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BUNDLED DISCOUNTING: FROM *LEPAGE'S* TO *PEACEHEALTH*, & BEYOND

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A bundled discount occurs when a bundle of goods or services is sold for a lower price than the price of the goods or services sold individually. At least theoretically, when a monopolist bundles goods, competition can be harmed if rivals (either alone or in concert with others) are unable to match the diversity or price of the bundles. The recent Ninth Circuit decision in *PeaceHealth* is the latest to address this subject and warrants careful study. Using that case as a springboard, this paper examines several issues related to bundling, including some of the tests proposed for assessing bundling, criticism of the Ninth Circuit's recent pronouncement, and the implications of those criticisms on the analysis adopted in the case.

I. SYNOPSIS

Bundled discounting is not a new phenomenon. It is a common (even "ubiquitous"[2] and "pervasive"[3]) business practice that can be observed throughout our economy. Nor is bundling a new concern for the legal community. Although the Third Circuit's *en banc* decision in *LePage's* may have brought to the fore the question of how properly to assess bundled discounting when conducted by a firm with monopoly power, courts have engaged that precise question since at least as early as 1978.[4] As the Ninth Circuit recently observed, "antitrust claims based on bundled discounting practices are nothing new under the sun."[5]

It is by now well accepted that price discounts are almost always procompetitive and "afford substantial benefits to consumers."[6] That is why, in the context of single-product discounts, the Supreme Court held in *Brooke Group* that discounts must be below "an appropriate measure" of the defendant's cost in order to create antitrust liability.[7] This rule encourages price discounting, while also ensuring that equally efficient competitors will not be driven out of business by aggressive pricing. Many analyzing bundled discounting have analogized the practice to predatory pricing, seeking refuge under *Brooke Group*'s price-cost test. While the analogy is apt, it has been less clear whether application of *Brooke Group* should necessarily follow suit. Courts that have considered the question have recognized that, in contrast to single-product pricing, a multi-product bundle can be sold above cost in aggregate terms, while the total discount of the bundle can be so high (based on a monopolist's high profit margins) that an equally efficient competitor may not be able to lower its prices to compete at a profitable (i.e., above-cost) level.[8]

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2 Antitrust Modernization Commission, *Report and Recommendations of the Antitrust Modernization Commission* 94 (April 2, 2007) ("AMC Report").

3 *PeaceHealth*, 2007 WL 2473229 at *4.

4 *See SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

5 *PeaceHealth*, 2007 WL 2473229 at *16 n.17 (citing *SmithKline v. Eli Lilly & Co.*, 427 F. Supp. 1089, 1124 (E.D. Pa. 1976)).

6 *Ortho*, 920 F. Supp. at 469-70; *see also Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) ("Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.") (internal quotation omitted).

7 *Brooke Group*, 509 U.S. at 222 (1993).

8 *See Brief for the United States as Amicus Curiae, 3M Co. v. LePage's Inc.*, No. 02-1865, 2004 WL 1205191 at **12-13 (U.S. May 28, 2004) ("U.S. Brief"); *LePage's*, 324 F.3d at 155-157; *SmithKline*, 427 F. Supp. at 1108; *Ortho*, 920 F. Supp at 467.

That possibility has prompted a wide-ranging academic search for a test defining when bundled discounts should be condemned under Section Two. The recently decided case of *PeaceHealth* serves as a good introduction to and basis for analyzing those standards. Indeed, at least four potential approaches were discussed in *PeaceHealth*:

> **Monopolists May Not Bundle.** Bundled discounting by a monopolist should be illegal per se. This was the position advocated by McKenzie-Willamette Hospital during the *PeaceHealth* appeal. The Ninth Circuit rejected this approach. It has found no support in the literature or courts.
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> **Monopolists may not sell bundles below cost.** Bundled discounting by a monopolist should be illegal only when the price of the bundle is below the aggregate cost of producing all of the products in the bundle. This approach, which comes directly from the predatory pricing standard announced by the Supreme Court in *Brooke Group*, was one of two alternative standards advocated by PeaceHealth. The Ninth Circuit rejected this approach.
>
> **Monopolists may not sell in a bundle products that are priced below an attributed cost basis.** Bundled discounting by a monopolist should be illegal only when the adjusted price of the competitive product (applying the discount for the bundle to the price of that product when sold outside the bundle) is below the cost of producing that product. This was one of two alternative standards advocated by PeaceHealth in its appeal. It was also the standard recommended by the Antitrust Modernization Commission ("AMC") in its report published after argument in the appeal. *The Ninth Circuit adopted this standard, deviating slightly from the approach recommended by the AMC.*
>
> **A monopolist may not sell bundles at a discount when doing so causes more harm than good to competition.** Bundled discounting by a monopolist should be assessed under the Rule of Reason and condemned only when the practice, on balance, harms competition. This was the approach advocated by one amicus in *PeaceHealth*. The Ninth Circuit reserved such Rule of Reason analysis for those cases failing the above-cost safe harbor it adopted for bundled discounting cases.

This paper focuses principally on these different approaches. After providing a very brief background on *Brooke Group*'s predatory pricing standard (the Supreme Court's clear statement that antitrust concerns itself with protection of only efficient competitors) and the Third Circuit's bundling decision in *LePage's* (until September 2007, the most prominent — but also much maligned — precedent), the article describes the *PeaceHealth* decision in some detail, addresses the safe harbor proposal advocated by the Antitrust Modernization Commission, and examines some issues implicated by the approach adopted in *PeaceHealth*.

II. THE PROMINENT CASES: *BROOKE GROUP*, *ORTHO*, *LEPAGE'S*, AND *PEACEHEALTH*

The *PeaceHealth* decision is one of only a few prominent opinions that directly confront the question of how to assess bundled discounting. A brief summary of those cases (as well as of the leading predatory pricing decision from which they draw) will help place the *PeaceHealth* decision into context.

A. *Brooke Group*

The Supreme Court's definitive pronouncement regarding single-product price discounting came in the primary-line price discrimination case of *Brooke Group*. Recognizing that "[l]ow prices benefit consumers regardless of how those prices are set," the Court held that it would impose liability for price discounting only where the prices were "below an appropriate measure of its rival's cost."[9] "[T]he exclusionary effect of prices above a relevant measure of cost," the Court explained, generally "reflects the lower cost structure of the alleged predator, and so represents competition on the merits."[10] In other words, antitrust law was not concerned with "exclusion" (so to speak) of less efficient competitors.[11] This conclusion was simply an extension and reaffirmation of the oft-repeated principle that antitrust law protects the competitive *process*, and not necessarily particular competitors.[12]

Importantly, the Court also imposed as a second requirement a demonstration of "a dangerous probability" that the defendant would "recoup[] its investment in below-cost prices."[13] As the Court explained:

> Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced.[14]

As with the below-cost element, this recoupment requirement was a recognition that low prices could be anticompetitive in only the narrowest of circumstances. It flows from the fact that "predatory pricing schemes are rarely tried, and even more rarely successful."[15]

The Supreme Court last term unanimously decided in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*[16] that *Brooke Group*'s test should not be confined exclusively to predatory pricing cases. In extending *Brooke Group* into the predatory overbidding setting, the Court reaffirmed that the central tenets of *Brooke Group* remained of principal concern. Specifically, it recognized that where a practice could potentially serve a procompetitive end, clear standards should be adopted in order to prevent "mistaken findings of liability [that] would 'chill the very conduct the antitrust laws are designed to protect.'"[17] Commending the clear, objective, and administrable standards announced in *Brooke Group*, the Court rejected the Ninth Circuit's more generalized approach and instead modified *Brooke Group*'s price-cost test for application to a predatory bidding claim.

B. *Ortho*

In *Ortho*, the court examined a pricing scheme through which a defendant selling five different blood testing products offered discounts to buyers who bought those products in packages bundling together either four or five of those products. A plaintiff who manufactured some but not all of those testing products sued, claiming that the pricing scheme had illegally driven it from the market. The plaintiff conceded that the packages were priced above cost on an aggregate basis.[18]

In assessing the pricing, the court noted that *Brooke Group* did not necessarily govern multi-product price discounting.[19] Whether *Brooke Group* should apply, the court observed, depended on "whether a firm that enjoys a monopoly on one or more of a group of complementary products, but which faces competition on others, can price all of its products above average variable

9 *Brooke Group*, 509 U.S. at 222-223 (citing *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990)).
10 *Id. at 223.*
11 *See Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983) (a price is not predatory if it does not have "a tendency to exclude or eliminate equally efficient competitors"); *Ortho*, 920 F. Supp. at 469 ("only price cutting that threatens equally or more efficient firms is condemned under Section 2"); *California Computer Prods. Inc. v. International Bus. Mach. Corp.*, 613 F.2d 727, 743 (9th Cir. 1979) ("only less efficient firms will be disadvantaged" by above-cost price reductions).
12 *See Brooke Group*, 509 U.S. at 224 ("It is axiomatic that the antitrust laws were passed for 'the protection of competition, not competitors.'") (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (citations omitted)); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993) ("The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself."); *see also PeaceHealth*, 2007 WL 2473229 at *10 ("The Supreme Court's long and consistent adherence to the principle that the antitrust laws protect the process of competition, and not the pursuits of any particular competitor, reinforce our conclusion of caution concerning bundled discounts that result in prices above an appropriate measure of costs.").
13 *Brooke Group*, 509 U.S. at 224.
14 *Id.*
15 *Id.* at 226 (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986)).
16 *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (Feb. 20, 2007).
17 *Id.* at 1075 (quoting *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 122 n.17 (1986)).
18 *Ortho*, 920 F. Supp. at 466.
19 *Id.*

cost and yet still drive an equally efficient competitor out of the market."[20] Using a simplified example of a two-competitor market in which both competitors manufactured shampoo but only one manufactured conditioner, the court demonstrated that the conditioner monopolist selling a shampoo-conditioner package at a price above the total cost of manufacturing both products could nevertheless make it impossible for the shampoo-only competitor (equally efficient in manufacturing shampoo) to compete.[21]

Thus, the Court concluded that *Brooke Group*'s standard would not be dispositive.[22] Instead, the court outlined an alternative test that would attribute the discount on the package to the competitive product in order to ascertain whether the plaintiff could compete:

> [A] Section 2 plaintiff in a case like this—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.[23]

As discussed in more detail, the Antitrust Modernization Commission recommended and the Ninth Circuit in *PeaceHealth* adopted an attribution test derived (with some modification) from this standard.

C. LePage's

Although prior cases had discussed bundled discounting to a degree, contemporary scholarship began to take serious and continuing notice after the Third Circuit's 2003 decision in *LePage's*. In that case, LePage's, a producer of private label transparent tape, sued 3M, which, in addition to private label tape, manufactured several products that LePage's did not (most notably Scotch brand transparent tape). The suit revolved around 3M's bundled rebate program, under which customers received increasingly higher rebates as they purchased across more of 3M's product lines. The jury found that 3M utilized the bundled rebate program illegally to maintain a monopoly in transparent tape.

On appeal, 3M argued that *Brooke Group* should have insulated the bundled rebate program, since LePage's conceded that 3M never engaged in below-cost pricing, however calculated (i.e., even on an attributed basis). In addition, 3M argued that evidence presented by the expert for LePage's showed that LePage's was a less efficient tape manufacturer than 3M. The *en banc* court was unpersuaded. It distinguished *Brooke Group* as applicable only to oligopolists facing competition (in contrast to 3M, which conceded monopoly power in the transparent tape market),[24] and as applicable only to pure pricing claims (as opposed to pricing claims revolving around bundling).[25] The Court affirmed the jury verdict. Offering no standard for assessing when bundled discounting violates Section Two, the Court simply observed:

> The principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.[26]

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20 *Id.* at 467
21 *Id.*
22 *Id.* at 468 ("[T]he fact that the components of [the] package all are priced at or above average variable cost is not alone fatal to [the] Section 2 claims.").
23 *Id.* at 469.
24 The supposed limitation of *Brooke Group* to oligopolists was disavowed by the Solicitor General in its brief in *LePage's* (*see* U.S. Brief at *14 n.11 ("[*Brooke Group*'s] language plainly applies to a monopolist") and by the Supreme Court in *Weyerhaeuser* (extending *Brooke Group* to claims of predatory overbidding by an avowed monopolist).
25 *LePage's*, 324 F.3d at 151-52. The Court thus ignored *Brooke Group*'s observation that "[l]ow prices . . . above predatory levels . . . do not threaten competition," a principle that the Supreme Court had embraced "regardless of the type of antitrust claim involved." *See also* 509 U.S. at 223 (quotation omitted).
26 *LePage's*, 324 F.3d at 155.

Three judges, including then-judge Alito, filed a dissent, suggesting that an attribution test *à la Ortho* was the more appropriate approach.

After 3M filed a petition for *certiorari*, the Supreme Court invited the Solicitor General's view on whether it should review the decision. Writing on behalf of the United States, the Solicitor General criticized *LePage's* for "provid[ing] few useful landmarks on how Section 2 should apply as a general matter in future cases involving bundled rebates."[27] In fact, the Solicitor General found the case so "unclear as to what aspect of bundled rebates constituted exclusionary conduct," and "why the evidence supported a jury verdict, . . . including what precisely rendered [the] conduct unlawful," that it did not provide "an attractive vehicle for this Court to attempt to provide . . . guidance."[28] Thus, the Solicitor General recommended that the Supreme Court "defer plenary review" and "await further development of the case law, and further insights from academic commentary, before attempting to devise a standard to govern an important business practice of currently uncertain exclusionary effect."[29] The Supreme Court denied 3M's petition accordingly.

A flood of criticism by the academy quickly followed. Too voluminous to repeat here, the critiques nearly universally assailed *LePage's* as lacking clear guidance, as producing false positives by wrongly condemning procompetitive above-cost price discounting, and as lacking a clear foundation in jurisprudence or economics.[30] The bipartisan Antitrust Modernization Commission, for example, condemned *LePage's* as "too vague," as "lack[ing] clear standards regarding bundling," and as "likely to discourage firms from offering procompetitive bundled discounts and rebates to consumers."[31]

D. *PeaceHealth*

As the Solicitor General had anticipated, bundling claims now have had a chance to ferment in the lower courts. Among other cases that have percolated through the courts,[32] the most noteworthy at this point is *PeaceHealth*.

1. Trial and Jury Verdict

PeaceHealth revolved around the sale by hospital systems to insurers of two types of health services: primary and secondary services on the one hand, and tertiary services on the other. Plaintiff/Appellee McKenzie-Willamette Hospital and Defendant/Appellant PeaceHealth both sold primary and secondary health care services; only PeaceHealth sold tertiary health care services. McKenzie claimed that PeaceHealth had engaged in illegal tying, exclusive dealing, monopolization, and attempted monopolization in connection with its contracting practices with health insurers. The district court granted summary judgment on McKenzie's tying claim.

Following the *en banc* decision in *LePage's*, and on the eve of trial, McKenzie ultimately added a claim that PeaceHealth also violated Section Two by "bundling" primary and secondary health services with tertiary and selling the resulting bundle at a discount. Specifically, McKenzie attacked PeaceHealth's preferred provider agreements with two insurers, under which one insurer received a 3% discount and another received a 5% discount in exchange for purchasing their primary/secondary and tertiary health care services from PeaceHealth on an exclusive basis. These

27 U.S. Brief at *16.
28 *Id.* at 8, 16, 19.
29 *Id.* at 8, 15, 16; *see also id.* at 19 ("The United States submits that, at 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.").
30 *See, e.g.*, Herbert J. Hovenkamp, *The Law of Exclusionary Pricing*, 2 Competition Policy International 21, at 30, 32 (2006) ("Hovenkamp") (*LePage's* improperly "condemned bundled discounts without a showing that an equally efficient rival could not match the discounts"); Timothy J. Muris, *Antitrust Law: Economics and Bundled Discounts*, at 9 (June 2005) (submitted on behalf of the United States Telecom Association in response to the Antitrust Modernization Commission's request for public comments) ("Muris") ("[T]he Third Circuit failed to articulate clearly what aspects of 3M's bundled rebates constitute exclusionary conduct."); Daniel L. Rubinfeld, *3M's Bundled Rebates: An Economic Perspective,* 72 U. Chi. L. Rev. 243, 264 (2005) (the *LePage's* decision "lacks a clear, coherent economic rationale and leaves unclear when package pricing . . . will or should be condemned under the antitrust laws"); Daniel A. Crane, *Multi-product Discounting: A Myth of Nonprice Predation*, 72 U. Chi. L. Rev 27, 43 (2005) ("Crane") ("The *LePage's* decision regrettably condemns as anticompetitive above-cost discounting without offering any clear guidance on when mixed bundling will be deemed illegal.").
31 AMC Report, at 94, 97.
32 *See, e.g.*, *PeaceHealth*, 2007 WL 2473229; *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. 02-4770, 2006 WL 1236666 (C.D. Cal. March 22, 2006) (rejecting bundling claim as basis for liability); *Invacare Corp. v. Respironics, Inc.*, No. 1:04CV1580, 2006 WL 3022968 (N.D. Ohio October 23, 2006) (granting partial summary judgment for defendant based on finding that that competing firms could offer the same bundle as the defendant); *J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, Nos. 1:01-CV-704, 1:03-CV-781, 2005 WL 1396940 at *13, 14, 16 (S.D. Ohio June 13, 2005), *reh'g and reh'g en banc denied,*, 485 F.3d 880 (6th Cir. May 10, 2007) (refusing to follow *LePage's*).

agreements, which covered 15% of the relevant market for insured non-medical health care services, reflected the common practice in insurance markets of closed-panel preferred provider contracting, through which an insurer receives pricing concessions for steering volume (by limiting participation in its panels). As the insurers maintained as intervenors in *PeaceHealth*, such preferred provider plans allowed them to minimize expenses and to pass along the savings to patients, the ultimate consumers. (For that same reason, several insurers also filed amicus briefs urging reversal on appeal.)[33] FTC staff have recognized the same and have advocated against so-called "any-willing provider" laws that would prevent such limited panel contracting.[34] In fact, when PeaceHealth offered to the two insurers whose contracts were at issue either a PeaceHealth-only panel (with a 3-5% discount) or a dual-provider panel that included McKenzie (without the discounts), one chose to contract with PeaceHealth exclusively, while the other chose an open-panel.

The district court borrowed directly from *LePage's* to instruct the jury. Seizing on the Third Circuit's general observations about bundled discounting, the lower court in PeaceHealth instructed the jury in equally vague terms:

> [P]laintiff . . . contends that defendant has bundled price discounts for its primary, secondary, and tertiary acute care products and that doing so is anticompetitive. Bundled pricing occurs when price discounts are offered for purchasing an entire line of services exclusively from one supplier. Bundled price discounts may be anti-competitive if they are offered by a monopolist and substantially foreclose portions of the market to a competitor who does not provide an equally diverse group of services and who therefore cannot make a comparable offer.[35]

After trial, the jury found for PeaceHealth on McKenzie's claims of exclusive dealing and monopolization, but against PeaceHealth on claims of attempted monopolization. The jury awarded McKenzie $5.4 million in pre-trebled damages.

2. Appeal

PeaceHealth appealed from the judgment making two principal arguments. It argued in the first instance that the subject contracts foreclosed McKenzie from only 15% (at most) of the market, an effect that was inadequate as a matter of law to create liability. By extension, PeaceHealth argued that the jury's finding for PeaceHealth on McKenzie's Section One claim precluded the jury's finding against PeaceHealth on McKenzie's Section Two *attempt* claim due to the same inadequate foreclosure.[36] The Ninth Circuit expressed skepticism toward these positions at oral argument and largely ignored them in its decision.

PeaceHealth also argued that the bundling instruction, a near verbatim reproduction of the Third Circuit's description of the vice of bundled discounting, suffered from the same fatal flaws as the *LePage's* decision from which it borrowed. In place of that largely standardless approach,

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33 *See, e.g.*, Amicus Brief of Regence Blue Cross Blue Shield, at 6 ("Limited provider products are an important competitive tool by which health insurance carriers attempt to lower costs for consumers.").

34 *See, e.g.*, Letter from FTC Staff to the Attorney General of Montana Regarding "Any-Willing-Provider" Laws, at 2 (Feb. 4, 1993), *reprinted in* John J. Miles, *Health Care & Antitrust Law: Principles and Practice*, at App. D36 (2003).

35 *PeaceHealth*, 2007 WL 2473229 at *7.

36 Under this theory, contracts deemed by the jury insufficient to create an unreasonable restraint of trade under Section 1, cannot suddenly become "predatory or anticompetitive conduct" carrying a dangerous probability of achieving monopoly power when they are viewed through the lens of Section 2. *See, e.g.*, *Colorado Interstate Gas Co. v. Natural Gas Pipeline Co.*, 885 F.2d 683, 695 (10th Cir. 1989) (finding attempt claim precluded by limited potential foreclosure, knowable "from the beginning" because of the contracts, which had left "no room for speculation about the probability that [defendant] would gain a monopoly").
This argument makes a critical distinction between maintenance and attempt claims. The concern in maintenance claims is that a monopolist should not be allowed to enhance or preserve its power through activities that would be perfectly legal for an entity that is not a monopolist. That concern does not exist with attempt claims, where an entity lacks the potential to abuse power that does not exist. *See California Computer Prods., Inc. v. International Bus. Mach. Corp.*, 613 F.2d 727, 737 n.11 (9th Cir. 1979) ("*Cal-Comp*") ("[T]he same conduct may provide a basis for the monopolization offense and yet be excluded as a basis for the attempt offense. This is so since a defendant's monopoly power or lack thereof is part of the 'reasonableness' calculus; conduct reasonable for other firms is not necessarily reasonable for the monopolist."); *Calculators Hawaii, Inc. v. Brandt, Inc.*, 724 F.2d 1332, 1339 (9th Cir. 1983) (for reasons identified in *Cal-Comp*, Section 2 analysis only "partially tracks" analysis under Section 1, even though both employ "the same 'reasonableness' standard").
Although the D.C. Circuit appears to have taken a different view in the *Microsoft* case (*see United States v. Microsoft Corp.,* 253 F.3d 34, 70 (D.C. Cir. 2001), the court limited its holding to claims against *monopolists*. *See R.J. Reynolds v. Philip Morris Inc.,* 199 F. Supp. 2d 362, 395 n.24 (M.D.N.C. 2002) ("The *Microsoft* court did identify a small window through which a Section 2 claim could pass, surviving the failure of a Section 1 claim based on the same conduct; however, the *Microsoft* window is open only to claims against monopolists, and even then in limited circumstances involving exclusive contracts.").

PeaceHealth urged that the Court instead adopt the objective and more administrable price-cost test modeled on *Brooke Group*. That test, PeaceHealth explained, could take two forms. First, *Brooke Group* could be applied to the bundle as whole, testing whether the price of the bundle exceeded the aggregate cost of producing it.[37] Recognizing, however, that *Brooke Group*'s single-product test may not adequately target the vice of bundling, PeaceHealth argued in the alternative for an *Ortho*-based attribution test under which the entire discount on the bundle is attributed to the competitive product alone before testing whether that product was being sold below-cost. This test, PeaceHealth observed, was facially objective and administrable — in contrast to the instruction derived from *LePage's* — but less administrable than the unadorned *Brooke Group* test, especially where a firm includes in a bundle multiple products in which it has monopoly power.

McKenzie never really joined issue, instead defending the bundling instruction as properly suggesting that bundled discounting by a monopolist is per se illegal: "The merit of *LePage's* is its simplicity: Monopolists may not bundle discounts."[38] McKenzie stood firm in this position at oral argument as well.

3. The AMC and Amici Provide "Further Insight" and Endorse a Price-Cost Standard

After oral argument, the Ninth Circuit took the extraordinary and nearly unprecedented step of inviting all interested parties to submit amicus briefs addressing the question of whether a cost standard should be used to analyze bundles — and, if so, which standard.[39] (The court did this notwithstanding the opportunity presented by PeaceHealth for the Court to avoid the more difficult bundling issues and to dismiss the case based on inadequate foreclosure.) A host of large companies and scholars filed briefs, most endorsing PeaceHealth's position that bundled discounts must be analyzed under *some* price-cost test.[40] Many of the briefs endorsed the attribution standard recommended by the Antitrust Modernization Commission shortly after oral argument. Even the lone submission that advocated affirmance recognized that a form of price-cost analysis would provide useful guidance for analyzing bundling claims.

4. The Ninth Circuit Adopts the Discount Attribution Standard

On September 4, 2007, the Ninth Circuit (with Judge Gould writing for a unanimous panel) vacated the Section Two bundling verdict in *PeaceHealth*. The Court expressly rejected the Third Circuit's approach in *LePage's* and instead embraced application of a price-cost test:

> [W]e decline to endorse the Third Circuit's definition of when bundled discounts constitute the exclusionary conduct proscribed by Section 2 of the Sherman Act. Instead, we think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct within the meaning of Section 2 of the Sherman Act unless the discounts resemble the behavior that the Supreme Court in *Brooke Group* identified as predatory. Accordingly, we hold that the exclusionary conduct element of a claim arising under Section 2 of the Sherman Act cannot be satisfied by reference to bundled discounts unless the discounts result in prices that are below an appropriate measure of the defendant's costs.[41]

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37 Although this position finds support by prominent academics (*see, e.g.*, Muris, at 21-27), some have criticized it as ignoring the real harm posed by bundling. *See, e.g.*, Jonathan M. Jacobson, "Exploring the Antitrust Modernization Commission's Proposed Test for Bundled Pricing," *Antitrust*, Vol. 21, No. 3, 24 (Summer 2007) ("Jacobson") ("The aggregate rule has the advantage of relative easy of administration. But it is analytically unsound because it ignores completely the bundling aspects of the multi-product seller's conduct and, if followed, would render bundling as such lawful per se.").

38 McKenzie's Brief, at 54; *see also id.* at 35 ("[McKenzie] contends that, on a stand-alone basis, bundling by a monopolist violates Section 2 of the Sherman Act."). Note that, although the jury instruction in PeaceHealth can be read this way, *LePage's* itself did not necessarily endorse the view that bundling is per se illegal.

39 *See Cascade Health Solutions v. PeaceHealth,* 479 F.3d 726, 726 (9th Cir. March 20, 2007) (granting leave for "any person or entity wishing to file a brief as an amicus curiae").

40 The amici supporting PeaceHealth included "Amicus Curiae Law Professors"; Caterpillar Inc.; Catholic Healthcare Association of the United States; The Coca-Cola Company; Kimberly-Clark Corp.; Kraft Foods, Inc.; Microsoft Corp.; Pacific Bell Telephone Co.; Pacific Source Health Plans; Regence BlueCross BlueShield of Oregon; United Technologies Corp; Honeywell International Inc.; Verizon Communications; and Visa U.S.A. Inc. Anyone wishing copies of the briefs should contact the authors at Heller Ehrman LLP in San Francisco.

41 *PeaceHealth*, 2007 WL 2473229 at *11.

As for the specific pricing test that should be applied, the Court adopted the attribution standard contained in the first prong of AMC's test (described more fully below). "Under this standard," the Court explained, "the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products. If the resulting price of the competitive product or products is below the defendant's incremental cost to produce them, the trier of fact may find that the bundled discount is exclusionary for the purpose of Section 2."[42]

In so holding, the Ninth Circuit rejected the aggregate price-cost test proposed in the first instance by PeaceHealth. Heeding *Ortho*'s warning that "a firm that enjoys a monopoly on one or more of a group of complementary products, but which faces competition on others, can price all of its products above average variable cost and yet still drive an equally efficient competitor out of the market," the Court concluded that the attribution "approach does a better job of identifying bundled discounts that threaten harm to competition."[43] The Ninth Circuit was careful to note, however, that its attribution test focused on whether "the discounts have the potential to exclude a *hypothetical* equally efficient producer of the competitive product."[44] This differed from *Ortho*, which required the plaintiff to prove that it was equally efficient.[45]

After deciding that a price-cost test would need to apply to the Section Two bundling claim, the Ninth Circuit held that the same conduct might constitute an illegal tie under Section One. The Court vacated summary judgment for PeaceHealth on McKenzie's tying claim, finding "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."[46] In so doing, the Court expressly left open the question of whether the discount attribution standard applied to the bundling claim should not also be applied to analyze coercion under the tying claim. Noting that the parties did not brief the issue, and that the AMC did not make a recommendation concerning the application of the bundling test to other contexts, the Ninth Circuit referred the question to the district court "to decide the issue in the first instance on remand."[47]

McKenzie has petitioned for *en banc* review of the bundled discounting portion of the opinion.[48] That petition is now pending.

III. ASSESSING *PEACEHEALTH* AGAINST OTHER PROMINENT PROPOSED APPROACHES

A. Antitrust Modernization Commission's Recommendation

Many of the amicus briefs in *PeaceHealth* endorsed the test proposed in the AMC Report, which was published shortly after oral argument. The AMC Report criticized *LePage's* as simply "too vague" and concluded that its "lack of clear standards . . . may discourage conduct that is procompetitive or competitively neutral and thus may actually harm consumer welfare."[49] Thus, drawing from *Ortho*, *Brooke Group*, and (then-recently decided) *Weyerhaeuser*, the AMC suggested a three-part test for determining when bundled discounting should be found illegal:

> (1) after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product;

42 *Id.* at *14; *see also id.* at *17 ("To prove that a bundled discount was exclusionary or predatory for the purposes of a monopolization or attempted monopolization claim under Section 2 of the Sherman Act, the plaintiff must establish that, after allocating the discount given by the defendant on the entire bundle of products to the competitive product or products, the defendant sold the competitive product or products below its average variable cost of producing them.").
43 *Id.* at **5, 13.
44 *Id.* at *14 (emphasis in original).
45 *Id.* at **13-14 (citing *Ortho*, 920 F. Supp. at 469).
46 *Id.* at *23.
47 *Id.* at *24 n.30.
48 McKenzie argues that the case is of exceptional importance and that the Ninth Circuit erred by adopting a standard in conflict with *LePage's*; by holding that predation can be proved only through evidence of sales beneath some measure of variable cost; and by holding that federal price discrimination law should guide interpretation of Oregon's price discrimination statute.
49 AMC Report, at 83, 94, 97.

(2) the defendant is likely to recoup these short-term losses; and

(3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.[50]

The first two prongs function as "safe harbors" that will screen bundled discounts that on their face pose little risk of harm to competition.[51] The AMC pronounced that application of this test "would bring the case law on bundled discounts into line with the reasoning of *Brooke Group*."[52]

Prong 1 (pricing). This pricing prong is the heart of the AMC's test. By tweaking *Brooke Group*'s below-cost standard to require attribution, the first prong targets the specific harm potentially threatened by bundled discounting while also ensuring that the practice is condemned only where it would exclude a hypothetical equally efficient competitor.[53] The AMC designed this prong to serve as a "safe harbor" that could "ameliorate the chilling of procompetitive bundled discounts" that existed under *LePage's*.[54] Although less administrable than tests that would examine the price and cost of a bundle in the aggregate, the AMC believed that this pricing test "would provide sufficient clarity to enable businesses to determine whether a particular bundled discount would be "screened out" from further scrutiny."[55]

Prong 2 (recoupment). As a second "safe harbor" or "screen," the recoupment prong functions like that of *Brooke Group*: It examines whether the losses incurred through bundled discounting might serve for the defendant as a short-term investment in a long-term goal of destroying competition, raising prices, and recovering the losses.[56] As the AMC observed, the recoupment requirement "would typically require a plaintiff to show that entry into the relevant market is not easy and therefore is unlikely to undermine the defendant's ability to recoup its losses"; it thus functions as a "safe harbor" where entry is easy.[57]

The AMC confronted two options when deciding how the recoupment test should operate. As Jonathan Jacobson (a Commissioner on the AMC and author of one of the amicus briefs in *PeaceHealth*) has explained, recoupment could mean two different things in the bundled discounting context: either (1) that the defendant will be able to recoup revenue on the competitive product that it lost by selling below an attributed cost basis or (2) that the defendant would be able to recoup losses from selling the bundle on an aggregate below-cost basis.[58] Because with bundles priced above cost in the aggregate "there will be no actual losses for the defendant to try to recoup,"[59] the AMC opted for examining recoupment on an aggregate basis. That recommendation substantially limited the scope of the AMC's proposed recoupment requirement. Any bundle priced below an *attributed* cost basis (thus failing prong one) but above an *aggregate* cost will have "simultaneous" recoupment (thus passing prong two); such bundles would proceed to a Rule of Reason analysis (prong three). As discussed below, the Ninth Circuit recognized the limited utility of recoupment (so understood) and dispensed with the requirement altogether.

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50 *Id.* at 83.
51 *See* Jacobson, at 25; AMC Report, at 100. The first prong also is consistent with the pricing test advocated by Hovenkamp and Areeda in their leading treatise. *See, e.g.*, 3 Areeda & Hovenkamp, Paragraph 749b2, at 335-36 (Supp. 2006) ("To see whether a package price is 'exclusionary' . . . one simply attributes the entire discount on all products in the package to the product for which exclusion is claimed. If the resulting price is less than the defendant's cost, then the package discount is exclusionary as against a rival who makes only one of the two goods in the package.").
52 AMC Report, at 100.
53 *Id.* at 100 ("This standard would permit bundled discounts that could exclude a less efficient competitor, even if the less efficient competitor had provided some constraint on pricing of the competitive product.").
54 *Id.*
55 *Id.* ("The first screen is also sufficiently administrable for courts to apply . . . .").
56 *See Brooke Group*, 509 U.S. at 224-26; AMC Report, at 98 ("[B]elow-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." (quoting *Ortho*, 920 F.Supp. at 466)).
57 *Id.* at 100.
58 Jacobson, at 25.
59 *Id.*

Prong 3 (harm to competition). "Under the third part of the test, a plaintiff would have to establish actual or probable harm to competition."[60] In other words, the third prong applies settled Section Two standards to conduct not filtered out by the first two prongs. As Jacobson explains, "Given that many package discounts will fail both the below-cost and recoupment safe harbors, it is especially important to ensure in applying the third part of the test that there be solid evidence that competition in a relevant market . . . has been or will be harmed."[61]

B. Rule of Reason

The only amicus brief in *PeaceHealth* that advocated affirming the judgment was that of amici American Antitrust Institute, Consumer Federation of America, and Consumers Union ("AAI Brief"). Although that AAI brief did not engage in a substantive defense of the holding in *LePage's*, it accepted as a starting point "the court's basic premise that single-product and multi-product discounts deserve different treatment."[62] The AAI maintained that bundling was not analogous to predatory pricing, but rather to tying, in which the competitive harm flows not from pricing as such, but rather from making that pricing contingent upon other purchases.[63] Since above-cost bundled discounting can potentially exclude even efficient competitors (based on a monopolist's large margins),[64] and since it can potentially prevent a competitor from reaching efficient scale,[65] the AAI Brief insisted that a price-cost test would not adequately prevent the potential harm from bundled discounting.

The AAI Brief argued that *Microsoft*'s "structured rule-of-reason" analysis should be used to analyze bundling claims.[66] Under this familiar three-part analysis, the plaintiff would have to establish a *prima facie* case that the defendant — either a monopolist (or a entity with a dangerous probability of becoming one) — acted in a manner that harmed competition and consumers; the defendant could then present procompetitive justifications for its conduct; and the plaintiff, bearing the ultimate burden of proof, could then demonstrate that harm from defendant's conduct outweighs the benefits therefrom. Although the AAI Brief argued that cost-based tests *à la Brooke Group* should not be dispositive under the first step, it did recognize that such tests "may certainly assist a court or jury in determining whether the plaintiff has met its [prima facie] burden."[67] According to the AAI, the test announced in *Ortho* and recommended by the AMC— with its emphasis on the competitive product, rather then on the bundle as a whole — "provides a good model" for proceeding under the first step.

C. PeaceHealth Departs from Second and Third Prongs of AMC Test

Although *PeaceHealth* paid significant attention to the approach to bundled discounting recommended by the AMC, the decision diverged from that recommendation by dispensing with the second prong (recoupment) and finding the third prong (harm to competition) redundant of the antitrust injury requirement.[68]

1. Recoupment

The Court rejected as "imported incorrectly" from single-product predatory pricing claims the recoupment prong of the AMC's recommended test. Invoking *Ortho*, the Court distinguished single-product predation (which "necessarily involves a loss for the defendant") from multi-product predation (which potentially can exclude less diverse rivals, even when sold above an aggregate cost basis). Because "exclusionary bundling does not necessarily involve any loss of profits for the bundled discounter," the Court concluded that it is not "helpful to think in terms of recoupment of a loss that did not occur."[69] Thus, the Ninth Circuit would not require a plaintiff to prove recoupment.

60 AMC Report, at 100.
61 Jacobson, at 26.
62 AAI Brief, at 15.
63 *Id.* at 16-17.
64 *See Ortho*, 920 F.Supp at 467; AAI Brief at 21.
65 This argument is developed and analyzed more fully below.
66 AAI Brief, at 21.
67 *Id.* at 22.
68 *PeaceHealth*, 2007 WL 2473229 at *17 n.21.
69 *Id.*

2. Harm to Competition

Assessing the AMC's third prong — which tests for harm to competition — the Ninth Circuit found it "redundant because it is no different than the general requirement of 'antitrust injury' that a plaintiff must prove in any private antitrust action."[70] Thus, the Court chose not to adopt the "superfluous" requirement.[71]

Although the concepts of antitrust injury (the type of injury against which antitrust laws were designed to protect) and harm to competition (harm to the competitive process) do not fully overlap, the Ninth Circuit certainly is right that courts have tended to treat the two similarly. Whatever the test is labeled, however, the Ninth Circuit correctly recognized that, as with all claims of exclusionary conduct, the test for bundled discounting must require a showing of marketwide harm above and beyond any harm to a particular competitor.

IV. BEYOND *PEACEHEALTH*

The interest in the bundling decisions in *LePage's* and *PeaceHealth* may cause some to overlook the limits of the issues at stake. Both cases address circumstances in which conduct allegedly harmful to competition is limited to price competition, without more. That is to say, the cases involve circumstances where a competitor claims to be disadvantaged by a monopolist's ability to offer an array of products at a discount that the rival claims it cannot meet. The cases assume that *some* form of predation is afoot, and at least the AMC goes so far as to propose a recoupment safe harbor (albeit one of limited application). What is *not* at issue in these cases is how *contracts* — e.g, ties by contract, exclusives, or market share commitments — that directly foreclose competitors' opportunities should be assessed. The line between the two (pure pricing competition and competition taking the form of a contract) may not always be clear.[72] For example, short-term contracts, or contracts terminable at will, generally represent nothing more than a form of price competition. In *PeaceHealth*, the contract competition took the form of offers with and without exclusivity, but even the exclusivity provisions were limited in duration and terminable on short notice. They were, in other words contestable in a way that resembled price competition.[73]

The distinction between price competition and exclusionary contracts that raise rivals' costs is important.[74] As Professor Salop has explained:

> Because predatory pricing and RRC [raising rivals' costs] are so different, there is no reason to think that they should be governed by the same standards for antitrust liability. In fact, the *Brooke Group* standard is not generally proposed as the liability standard for exclusionary conduct other than predatory pricing.[75]

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 *Brooke Group*. 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

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70 *PeaceHealth*, 2007 WL 2473229 at *17 n.21.

71 *Id.*

72 *See* Jacobson, at 23 ("Bundled pricing resembles predatory pricing because it involves a form of price cutting. . . . It resembles tying in that power in one product might be used to attract added patronage of another. And it resembles exclusive dealing in that customers might be induced to patronize the defendant exclusively. [Paragraph] These analogies are imperfect, however. Bundled pricing is unlike predatory pricing in that the multi-product seller may exclude rivals without short-term losses by lowering the package price to a level that is above its total (incremental) cost but that provides discounts in amounts that equally efficient single-product sellers cannot meet. It is unlike tying because there may be no element of coercion. And it is unlike exclusive dealing because there may be no agreement . . . requiring the customer to take any portion its requirements form the defendant.") (emphasis added); *see also* AMC Report, at 95-96.

73 This is because short duration and easy termination make the exclusivity porous and readily subject to competitors' new offers. This is "competition-for-the-contract," which is "a form of competition that antitrust laws protect rather than proscribe, and it is common." *Paddock Publ'ns, Inc. v. Chicago Tribune Co.*, 103 F.3d 42, 45 (7th Cir. 1996).

74 Important differences include that raising rivals' cost conduct (1) does not require a profit sacrifice during the initial predatory period; (2) does not require the exit of rivals to be successful; (3) is not necessarily more costly in the short run to the defendant than to its victims; (4) does not always involve a short term consumer benefit; and (5) may not have any valid efficiency benefits. Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 Antitrust L.J. 311, 315-18 (2006).

75 *Id.* at 318.

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.

A. Critique of AMC Test

The AMC analysis springs from the apparent assumption that bundled discounting, without more, is inevitably a form of predatory pricing and should be addressed as such. Hence, the AMC test requires a showing of recoupment (a requirement dismissed by the Ninth Circuit). That test also requires a plaintiff that escapes the pricing and recoupment safe harbors prove harm to consumer welfare. In practice, that has comes to mean that a plaintiff must demonstrate a risk of sufficient market foreclosure to support a finding that competition (and hence consumer welfare) has been harmed by the pricing conduct. That inquiry, of course, is common to *all* exclusionary practice claims, including tying (at least in some Circuits) and exclusive dealing.

Indeed, PeaceHealth itself argued that McKenzie's failure to prove meaningful foreclosure was itself a sufficient ground for reversal, without even addressing how one assesses the legality of bundled discounting.[76] The evidence demonstrated that in the relevant market (defined by the pool of insurers supposedly preempted by the bundles), only 15% of insured lives were beyond McKenzie's potential reach. What is particularly striking about the facts in *PeaceHealth* is that the price competition associated with attempts by McKenzie to be included in the insurance company PPO plans resulted in two exclusive contracts favoring PeaceHealth — contracts that themselves were exonerated by the jury because the foreclosure in the insurance arena was so paltry.

The price predation model that drives the AMC test has been criticized by commentators on a number of grounds. Noting that below-cost concerns have never informed Section Two jurisprudence governing foreclosure through exclusives and other contractual devices, these commentators argue that an AMC-type analysis is too generous to defendants and undermines genuine competition concerns arising from conduct that limits entry or expansion into markets dominated by monopolists. These scholars criticize the AMC test as "flawed," proceeding as it does from a "predation-like perspective."[77] Scholars such as Timothy Brennan, for example, argue that the test focuses on competition among rivals in the supply market at the expense of ignoring effects in the downstream market (and the secondary ripple effects those may have in the supply market).[78]

Other scholars have focused attention on foreclosure not in the downstream market, but rather within the same market as the bundling monopolist's products. These analyses recognize that exclusionary conditions on sales to downstream buyers foreclose rivals by limiting their ability to reach those buyers. As Barry Nalebuff demonstrates, for example, such effects may prevent a would-be competitor from entering the market at all.[79] This outcome, Nalebuff explains, has little to do with the more traditional fear that a firm might use bundling "to leverage a monopoly from one market to another."[80]

Other scholars recognize that, even where entry is not completely precluded, bundling that limits competitors' outlets for (and therefore the volume of) sales can effectively prevent competitors from achieving an efficient scale.[81] As Professor Elhauge explains, the proper concern in bundled discounting cases should be that the discounts "will foreclose a sufficient market share to impede the competitiveness of rivals, and thus increase the seller's market power in the foreclosed market, and perhaps also . . . in both bundled markets."[82] It is for this reason that Elhauge criticizes the attribution

76 McKenzie maintained in its briefs on appeal and now in its pending rehearing petition that "[p]rice predation is not the issue." Rather, "[i]t is a foreclosure case. It rests upon the proposition that bundling forecloses a plaintiff or the competitor from access to a substantial share of the market." Petition for Rehearing, at 2.

77 Timothy J. Brennan, *Bundled Rebates as Exclusion, Not Predation*, 2-3 (June 18, 2007) ("Brennan").

78 Brennan proposes analyzing foreclosure by assessing whether a hypothetical merger among the buyers of a bundle would create antitrust concerns. *See id.* at 4.

79 Barry Nalebuff, *Bundling as an Entry Barrier*, The Quarterly Journal of Economics, 119(1), 159-187 (2004).

80 *Id.* at 26-27 (concluding that it is in its role as preventing entry that "bundling truly shines").

81 *See* Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 320-21 (Nov. 2003).

82 Einer Elhauge, Damien Geradin, *Global Antitrust Law and Economics* 626 (2007) ("Elhauge").

test as an unduly conservative test of foreclosure: It ignores "the concern that foreclosure might impair rival expandability," thus preventing scale efficiency by "relegat[ing rivals] to the high cost portion of their cost curve."[83] The attribution test's focus on only equally efficient producers also ignores the fact that "impairing or excluding less efficient rivals can also have anticompetitive effects by removing a constraint on the defendant's market power."[84] As Elhauge concludes, "if the anticompetitive concern is that exclusionary discounts will create marketwide foreclosure that impairs rival efficiency, then [the attribution] test assumes away the very anticompetitive concern being tested."[85]

Moreover, as both Brennan and Elhauge recognize, the ability to reduce exclusionary conduct to price-cost terms should not itself justify application of a *Brooke Group*-derived safe harbor where pricing is above some measure of cost. This criticism accepts the proposition that all exclusionary conduct can be analyzed according to the question of "whether an equally efficient rival selling at cost could offset the price penalties" associated with buying from defendants' competitors.[86] Such penalties would include the cost of breaching an exclusive contract (liquidated damages, cost of litigation, etc., for example). This approach "effectively convert[s] all exclusionary agreement cases into predatory pricing cases."[87] That conversion is inappropriate — or at least unnecessary — where the exclusionary conduct does not carry with it the ambiguous impact of price discounts and the attendant concern over false positives.

B. De Facto Tying

If application of the pricing safe harbor is to be reserved for only those cases where the central harm is from pricing alone, the question arises as to whether tying claims based on bundled discounts present that kind of harm. In other words, where pricing is the element that makes bundles attractive to buyers, is the harm akin to that of price discounting (with its attendant concerns over false positives)? The Ninth Circuit translated the question into one concerning how far to extend its attribution test: "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 its costs."[88]

The AMC (and Ninth Circuit in *PeaceHealth*) both sidestepped the question, leaving it to scholars (and the district court on remand) to sort out. In its amicus brief, the AAI maintained that the potential harm in such cases "arises not from the low price itself but from making that low price contingent on the consumer purchasing the entire bundle from the monopolist" — a harm that "arises independently of the monopolist's cost structure."[89] Professor Hovenkamp agrees that "[t]he tying analogy is the better one" and that such potential harm has more to do with the contingency of the offer than the price discounting itself.[90] Nevertheless, Hovenkamp would apply a pricing test to assess the first element of a tying claim, namely, whether the products have actually been tied together:

> [A] price/cost analysis would have to be used to establish that the products in the bundle are actually tied together. Tying would occur if, when all discounts are attributed to the product upon which exclusion is claimed, the price of that product falls below the relevant measure of cost. If the overall price of the bundle exceeds cost, however, then all the defenses normally applied in tying arrangement cases would apply. . . .[91]

The Areeda treatise (co-written by Hovenkamp) takes the same approach. Where an alleged tie is not "explicit," but rather of the de facto (tie-by-price) variety, the treatise casts the "below cost" prong of an attribution test as a test for coercion: "[T]he first element in a package discount case is 'coercion' or 'exclusion'. . . . This cost/price test establishes . . . that the two products are 'tied together,' in the sense that the customer cannot reasonably be expected not to take them together."[92] In other words,

83 *Id.* at 629; *see also* Brennan at 16 (bundled discounts raise rivals' costs of competing).
84 Elhauge at 630.
85 *Id.* at 629.
86 *Id.* at 629.
87 *Id.*
88 *PeaceHealth*, 2007 WL 2473229 at *24 n.30.
89 AAI Brief, at 17.
90 Hovenkamp, at 32.
91 *Id.*
92 Areeda & Hovenkamp, Paragraph 749b2(B), at 257 (2007 supplement).

the test addresses the "requirement that the products actually be 'tied together,' which means that buyers are either required to take them together or face significant penalties if they failed to do so."[93]

The Areeda-Hovenkamp test is thus a recognition that where the same conduct is attacked as both a tie and a price discount, there should be no difference in the test applied to each. Where the inducement to purchase is a price discount — and not, for example, an explicit/contractual tie — the same concerns exist over false positives that might condemn (or chill) pro-consumer discounting.

The AMC was more guarded, of course, noting that it had not adequately studied the question of whether the same test should apply.[94] As AMC Commissioner Jacobson explains, however, that reservation was made as a recognition that the facts of certain cases would make the test "inapt," where, for example, due to a technological tie-in, "there is no stand-alone price from which the attributed price-cost test be computed."[95] Indeed, Jacobson would treat bundled discounting as tying or exclusive dealing only where the "the practical effect" required such treatment:

> [I]f the defendant's contract terms lead to exclusive . . . arrangements covering an appropriately large portion of the relevant market (typically in excess of 40 percent), the plaintiff could present the case as one of exclusive dealing. Similarly, if the defendant has significant market power in the market for one product and its contractual arrangements are such that customers have no practical choice but to take a distinct second product from the defendant as a condition of the getting the first, the arrangement is appropriately regarded as tying and normal tying rules should apply.[96]

He concludes, however, that the "vast majority" of bundled discount cases will not properly fall within these categories.[97]

This "practical" approach militates in favor of applying a price-cost analysis to tying claims where the coercive mechanism is not a contract (as in explicit tying) but rather the same price discount alleged to be an illegal bundled discount under Section Two. Conduct that does not harm competition under the latter should not be able to harm competition under the former. This was certainly the case in *PeaceHealth*, where the only "tie" was allegedly "coerced" through price discounting. Insurers could have purchased (and did actually purchase) tertiary health care services separately from primary and secondary. Those purchasing tertiary independently simply paid more for those services than insurers buying all their health care needs from PeaceHealth. The price difference — the only potentially coercive device — was nothing other than the discount at which the price-cost test aims. As Areeda and Hovenkamp suggest, if that discounted price is above an attributed cost basis, it simply cannot "coerce" tied purchases.

V. CONCLUSION

The law on bundled discounting (and its relationship to exclusive dealing and tying) continues to evolve under the focused attention of academics and courts. The Ninth Circuit's decision in *PeaceHealth* is an important step toward developing a clear and objective approach to bundled discounting, a subject that is now ripe for resolution by the Supreme Court.

Epilogue

On February 1, 2008 the Ninth Circuit denied McKenzie's petition for rehearing on the federal claims eliminating any further appeal of right on those claims. However, in the same order the Ninth Circuit partially granted McKenzie's petition for rehearing on the state price

93 *Id.* at 251.
94 AMC Report, at 114 n.157 ("The recommended three-part test is proposed here for challenges to bundled *pricing* practices, and its purpose . . . is to avoid deterring procompetitive price reductions. The Commission it not recommending application of this test outside the bundled pricing context, for example in tying or exclusive dealing cases. The Commission did not undertake to study tying and exclusive dealing issues more generally.").
95 Jacobson, at 26-27.
96 *Id.* at 27.
97 *Id.*

discrimination claim and certified to the Oregon Supreme Court for discretionary review the question whether, under Oregon's analogue to the Robinson Patman Act, a plaintiff is required to follow the elements of a primary line price discrimination claim as outlined in *Brooke Group*, 515 F.3d 973 (9th Cir 2008). In its original opinion (now reported at 502 F.3d 895 (9th Cir. 2007)), the Ninth Circuit panel had "divine[d]" that it would (502 F.3d at 919) but on rehearing it apparently determined that it was presumptuous to do so. However, in its certification order it firmly stated its view that it is "likely that the Oregon Supreme Court will decide to follow *Brooke Group*" (515 F.3d at 977). The Oregon Supreme Court accepted the referral on February 20, 2008 and oral argument is set for October 8, 2008.

Possible review of the federal claims in the United States Supreme Court awaits a final Ninth Circuit disposition which is now contingent on the outcome in Oregon. For recent articles addressing bundled pricing and the Ninth Circuit's opinion in *PeaceHealth*, *see* Herbert Hovenkamp, "Exclusionary Bundled Discounts and the Antitrust Modernization Commission" (U. Iowa L. Stud. Res. Paper, No. 08-14, June 2008, available at http://ssrn.com/abstyract=1126723); Richard M. Steur, "Bundles of Joy," 22 Antitrust 25 (2008); and Mark S. Popofsky, "Essay: Section 2, Safe Harbors and the Rule of Reason," Geo. Mason L. Rev. (forthcoming fall 2008).