Bundling and Bundling-Related Pricing

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This is one of the major open questions in antitrust. We can only touch on the high points in this session, but I hope to identify some of the key questions and sources.

Sources:

Section 2 Generally

Aspen Skiing Co. v. Aspen Highland Skiing Corp., 472 U.S. 585 (1985).

Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

Bundled Rebates

SmithKline Corp. v. Eli Lilly & Co., 575 F.2d 1056 (3rd Cir. 1978).

Concord Boat Corp. v. Brunswick Corp., 207 F3d 1039 (8th Cir.) (2000).

LePage's Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003).

McKenzie-Willamette Hospital v. PeaceHealth, ___ F.3d ___ (9th Cir. ____) (forthcoming)

Predatory Pricing and Buying

Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986).

Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S.Ct. 1069 (2007).

Recent Articles

H. Hovencamp, "Discounts and Exclusion," 2006 Utah L. Rev. 841 (2006)

R. Lande, "Should Predatory Pricing Rules Immunize Exclusionary Discounts?" 2006 Utah L. Rev. 863 (2006)

Thoughts and Questions

Section 1 Cases

Bundling is often close to or identical to tying. Rather than formally conditioning the sale of one product (the tying product) on the purchase of the other product (the tied product), the "conditioning" may be done through a bundled price that is so attractive that customers in effect cannot refuse. The issue is typically the extent of foreclosure. If sufficient non-foreclosed capacity remains in the market for other competitors to be able to reach consumers, then there is no unreasonable restraint. The maximum percentage of foreclosure varies from decision to decision.

What if the contracts are short term or terminable at will? If other competitors can rapidly contest the current contract, then competition should be possible. The competition is for the contract. But what is the actual pattern is that the contracts never are changed? Should this be a factor for the jury or a basis for summary judgment? Cases vary.

Intersection of Section 1 and Section 2

Does a finding for the defendant under Section 1 negate a finding for the plaintiff under Section 2? If the same conduct by the same defendant with the same market share in the same market does not rise to the level of a violation under the rule of reason for purposes of Section 1, it seems that it should not satisfy Section 2 either. But, can we assume entire consistency by juries? Courts have tended not to find a Section 1 ruling for the defendant to be dispositive on a related Section 2 claim.

Section 2 Cases

The Antitrust Division of the Department of Justice has argued in several cases that the test should be whether the challenged conduct makes no economic sense other than its tendency to reduce or eliminate competition.

Anticompetitive conduct is a conduct that is not based on the superior product, business acumen, historical accident, or efficiency. *Trinko*, 540 U.S. at 407; *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); *Aspen*, 472 U.S. at 605. In *Trinko*, the Court recognized that "the means of illicit exclusion, like the means of legitimate competition, are myriad." 540 U.S. at 414 (citation omitted).

Exclusionary conduct has been defined broadly as "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." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 n.32 (1985).

It is well recognized that the antitrust laws protect *competition – not* competitors. But, the statement that the antitrust laws protect competition rather than competitors is most meaningful

in the context of a significantly competitive market with numerous competitors. There, harm to one competitor generally does not harm competition. It is not so clear in the context of an action by a monopolist that has the purpose and effect of eliminating its only significant competitor.

While discount pricing of bundled goods or services is common and generally either neutral or pro-competitive, whether that generalization applies in the particular context of a monopolist is another question.

What if the bundle includes some products—either monopoly or "merely" dominant—that the retailer "must have" and the contract in question lumps those products together with other products in a strategic way that economically "forces" the customers to drop the plaintiff's competitive product? It may be the case that a retailer can get over a volume threshold by converting purchases of a competitive product to the product of the bundler and obtain an additional rebate on all the products that is more than the entire revenue of the competitive supplier.

The central question is whether the law on single product predatory pricing should control every price-related or price-affecting practice by a monopolist that is alleged to be exclusionary. The argument is that otherwise there will be too many "false positives" and consumers will suffer because dominant firms will compete less vigorously. Along these lines, in *Trinko*, the Court stated that "the cost of false-positives counsels against an undue expansion of § 2 liability." 540 U.S. at 414.

What does "competition on the merits" mean? The term is frequently used but has not been defined precisely.

When is exclusion based on something other than "efficiency"?

Is it enough to allow (require) the defendant to prove a business justification for the practice in question?

If, as some cases say, a monopolist is subject to different standards than a firm in a competitive market, what would be lost in requiring it not to bundle its monopoly products or, if it does, to be subject to a jury's review under general monopolization standards, which make it clear that it is not illegal simply to have monopoly power?

One way of phrasing the question is whether the competing company can make the customer "indifferent on price" without having to sell below its own variable cost, assuming that its cost structured is comparable to the defendants. Arguably, if it can do so without going below "some measure of cost" then it should simply compete by lowering its price. The "offer that cannot be refused" theory of tying arguably does not apply if the plaintiff could offer a discount that would make the customer indifferent between the package discount and buying the two products separately.

One way that has been suggested to reduce the potential for juries to condemn conduct by a monopolist that benefits consumers is to impose a price/cost standard as an initial hurdle.

Suggested Variations of the Brook Group Standard

1) Taking all the discounts together, the price of everything in the bundle must be below the overall average variable cost of all the products.

2) Taking all the discounts together and applying them to the "competitive" product in question, the price of the competitive product must be below the defendant's average variable cost for that product. This is what the Antitrust Modernization Commission suggests. AMC Report at 99-100.

The discount reallocation screen treats the entire package discount as if it had been given on just the competitive product and asks whether the plaintiff could profitably have met such a large discount.

Hovenkamp would apply the aggregate rule in bundled discount cases *except* where no rival or group of rivals could produce all of the goods or services in the challenged bundle. In that narrow circumstance, he would use the second test where the discount is applied against the competitive product.

In *Information Res. Inc. v. Dun & Bradstreet*, 359 F. Supp. 2d 307 (S.D.N.Y. 2004), the Court applied the discounts to the competitive product.

Why should we allow a firm with a 70% market share to give discounts that require each retailer to commit to purchase at least 70% in order to get the best price? On its face, this kind of pricing structure seems designed to lock in market share and retard entry or expansion of competitors, particularly if the defendant's product is one that most retailers need to sell to be competitive. Should a jury be allowed to conclude that it had that purpose and effect without more?

We want consumers to have the benefit of good prices, but what evidence is there that the monopolists would not price aggressively on single products if they had some risk in liability for strategic bundling that harmed their (by definition) few effective competitors. The cases often involve a situation where a new competitor has appeared. Even if bundling were not possible, would the monopolist still respond to the competition? In other words, what is the likely difference in the prices that consumers would get?

The predatory pricing standard is premised on the conclusion that predatory pricing is not often tried and even less often successful. Query if this is still factually correct? Even if it is correct, what evidence is there that strategic bundling that targets competitors is not often tried and even less often successful? Some commentators have argued that it is less costly to the monopolist than "traditional" predatory pricing.

Should the minimum foreclosure standards from Section 1 cases apply in Section 2 cases? The trend seems to be against it. One might argue that a monopolist with very few competitors may be able to judge that foreclosing a relatively small percentage of the market would be sufficient to push the competitor over the edge.

The predatory pricing standard is set on the assumption that "an equally efficient competitor" should be able to survive prices that are set at the defendant's average variable cost. Assuming that is the right standard for predatory pricing, why shouldn't we care about the elimination of a somewhat less efficient competitor as a result of strategic bundling decisions? A tougher standard on bundling would not limit the monopolist's ability to price aggressively on a product-by-product basis. Presumably even a less efficient competitor exerts some competitive restraint on the monopolist. Why should we trade a short period of lower prices for consumers as a result of the bundle for less constrained monopoly power in the long term?

As a practical matter, we know that it is virtually impossible to win a predatory pricing case. With the additional complication of multiple products, bundling cases subject to the predatory pricing standard will probably be even more difficult. Given that dominant firms already have a great deal of leeway to price very aggressively with a single product, does the law need to make it so hard to prove a bundling case too?.

While it is not and should not be illegal for someone to have monopoly power, it is not a great thing for society either. While we want to allow a monopolist to compete aggressively, one could argue that it is not wrong to put some constraints on the use of the monopoly product, particularly where it is being used in a way to disadvantage a competitor that could otherwise survive in the market.

One possible variation might be to reverse the burden for the pricing analysis: Rather than imposing the burden of proof on the plaintiff to meet the predatory pricing standard, perhaps we should have a rule that requires the monopolist to prove that it has not exceeded some appropriate objective standard and make it an affirmative defense.

Does it matter whether the bundle is something that was put in place in the ordinary course of business or something that was added to respond to a threat from a competitor?

Where bundling is one of several allegedly exclusionary practices, what effect does the old rule from *Continental Ore v. Union Carbide*, 370 U.S. 690 (1962), against subdividing the plaintiff's proof have today? Obviously, once certain minimum standards are met, the question is how much latitude should we leave to juries?

There are potential legitimate efficiencies that might flow from bundled discounts such as integration efficiencies, economy of scope and distributing product, packaging cost savings, reduced transportation costs, and increased reliability for consumers. Such efficiencies could be asserted as a legitimate business justification. In *LePage's*, the Court allowed the defendant to articulate "legitimate business justifications."

One factor that has been recognized in other contexts is that the use of a given practice and competitive markets tends to suggest that it does have legitimate and pro-competitive qualities. But, the fact that bundling can be pro-competitive does not answer the question whether it is in a particular circumstance.

One of the uses of bundled discounts is to price discriminate, but the economic effect of price discrimination is far from clear. Is it so obviously pro-competitive that it should offset the harm to competition generally?

An important question is the extent to which the Supreme Court's decision in *Weyerhaeuser* forecloses the continued viability of *LePage's*. Although the issues are different, *Weyerhaeuser* is at least an example of the *Brooke Group* standard migrating to other areas.

The *PeaceHealth* Case.

Plaintiff McKenzie is a community hospital. Its theory is that PeaceHealth, a competitor tertiary care hospital, monopolized by offering across-the-board discounts on hospital services, including on services that Plaintiff did not provide. The contracts at issue involved 15% of the commercially insured lives in Lane County. The difference in the *PeaceHealth* proposal was five percent, although it applied to the tertiary services also. After trial, three large health insurance companies objected to an injunction against bundled price discounts. Defendant argued that the critical bundling instruction allows a jury to condemn price-cutting even when (a) it produces savings for consumers; and (b) an equally efficient firm *could* match the discount without selling it at a loss.

Plaintiff argues that *LePage's* was right not to require price/cost proof. It notes that *SmithKline* case did not require proof of an equally efficient producer or beneath cost selling. Plaintiff argues baldly that "Monopolists may not bundle discounts. Its services can and should be sold on their individual merits at whatever discount is negotiated."

The Ninth Circuit invited interested parties to submit amicus briefs on the correct standard to apply, and a number of such briefs were filed. The decision is sure to be important, and the case could easily wind up at the Supreme Court.