PeaceHealth* decision the Ninth Circuit refined the *Ortho* approach in order to "discern where antitrust law draws the line between bundled discounts that are procompetitive and part of the normal rough-and-tumble of our competitive economy and bundled discounts, offered by firms holding or on the verge of gaining monopoly power in the relevant market, that harm competition and are thus proscribed by § 2 of the Sherman Act."[63]

In that case, plaintiff hospital owner Cascade alleged that defendant, rival hospital system PeaceHealth, offered bundled discounting involving several classes of hospital care.

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54 *Id.* at 162-63.
55 *Id.* at 164.
56 *See, e.g., J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, Nos. 1:01-CV-704 & 1:03-CV-781, 2005 WL 1396940, at *14 (S.D. Ohio Jun. 13, 2005), *reh'g and reh'g en banc denied*, 485 F.3d 880 (6th Cir. 2007) (holding that the *LePage's* "verdict imposed a heavy penalty on 3M without producing consistent guidance for what is permissible price competition in the retail market for a simple item like transparent tape").
57 *LePage's*, 324 F.3d at 151-52 (holding that the predatory pricing standards of *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) should not be applied to 3M, which unlike *Brooke Group* defendant Brown & Williamson was a monopolist and therefore 1) could price its monopoly product without regard to competitive restraints and 2) should be subject to a higher level of scrutiny than a mere oligopolist).
58 Antitrust Modernization Commission Report and Recommendations, at 97 (2007).
59 *Id.*
60 *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).
61 *Id. at* 469.
62 *Id.*
63 *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 897 (9th Cir. 2008).

PeaceHealth was the only local hospital provider to offer the most complex type of hospital services, known as "tertiary care," while both PeaceHealth and Cascade offered the less-sophisticated primary and secondary classes of hospital care services. PeaceHealth sold all three classes of care together to insurers at a lower price than it offered for tertiary services and primary/secondary services as separate *a la carte* offerings. Cascade alleged that this pricing scheme resulted in its exclusion from being able to sell primary/secondary services to these insurers because the "bundled" offering from PeaceHealth was economically more attractive than purchasing tertiary services from PeaceHealth and primary/secondary services from Cascade.[64]

After explaining in detail the potentially procompetitive benefits of bundled discounts, the Ninth Circuit unanimously rejected the *LePage's* analysis because "it does not consider whether the bundled discounts constitute competition on the merits, but simply concludes that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line."[65] The court went on to cite Judge Greenberg's dissent in *LePage's*, which argued that the anticompetitive foreclosure test "risks curtailing price competition and a method of pricing beneficial to customers because the bundled rebates effectively lowered [the seller's] costs."[66]

Instead, the Ninth Circuit applied a "discount attribution" test to determine whether PeaceHealth's discounts could meet a threshold showing demonstrating that they were unlikely to harm competition and therefore not worthy of further scrutiny.

> A plaintiff who challenges a package discount as anticompetitive must prove that, when the full amount of the discounts given by the defendant is allocated to the competitive product or products, the resulting price of the competitive product or products is below the defendant's incremental cost to produce them.[67]

Like the anticompetitive foreclosure test, the *PeaceHealth* standard applies only to a seller who is a monopolist in Product A, faces actual or potential competition for Product B, and sells both products as a bundle at a discounted price. However, the *PeaceHealth* discount attribution test attempts to determine whether the discount is anticompetitive based on whether an equally-efficient competitor could compete for sales of Product B if the defendant's discount on the entire bundle is attributed solely to Product B. If the net price of Product B after the bundled discount is fully attributed to it is below the seller's average variable cost for Product B, then the arrangement is likely to be anticompetitive because the discount would tend to exclude competition from a hypothetical, equally efficient producer of Product B.[68] The *PeaceHealth* court went on to overturn the jury verdict on the attempted monopolization claim because the jury instructions were based on the *LePage's* anticompetitive foreclosure standard.[69]

64 *Id.* at 891-892.
65 *Id.* at 899 (citing Antitrust Modernization Commission Report and Recommendations, at 97 (2007)).
66 *Id.* at 899 (citing *LePage's*, 324 F.3d at 179 (Greenberg, J., dissenting)).
67 *Id.* at 909.
68 *Id.* at 910. In adopting the discount attribution standard and comparing price to costs incurred by the seller, the *PeaceHealth* court explicitly rejected the standard set by the district court in *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996). In *Ortho*, the court condemned bundled discounting where the pricing excluded an equally efficient competitor, requiring that plaintiffs prove their cost bases were equal to or below the defendants; the Ninth Circuit rejected this standard in part because it "does not provide adequate guidance to sellers . . . because the standard looks to the costs of the actual plaintiff." *PeaceHealth*, 515 F.3d at 905. *PeaceHealth* remedies this by comparing price to the costs of the defendant, analogizing these to those of a hypothetical, equally efficient competitor.
69 *PeaceHealth*, 515 F.3d at 910; *see also Safeway, Inc. v. Abbott Labs., Inc.*, 2010 WL 147988 (N.D. Cal. Jan. 12, 2010) (holding that plaintiff drug purchasers sufficiently alleged that bundled pricing of pharmaceuticals violated Section Two under the *PeaceHealth* discount attribution test).

The Ninth Circuit's decision does not automatically condemn all bundled discounting that results in below-cost pricing. The court noted in a footnote that plaintiffs would still need to prove "antitrust injury," meaning harm to competition (as opposed to harm to an individual competitor) of the type the antitrust laws were designed to prevent.[70]

However, after applying the discount attribution standard to plaintiff's monopolization claim, the Ninth Circuit went on to consider the district court's grant of summary judgment in favor of PeaceHealth on plaintiff's claim that "PeaceHealth illegally *tied* primary and secondary services to its provision of tertiary services."[71] The court held that the only issue in contention was the coercion element of the tying test; the district court had granted summary judgment based on evidence presented by PeaceHealth that buyers of its services did not consider themselves to be coerced, and that some insurers bought PeaceHealth services on a non-exclusive basis.[72] The appellate court disagreed, pointing to evidence presented by the plaintiff that (1) the loss of PeaceHealth's bundled discounts "would have had a 'large impact'" on certain insurers, and (2) just 4 of 28 (14 percent) of local insurers bought unbundled services from PeaceHealth.[73] Taken together with evidence of "substantial market power" wielded by PeaceHealth in the market for tertiary services, the court held this evidence was sufficient to establish "genuine factual disputes about whether PeaceHealth forced insurers, either as an implied condition of dealing or as a matter of economic imperative through its bundled discounting, to take its primary and secondary services if the insurers wanted tertiary services."[74]

C. The European Approach

Bundled discounting has generally been treated with greater suspicion by European courts, which have considered bundled discounts to be an abuse when practiced by a dominant firm. Take, for example, *Hilti v. Commission*, in which a dominant manufacturer of nail guns and the consumable nail cartridges and nails used in those guns was condemned by the European Commission and the Court of First Instance for offering larger discounts to purchasers who bought cartridge strips with nails than to those who bought only cartridge strips alone.[75] In that matter, the Commission based its decision on the fact that Hilti had market power and that, among other things, it had "attempted to block the sale of competitors' nails by a policy of reducing discounts for orders of cartridges without nails."[76] The Commission undertook no particular analysis of effects on competition, other than to say that Hilti had been able "to limit the market penetration of independent nail and cartridge strip producers . . . ."[77] The CFI's decision confirming the Commission's analysis reflects neither the consideration of empirical evidence demonstrating foreclosure, nor of evidence that the levels of discounting offered by Hilti prevented an equally-efficient competitor from being able to compete.

The recent Guidance issued by the European Commission indicates an evolution in its approach, suggesting that bundled discount arrangements should be evaluated using

70 *Id.* at 910 n.21 (specifically rejecting the Antitrust Modernization Committee's proposal that plaintiffs be required to show a third element in bundled discounting cases: that "the bundled discount or rebate program has had or is likely to have an adverse effect on competition," instead finding that this requirement is identical to "the general requirement of 'antitrust injury' that a plaintiff must prove in any private antitrust action") (citing Antitrust Modernization Commission Report and Recommendations, at 99 (2007); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977)).
71 *PeaceHealth*, 515 F.3d at 912 (emphasis added).
72 *Id.* at 914.
73 *Id.* at 914-15.
74 *Id.* at 914.
75 Case T-30/89, *Hilti AG v. Comm'n*, [1991] ECR II-1439.
76 *Id.* at ¶ 16.
77 *Id.* at ¶ 17.

the same anticompetitive foreclosure standard applied to tying arrangements.[78] However, the Commission's Guidance incorporates a price-cost test as a sort of "safe harbor" for multi-product discounts:

> If the incremental price that customers pay for each of the dominant undertaking's products in the bundle remains above the [long run average incremental cost ("LRAIC")] of the dominant undertaking from including that product in the bundle, the Commission will normally not intervene since an equally efficient competitor with only one product should in principle be able to compete profitably against the bundle.[79]

For bundled discounts that result in a price below the LRAIC of including that product in a bundle, the Guidance states that "enforcement action may . . . be warranted."[80] This standard roughly mirrors the *PeaceHealth* discount attribution test, although the lower threshold for "dominance" may result in broader application in the EU than in the U.S.

IV. THE SEARCH FOR APPROPRIATE ANALYTICAL STANDARDS

There has recently been a great deal of commentary and very healthy debate over the appropriate standards that courts and regulators should apply to various forms of bundling practices. While much is unsettled in this area of competition law, it would appear that there is consensus regarding the goals of avoiding overdeterrence and underdeterrence that would harm consumer welfare – although experts advocate a variety of approaches designed to achieve those goals.

A. Underlying Goals of Antitrust Standards

One of the most challenging issues in antitrust law is distinguishing, with respect to single-firm conduct, what constitutes competition on the merits that benefits consumers from what constitutes "exclusionary" conduct that ultimately harms competition itself and should be prohibited. As stated by the Antitrust Modernization Commission:

> How to evaluate single-firm conduct under Section 2 poses among the most difficult questions in antitrust law. Appropriate antitrust enforcement must distinguish aggressive competition that benefits consumers, such as most price discounting, from conduct that tends to destroy competition itself, and thus maintains, or facilitates acquiring, monopoly power. The Supreme Court has defined improper "exclusionary" conduct under Section 2 to "comprehend[] at the most behavior that not only (1) tends to impair the opportunities of rivals, but also (2) either does not further competition on the merits or does so in an unnecessarily restrictive way." Thus, a crucial distinction in Section 2 enforcement entails whether a firm's conduct represents competition on the merits or improper "exclusionary" conduct.[81]

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78 *Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, ¶¶ 47-62, COM (2009) 864 final (Feb. 9, 2009).
79 *Id.* at ¶ 60.
80 *Id.*
81 Antitrust Modernization Commission Report and Recommendations, at 81 (2007) (citing *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 n.32 (1985) (quoting III Phillip E. Areeda & Donald F. Turner, Antitrust Law 78 (1978)).

Thus, in developing standards to evaluate single-firm conduct, courts and academics agree that such tests should strive to encompass those forms of conduct that unduly exclude competition, but are not so broad as to have a chilling effect on conduct that represents legitimate competition on the merits that benefits consumers. As the Supreme Court has stated with respect to evaluating pricing practices by a monopolist, a central goal of such standards should be to avoid "mistaken findings of liability [that] would 'chill the very conduct the antitrust laws are designed to protect.'"[82] As explained by the Antitrust Modernization Committee:

> The recognition of potential consumer harm from overdeterrence has led courts to try to avoid "false positives" – that is, finding Section 2 liability for a firm that has not engaged in unreasonably exclusionary conduct, but instead was simply competing aggressively on the merits. Nonetheless, it remains important to avoid underdeterrence that results in "false negatives" – that is, failing to condemn anticompetitive conduct – when the challenged conduct typically provides few or no benefits to consumer welfare and does not resemble competition on the merits. In an ideal world, of course, legal rules would avoid both underdeterrence and overdeterrence. In practical reality, however, such precision is often difficult to achieve. Thus, courts may need to make a trade-off between accuracy and the risks of either chilling precompetitive, or encouraging anticompetitive, conduct.[83]

Further, there are many practical difficulties in selecting standards that (1) provide enough guidance to courts and enforcement authorities to make consistent enforcement feasible, (2) limit, to the extent possible, the burden on litigants and courts of weeding out unmeritorious claims, and (3) give businesses objective standards by which they can evaluate the legality of their conduct *ex ante* so that procompetitive practices are not unnecessarily deterred. As summed up by the Antitrust Modernization Committee, "standards for applying Section 2 of the Sherman Act's broad proscription against anticompetitive conduct should be clear and predictable in application, administrable, and designed to minimize overdeterrence and underdeterrence, both of which impair consumer welfare."[84]

B. The Continuum of "Bundling" Conduct

The common thread running through the conduct at issue here is that it involves the sale of two or more distinct products in some sort of "package" for a single price. On one end of the continuum, a seller offers on a spot-purchase basis, two products as a "bundle" for a single price that is less than the price for the two items purchased separately. Simple examples include a hamburger and soft-drink, or shampoo and conditioner, sold together at a discounted price. At the other end of the continuum, a seller with market power in Product A refuses to sell Product A alone unless purchasers also buy Product B, for which the seller faces actual or potential competition. This is classic tying behavior.

But the realities of the business world are rarely so simple. There are a myriad of forms by which sellers package their products and services together, limited only by the

82 *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.,* 549 U.S. 312, 320 (2007) (quoting *Cargill, Inc. v. Monfort of Colo., Inc.,* 479 U.S. 104, 122 n.17 (1986)).

83 Antitrust Modernization Commission Report and Recommendations, at 90 (2007) (footnotes omitted).

84 *Id.* at 88; *see also id.* at 96 ("[W]hatever legal standards are adopted should be sufficiently clear to enable companies to conform their conduct to the law, be administrable by the courts, and avoid chilling procompetitive discounting.").

imagination and creativity of the free-market system.[85] These types of "bundles" might include, for example, loyalty or fidelity agreements in which a buyer is granted discounts or rebates in return for an agreed or *de facto* commitment to purchase a large or increasing share of its requirements for multiple products from the supplier. They may also include market share agreements or requirements contracts, where a buyer is granted price concessions for purchasing all or a certain proportion of its requirements across more than one product line from the seller.

From an analytical perspective, the challenge is in categorizing these arrangements as bundled discounts, exclusive agreements, ties or otherwise – and then applying the appropriate standard to achieve the desired goals. As widely noted, however, the lines between these categories of conduct often are not easily drawn.[86] And the legal standards appropriate for each category of conduct are far from clear.[87]

C. Proponents of a Uniform Test

In the face of the difficulties of appropriately categorizing bundling practices and their attendant potential for anticompetitive effects, some commentators advocate a uniform approach to all forms of conduct by a monopolist in which multiple products are bundled together.

Some have argued that all forms of bundling should be condemned *per se.*[88] However, this certainly would over deter procompetitive price-cutting conduct that benefits consumers and the consensus is that such an approach is clearly overbroad.

Another approach is to apply a rule of reason-type approach to all forms of bundling/tying to avoid the possibility of underdeterrence that may result from incorrect or inappropriate categorization of the conduct. For example, the amicus brief of the American Antitrust Institute in the *PeaceHealth* appeal argues that a rule of reason analysis should be applied to bundled discounts because even above-cost pricing can result in the exclusion of equally-efficient or less-efficient competitors that have an important role in constraining exclusionary conduct by the monopolist.[89] Under the proposed "structured rule of reason analysis," as set forth in the D.C. Circuit Court's opinion in *Microsoft*, the plaintiff would bear the initial burden of demonstrating that the monopolist's bundling arrangements resulted in harm to competition. The burden then shifts to the defendant to put forth evidence of the procompetitive efficiencies of the arrangements. Then the burden shifts back to the plaintiff to demonstrate that, on balance, the harm to competition outweighs the proffered procompetitive benefits. However, even the AAI recognized that the price-cost test of the variety later accepted by the *PeaceHealth* court could assist in determining whether plaintiff met its initial burden of demonstrating anticompetitive effects.[90]

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85 *See, e.g.*, *id.* at 94 ("Large and small firms, incumbents, and new entrants use bundled discounts and rebates in a wide variety of industries and market circumstances.").

86 *See, e.g.*, M. Laurence Popofsky & Adam J. Gromfin, *Bundled Discounting: From LePage's to PeaceHealth, & Beyond*, 9 SEDONA CONF. J. 99, 109 and n.72 (2008).

87 *See, e.g.*, Antitrust Modernization Commission Report and Recommendations, at 91 (2007) (noting that "bundling" is an area of Section 2 law where "there is currently a lack of clear and consistent standards").

88 *See* Popofsky & Gromfin, *supra* note 86, at 100 (noting that this position was advocated by plaintiffs in the *PeaceHealth* appeal to the Ninth Circuit and "has found no support in the literature or courts").

89 Brief for American Antitrust Institute as Amici Curiae Supporting Appellants at 55-22, *Cascade Health Solutions v. PeaceHealth,* 515 F.3d 883 (9th Cir. 2008) (Nos. 05-36153 & 05-36202).

90 *Id.* at 22.

A similar approach, recently advocated by Economides and Lianos, calls for the application of a foreclosure analysis to all forms of bundling and tying.[91] They argue that this uniform approach will afford consistency in application and eliminate the tension between the discount attribution approach applied to bundling and the anticompetitive foreclosure analysis applied to all other forms of exclusionary practice.

Their proposed test would focus on anticompetitive foreclosure and the absence of objective justifications – much like the structured rule of reason approach promoted by the AAI. In this model, the distinct product element of the tying test is "reconsidered" and the coercion element of is eliminated. Economides and Lianos reject application of the price-cost test to bundling practices, primarily because the price-cost test can permit predation against less efficient competitors who still may constrain price, and can neglect the benefits to consumers in the form of lower prices and higher investment in quality and variety. They argue that the anticompetitive foreclosure test corrects a number of economic deficiencies caused by the price-cost test, including the difficulty of designating an appropriate measure of cost, disregard for the effect of bundled discounting on rivals' costs, and the difficulty of assessing the appropriate "discount" to be attributed to the competitive product(s).[92]

However, there is widespread disagreement about the competitive benefits of protecting less efficient competitors, particularly given the difficulties and burden of applying a full-blown rule of reason analysis. Noting that the price-cost standard would permit bundled discounts that exclude a less efficient competitor that provides some competitive restraint on the monopolist's pricing, the Antitrust Modernization Committee concluded that "[t]he difficulties of assessing such circumstances, the lack of predictability and administrability in any standard that would capture such instances, and the undesirability of a test that would protect less efficient competitors, however, counsel against the adoption of a screen that protects less efficient competitors."[93]

Moreover, even though there may be some benefits to consistency in analytical approach and evaluating each case through the lens of all the competitive factors at play, there are significant costs associated with applying a foreclosure or rule of reason standard to all forms of bundling conduct. The effort and expense required to bring and defend a lawsuit involving a rule of reason approach is massive and costly, largely due to the highly fact-intensive nature of the inquiry.[94] Closely related to the high cost of rule of reason litigation is the high degree of uncertainty associated with it. This serves to chill procompetitive pricing behavior, both by making it next to impossible for sellers to know *ex ante* what practices will be determined later to be illegal once all the evidence of marketplace conditions and rivals' cost structures are evaluated, and by raising the potential cost to them of defending such a suit.

These criticisms were articulated in response to the Third Circuit's decision in *LePage's*, which produced a wide range of commentary by courts and authorities. For example, the Antitrust Modernization Commission concluded that "[t]he lack of clear standards regarding bundling, as reflected in *LePage's v. 3M*, may discourage conduct that is procompetitive or competitively neutral and thus may actually harm consumer welfare."[95]

91 Nicholas Economides & Ioannis Lianos, *The Elusive Antitrust Standard on Bundling in Europe and in the United States in the Aftermath of the Microsoft Cases*, 76 ANTITRUST L.J. 483, 510-534 (2009).
92 *Id.* at 511-516.
93 Antitrust Modernization Commission Report and Recommendations, at 100 (2007).
94 For additional analysis of the high cost of rule of reason litigation, see Maurice E. Stucke, *Does the Rule of Reason Violate the Rule of Law?*, 42 U.C. DAVIS L. REV. 1375, 1460-66 (2009).
95 Antitrust Modernization Commission Report and Recommendations, at 94 (2007). "Because the court failed to evaluate whether 3M's program of bundled rebates represented competition on the merits, its decision offers no clear standards by which firms can assess whether their bundled rebates are likely to pass antitrust muster. Therefore, the Third Circuit's decision is likely to discourage firms from offering procompetitive bundled discounts and rebates to consumers." *Id.*

For these reasons, there are enormous benefits to a standard that provides a safe harbor from rule of reason analysis for pricing behavior that is very rarely likely to harm competition.

D. Benefits of a Diversified Approach

As described above, U.S. courts have applied different standards to different forms of bundling/tying arrangements, recognizing their respective potential for anticompetitive harm and the need for clear and applicable standards that strike a balance between overdeterrence and underdeterrence. Although this area of competition analysis is still evolving and lacks consensus, the Antitrust Modernization Committee has endorsed different standards for bundling and tying[96] and a growing number of commentators have concurred.

> Where price alone is the mechanism that compels purchases, courts confront lower prices that presumptively benefit consumers and reflect efficiencies – presumptions that should not be disregarded when the risk of false positives is inevitably high. In those cases, a high bar or broad safe harbor makes sense, and it is appropriate (indeed, necessary) to apply a derivative of [the price-cost test]. Because price discounting generally benefits consumers, the risk of false positives compels the application of a test that condemns only the rarest and most narrow of practices that would exclude an equally efficient competitor. Where, however, something more than price discounting is at issue, the risk of false positives dissipates and there is the need to balance foreclosure concerns against claimed efficiencies. Safe harbors are inappropriate in those situations; in place of a predatory pricing test, the more traditional Rule of Reason approach amplified by the D.C. Circuit in *Microsoft* should apply.[97]

A rational way to balance these various interests and goals is to evaluate different bundling/tying practices in three general categories.

1. Bundled Discounts

The first category of conduct involves the type of pure bundled discounts that are not based on a commitment with respect to overall requirements, market share or loyalty targets, or exclusivity over a period of time. For these types of discounts, the discount attribution test articulated by the Ninth Circuit in *PeaceHealth* strikes an appropriate balance for distinguishing between practices that are not likely to exclude efficient rivals and those that may have some exclusionary impact and should be further evaluated with respect to their impact on competition. As the Ninth Circuit put it, this test is "safer for consumers and our competitive economy" because it avoids the concern articulated by the Supreme Court in *Weyerhaeuser*: that "mistaken findings of liability would 'chill the very conduct the antitrust laws are designed to protect.'"[98]

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96 *Id.* at 114 n.157 ("The Commission is not recommending application of this test outside the bundled pricing context, for example in tying or exclusive dealing cases.").
97 Popofsky & Gromfin, *supra* note 86, at 109-10.
98 *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 903 (9th Cir. 2008) (citing *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 320 (2007).

The relative merits of this approach have been endorsed by the Antitrust Modernization Committee and numerous other commentators. "A test that compares incremental revenues with incremental costs . . . offers the most promising source of an economically sensible and administrable safe harbor for bundled rebates or discounts."[99] Noting that the price-cost test can operate as a "safe harbor," the Antitrust Modernization Committee suggested that this screen "would provide sufficient clarity to enable businesses to determine whether a particular bundled discount would be 'screened out' from further scrutiny."[100]

Bundling practices that fall outside the initial price-cost safe harbor may be further evaluated in a rule of reason-type analysis to measure their impact on competition and potential procompetitive benefits.

2. Tying

A second category of "bundled" arrangements (sometimes referred to as "contractual tying") involves the classic tying situation where a seller with market power requires customers to purchase two or more products together. As noted above, U.S. courts have traditionally treated tying arrangements as *per se* unlawful under Section 1 of the Sherman Act because they are almost always deemed to harm competition with no countervailing procompetitive justification. Those standards have evolved in *Microsoft* and other cases to permit the defendant in certain circumstances to demonstrate the efficiencies and procompetitive benefits resulting from the tie. The "separate products" and "coercion" elements of the tying standard serve to segregate conduct that may be procompetitive, and thus more appropriately analyzed pursuant to a more lenient standard, from conduct that is unlikely to be worthy of more extensive analysis. Although there is the possibility for over deterrence and courts continue to evolve in their approaches to tying cases, this standard aims to prohibit the most egregious forms of "bundling" – where customers are forced to purchase products they might otherwise choose to obtain from competitive sources – and provides predictability for practitioners and administrability for courts.

An unsettled question posed by the Ninth Circuit, the Antitrust Modernization Committee Report and others is whether the price-cost test can or should play any role in the tying analysis. In reversing the district court's grant of summary judgment for PeaceHealth on plaintiff's tying claim, the Ninth Circuit remanded the issue to the district court to evaluate "whether, to establish the coercion element of a tying claim through a bundled discount, McKenzie must prove that PeaceHealth priced below a relevant measure of cost."[101] Professors Areeda and Hovenkamp also have suggested that the price-cost test can be employed in a traditional tying analysis, either to determine whether the "separate product" element of the tying standard is met or in evaluating the element of "coercion."[102] Those issues are worthy of further study and consideration.

99 Antitrust Modernization Commission Report and Recommendations, at 95 (2007).

100 *Id.* at 100. Note that the Antitrust Modernization Committee also advocated two other "prongs" to its proposed test for bundled discounting: (1) that "the defendant is likely to recoup" short term losses incurred through the offering of bundled discounts and (2) that "the bundled discount or rebate program has had or is likely to have an adverse effect on competition." *Id.* at 99. The *PeaceHealth* court rejected the application of these additional prongs, holding that the recoupment element is unnecessary because "exclusionary bundling does not necessarily involve any loss of profits for the bundled discounter," and that a separate requirement of competitive effect "is redundant because it is no different than the general requirement of 'antitrust injury' that a plaintiff must prove in any private antitrust action." *PeaceHealth*, 515 F.3d at 910 n.21 (internal citations omitted).

101 *PeaceHealth*, 515 F.3d at 916.

102 *See* AREEDA & HOVENKAMP, 32 & ¶ 749b2(B), at 257 (Supp. 2007).

3. Exclusive Dealing and Other Forms of Bundling

Bundling practices that do not fall within either of the categories described above may present the greatest challenge from an analytical perspective. Most often these arrangements involve discounts or rebates that are not tied to a single sale, but involve an incentive or commitment for the purchaser to buy all or a large portion of its requirements across several product lines, typically over a period of time, from a seller who has market power in at least one product in the bundle. These may take the form of market share or loyalty agreements, and often the discounts/rebates are tiered and apply to all purchases within a defined reference period.

The concern generally articulated with respect to these types of arrangements is that they foreclose competition by acting as *de facto* exclusive agreements. Buyers are not "coerced" into purchasing the bundle of products in the same way as the classic tying case, but the economic incentives are such that exclusivity is almost assured. Accordingly, the standards applied to exclusive agreements may be most appropriate. The fact-finder will be concerned with assessing whether the arrangements operate as *de facto* exclusive agreements, the degree of market foreclosure that results, and the competitive impact of that foreclosure weighed against any procompetitive justifications.[103] In these cases, a rule of reason/foreclosure analysis may be best suited to determine the unique competitive effects of the arrangement, notwithstanding the costs, burdens and uncertainty associated with that standard.

V. CONCLUSION

A multiple-standard approach to cases of tying and bundled discounting may strike the most appropriate balance between efficiency for courts and the parties, predictability and certainty for sellers and buyers, and deterrence of the most harmful forms of anticompetitive behavior. However, given the relatively limited experience courts have with bundled discounting, and the recent evolution of tying standards to incorporate some elements of the rule of reason test, no standard should be so hidebound as to preclude change as courts and regulators gain more experience. As has been noted by Professors Areeda and Hovenkamp, a similar rationale underlay courts' early decision to apply below-cost pricing standards to cases of predatory pricing:

> It is one thing to develop a theory showing that a particular practice can be anticompetitive. It is quite another to show that this theory explains a particular practice without producing an unacceptably high number of false positives. In the case of predatory pricing, the result of this concern was the development of tests requiring prices to be below marginal cost or average variable cost. . . . The reason these tests for predatory pricing were adopted was *not* because there is widespread consensus that above-cost pricing strategies can never be anticompetitive in the long run. Rather, it is because our measurement tools are too imprecise to evaluate such strategies without creating an intolerable risk of chilling competitive behavior.[104]

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103 For an exposition of the analysis applied to exclusive dealing cases, see *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 187 (3d Cir. 2005).
104 AREEDA & HOVENKAMP, ¶ 749, at 144 (Supp. 2008).

As has been the case in the predatory pricing context, it can be expected that the experience and sophistication of the courts, regulators, academics and practitioners will grow and evolve over time.[105] As that takes place, it remains possible that a full anticompetitive foreclosure analysis under the rule of reason will become more efficient and afford more certainty. Until then, the relative benefits of differentiated standards for different types of tying and bundled discounting should guide the way.

105 *See* Antitrust Modernization Commission Report and Recommendations, at 100 (2007) (encouraging further empirical economic research in this area, suggesting that "[t]he courts, the antitrust agencies, and antitrust practitioners generally would benefit from a more thorough and empirically based understanding of the likely competitive effects of bundled discounts in a variety of settings").