

Backing Bundled Discounts After *Brooke Group*: Analyzing the Debate over the Legality of Above-Cost Bundled Discounts

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ABSTRACT: Congress passed the Sherman Act in 1890 to restrain Standard Oil's monopolistic practices. The Act seeks to foster an appropriate level of competition while forbidding overly zealous competition, such as predatory pricing, that excludes fellow competitors from the market. The pricing tactic commonly known as a bundled discount has come under increased scrutiny in recent years. In bundled discounts, companies offer consumers a package of diverse goods for a price that is less than the price of the constituent parts. In Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., a predatory-pricing case brought under the Clayton Act involving an oligopoly market, the Supreme Court held that discounts remaining above an appropriate measure of an antitrust defendant's cost do not violate the Sherman Act. Lower courts have struggled to determine whether courts should extend Brooke Group to cases involving bundled discounts. This Note considers the antitrust theories used to analyze bundled discounts and examines the two circuit court decisions addressing bundled discounts—the decisions of the Third and Ninth Circuits. It then analyzes the circuit split and concludes that the Ninth Circuit's analysis is essentially correct. Finally, this Note adopts the Ninth Circuit's contention that courts should apply Brooke Group to bundled-discount cases and proposes a test to aid courts in determining the appropriate measure of a defendant's cost.

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I. INTRODUCTION

It is 12:01 p.m. and drive-thru speakers all over the nation crackle to life. A group of cash-strapped college students heads to McDonald's. When they reach the speaker, the driver shouts, "four cheeseburgers, three fries, and three Cokes, please." The driver pulls around and the attendant pushes four value meals out the window—each complete with a cheeseburger, fries, and a Coke. "Hey, we're not paying for this food we didn't order! We're broke," the students snarl. The drive-thru attendant calmly replies, "Well, you can either keep the four value meals or pay me another five bucks and I'll keep the extra fry and Coke: the value meal is cheaper."¹ The students thank the attendant for the economics lesson, take the food, and head back to class. Across town, a more health-conscious student is elated to discover that her gym is offering twenty-percent-off dietary counseling with the purchase of three personal-training sessions.²

As the above examples suggest, bundled discounts are ubiquitous in today's society.³ A bundled discount is a pricing strategy whereby a company offers a package of diverse products at a price that is less than the sum of the prices of the bundle's constituent products.⁴ From a consumer's perspective, discounts and price cuts are generally welcome.⁵ From a critic's perspective,

1. See John Thorne, *Discounted Bundling by Dominant Firms*, 13 GEO. MASON L. REV. 339, 341 (2005) (explaining that fast-food value meals are an example of a bundled discount); PREVENTION INST., FROM WALLET TO WAISTLINE: THE HIDDEN COSTS OF "SUPER SIZING," <http://www.preventioninstitute.org/portionsizerept.html> (last visited Oct. 16, 2008) (explaining that the average cost of a Quarter-Pounder Value Meal is \$3.74, while the cost for a customer to purchase the component parts is \$5.03).

2. See Christopher S. Yates & Heather L. Thompson, *Tying, Exclusive Dealing and Refusals to Deal*, in 47TH ANNUAL ADVANCED ANTITRUST SEMINAR—DISTRIBUTION AND MARKETING, at 79, 93 (PLI Corp. L. & Practice Course Handbook Series No. 1648, 2008) (explaining that gyms sometimes offer personal-training packages as bundled discounts).

3. See Brief for Daniel A. Crane et al. as Amici Curiae Supporting Appellant at 12, *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir. 2007) (No. CV-02-06032-HA), available at http://lawprofessors.typepad.com/antitrustprof_blog/files/peacehealth_amicus_brief.pdf (offering fast-food restaurants, grocery stores, telephone companies, book stores, and ski companies as examples of companies that use bundled discounts); Bruce H. Kobayashi, *Two Tales of Bundling: Implications for the Application of Antitrust Law to Bundled Discounts*, in ANTITRUST POLICY AND VERTICAL RESTRAINTS 10, 10 (Robert W. Hahn ed., 2006) [hereinafter ANTITRUST POLICY] (explaining that a wide variety of industries regularly offer bundled discounts).

4. See David S. Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE J. ON REG. 37, 41 (2005) (explaining and defining bundled discounts); Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1689 (2005) (same); ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 82 (2007) [hereinafter AMC REPORT], available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf (same).

5. See Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 EMORY L.J. 423, 473 (2006) (arguing that bundled discounts generally benefit consumers); Herbert Hovenkamp, *Discounts and Exclusions*, 2006 UTAH L. REV. 841, 843 (same); Bruce H. Kobayashi, *Does Economics Provide a Reliable Guide to Regulating Commodity Bundling by Firms? A Survey of the*

however, bundled discounts are just another way for monopolistic companies to temporarily slash prices, push their competitors out of the market, and then recover short-term losses by raising prices.⁶ The courts are currently struggling to determine whether bundled discounts violate the Sherman Act.⁷

This Note focuses on how courts should analyze above-cost bundled discounts. Part II.A defines what courts should and should not consider a bundled discount. Part II.B discusses the statutory antitrust provisions and interpretive case law. Part II.C discusses how companies can use bundled discounts in both a procompetitive and anticompetitive manner. Part III.A details the Supreme Court decision, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*—a decision that has prompted the lower courts' debate over the legality of bundled discounts. Part III.B–C discusses the major opinions from the split between the Third and Ninth Circuits regarding the legality of bundled discounts. Part IV analyzes *Cascade's* implications. Part V proposes a test that would resolve the circuit split. Finally, this Note concludes by arguing that the Supreme Court should adopt a modified version of the Ninth Circuit's test when resolving the circuit split.

II. BACKGROUND

In order to understand the debate surrounding the legality of bundled discounts, it is necessary to analyze how courts and commentators define and categorize the discounts. The interplay between the Sherman Act, the case law, and the scholarly analyses interpreting the Act informs this analysis. An overview of how companies can use bundled discounts in ways that both do and do not violate the Sherman Act illuminates the conflict over what legal standard courts should apply to the discounts. Finally, an analysis of the scholarly commentary on bundled discounts sheds light on the conflict surrounding the legality of bundled discounts.

A. DEFINING BUNDLED DISCOUNTS

Courts and commentators have struggled to define and categorize bundled discounts.⁸ Rather than craft a new test for a new practice, courts

Economic Literature, 1 J. OF COMPETITION L. & ECON. 707, 708 (2005) (same); Lambert, *supra* note 4, at 1726 (same); Thorne, *supra* note 1, at 344 (same).

6. See Hovenkamp, *supra* note 5 (stating that while some discounts may be anticompetitive, the research concluding that the discounts are anticompetitive is often based on misplaced assumptions); Thorne, *supra* note 1, at 345 (surveying critics' arguments against bundled discounts).

7. See *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 903 (9th Cir. 2008) (declining to endorse the Third Circuit's *LePage's* decision and holding that above-cost bundled discounts do not violate the Sherman Act); *LePage's Inc. v. 3M*, 324 F.3d 141, 169 (3d Cir. 2002) (en banc) (holding that above-cost bundled discounts may violate the Sherman Act).

8. See Peter M. Boyle & Sean M. Green, *Courts Struggle to Sort Out Bundled Discounts: Two Circuits and a Congressional Panel Land in Different Places*, NAT'L L.J., Nov. 5, 2007, at 10

unsuccessfully tried to graft their tying jurisprudence to bundled discounts.⁹ In order to advance bundling jurisprudence, courts must disentangle bundles from ties.¹⁰

The Antitrust Commission's 2007 Report and its specific reference to and definition of bundled discounts clarified the distinction between bundles and ties.¹¹ The Commission's Report also firmly established that courts should analyze bundled discounts under section 2 of the Sherman Act.¹² Since courts traditionally apply different legal standards to the two practices, the courts' failure to properly categorize and distinguish the pricing methods has resulted in erroneous condemnation of bundled discounts and has ultimately harmed consumer welfare.¹³

1. Bundling as a Structured Discount

A bundled discount is a form of a structured discount—a pricing strategy that requires a purchaser to do something to get the discount.¹⁴ Professor Herbert Hovenkamp has identified several forms of structured

(discussing the circuit split); Evans & Salinger, *supra* note 4 (distinguishing courts' divergent treatment of bundled discounts and tying arrangements).

9. See *LePage's Inc.*, 324 F.3d at 169–70 (Greenberg, J., dissenting) (criticizing the majority for utilizing a tying analogy); Thomas A. Lambert, *Markets and the Law: Weyerhaeuser and the Search for Antitrust's Holy Grail*, 2007 CATO SUP. CT. REV. 277, 277–81 (explaining the legal standards for tying arrangements and bundled discounts).

10. See AMC REPORT, *supra* note 4 (analyzing bundled discounts and tying arrangements separately).

11. *Id.* Recognizing the need for clarity in the antitrust field, Congress established the Antitrust Modernization Commission in 2002. Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-23, 116 Stat. 1856. The Commission submitted its report to Congress and the President on April 2, 2007. AMC REPORT, *supra* note 4, at 1.

12. AMC REPORT, *supra* note 4 (discussing the commission's recommended analytical framework).

13. *Id.* at 83 (stating that the lack of clear bundling standards is discouraging companies from offering bundled discounts and harming consumers).

14. Hovenkamp, *supra* note 5, at 850 (distinguishing bundled discounts from tying arrangements). The key to distinguishing between a tie and a bundled discount lies in the concept of coercion. *Id.* In a true tying arrangement, the necessary coercion element is established by virtue of the tie. *Id.* In a tie, the company offering the tie does not offer the tying product—the product the company has monopolized—without the tied product. *Id.* Any consumer who wishes to purchase the tying product is essentially coerced into purchasing the tied product as well. *Id.* A company that offers a bundled discount continues to offer all of the constituent products of the bundle individually. If the consumer does not want both the products in a bundle, he or she can choose to buy the products individually, albeit at a higher price. *Id.* Many commentators further distinguish bundles into mixed bundles, products that are offered separately or together, and pure bundles, products that are only offered as packages. See Evans & Salinger, *supra* note 4, at 54 (distinguishing between different types of bundling practices). Since this classification tends to collapse the two different practices, this Note distinguishes between bundles and tying arrangements. This Note discusses the bundles that Evans and Salinger classify as mixed bundles.

discounts including: slotted discounts,¹⁵ market-share discounts,¹⁶ and bundled discounts.¹⁷ Although Hovenkamp recognizes that “bundled discounts are a different competitive animal,” he ultimately argues, as will this Note, that above-cost structured discounts benefit consumers.¹⁸

A bundled discount is a seller’s practice of offering two or more goods or services as a package for a lower price than the price of the constituent parts in the package.¹⁹ A seller, for example, could offer products A and B as a \$5.00 bundle, whereas the same seller would charge \$3.00 for item A and \$3.00 for item B if the consumer chose to purchase the products individually.²⁰ A bundled discount’s distinguishing feature is that the consumer is able—unlike in the case of other bundle-like discounts—to choose whether she receives the discount. The consumer can choose to capitalize on the discount by purchasing the products together, or forgo the discount and purchase some or all of the items individually.²¹ The Supreme Court has not expressly spoken on the legal standard a court should apply to bundled discounts, and lower courts continue to grapple with it.²²

15. See Thomas A. Lambert, *Tweaking Antitrust’s Business Model*, 85 TEX. L. REV. 153, 173–75 (2006) (reviewing HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION* (2005)) (categorizing discounts and defining a slotted discount as a strategy that allows a company to require a manufacturer to give a retail store a discount for allowing the manufacturer to place its products on the retailer’s shelf).

16. See *id.* (defining market-share discounts as a practice that enables a purchaser to obtain a discount in exchange for purchasing a predetermined share of its requirements for a particular product).

17. See *id.* (defining bundled discounts).

18. See *id.* at 174 (arguing that most discounts benefit consumers).

19. See *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 913 (9th Cir. 2007) (defining bundled discounts); Crane, *supra* note 5, at 55 (same); Daniel A. Crane, *Multiproduct Discounting: A Myth of Nonprice Predation*, 72 U. CHI. L. REV. 27, 28 (2005) (using terminology such as “multiproduct discounting” and “package discounting” to discuss bundled discounts); Evans & Salinger, *supra* note 4, at 41 (same); Lambert, *supra* note 4, at 1693 (same).

20. See *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996) (providing a similar example of a bundled discount); Lambert, *supra* note 4, at 1696 (same).

21. Hovenkamp, *supra* note 5; *supra* text accompanying note 5.

22. See, e.g., *Cascade Health*, 502 F.3d at 905 (examining bundled discounts in the healthcare field); *LePage’s Inc. v. 3M*, 324 F.3d 141, 154–57 (3d Cir. 2003) (en banc) (discussing the legality of 3M’s tiered-rebate program that offered a rebate to consumers who purchased a predetermined number of products across particular lines); *Invacare Corp. v. Respironics, Inc.*, No. 1:04 CV 1580, 2006 WL 3022968, at *10–12 (N.D. Ohio Oct. 23, 2006) (discussing the legality of bundling medical products where one product is required for the proper functioning of the other); *Masimo Corp. v. Tyco Health Care Group*, No. CV 02-4470 MRP, 2006 U.S. Dist. Lexis 29977, at *13–20 (C.D. Cal. Mar. 22, 2006) (discussing the legality of rebates Tyco offered to hospitals if they agreed to purchase two products from different lines); *J.B.D.L. Corp. v. Wyeth-Averst Labs., Inc.*, No. 1:01-CV-704, 2005 U.S. Dist. LEXIS 11676, at *43–49 (S.D. Ohio June 13, 2005) (discussing the legality of offering pharmaceutical drugs as a bundled discount); Neal R. Stoll & Shepard Goldfein, *Brooke Group’ Test on Multiproduct Discounting Nears?*, N.Y. L.J., Oct. 16, 2007, at 1–2 (2007), available at <http://www.skadden.com/>

2. Non-Bundling Structured Discounts

Bundled discounts are distinguishable from both tying arrangements and volume discounts.²³ Although all these pricing strategies are conditional, the conditions they depend upon vary.²⁴ In bundled discounts, the condition requires a consumer to purchase all the bundled products to get the discount.²⁵ In a tying arrangement, a consumer who wants product A, the tied product, must also purchase product B, the tying product.²⁶ In a volume-discount situation, the condition requires a consumer to purchase a particular amount of product A to get the discount.²⁷

A pair of shoes, for example, is a tied product.²⁸ A store generally does not allow a consumer to purchase the left shoe without the right shoe,²⁹ even though some consumers may prefer to purchase just the left shoe—“perhaps [those consumers] with no right leg or with a dog who has eaten their left shoe.”³⁰ In contrast, if a store offered shoes as a bundled discount, a consumer could purchase either the left or the right shoe, but the store would offer a discount only to consumers who purchased both shoes.³¹ By focusing on the condition on which each pricing practice depends, courts can distinguish the various structured discounts and subject them to the

content%5CPublications%5CPublications1327_0.pdf (commenting on the lack of Supreme Court guidance in the bundled-discount context).

23. See Alan Devlin, *A Neo-Chicago Perspective on the Law of Product Tying*, 44 AM. BUS. L.J. 521, 523 (2007) (distinguishing bundled discounts from tying discounts); Thorne, *supra* note 1, at 339 (same); J. Thomas Rosch, Comm’r, Fed. Trade Comm’n, Address at the George Mason Law Review 11th Annual Antitrust Symposium: The Common Law of Section 2: Is It Still Alive and Well? 9–10 (Oct. 31, 2007), available at <http://www.ftc.gov/speeches/rosch/071031gmlr.pdf> (discussing the different standards applicable to various types of bundles and rebates).

24. See Devlin, *supra* note 23 (distinguishing bundled discounts from tying discounts).

25. See *Cascade*, 502 F.3d at 903 (explaining that in order to get the discount at issue in *Cascade*, an insurance company had to purchase primary, secondary, and tertiary services from a single hospital).

26. See *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5–6 (1958) (defining tying arrangements). The Supreme Court stated:

For our purposes, a tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchase a different (or tied) product, or at least agrees that he will not purchase [the tied product] from any other supplier.

Id.

27. See *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1044 (8th Cir. 2000) (explaining a discount that a manufacturer conditioned on the purchase of a particular amount of motors).

28. See *Evans & Salinger*, *supra* note 4, at 83 (discussing the practice of “competitive tying” and its benefits to both producers and consumers); Thorne, *supra* note 1, at 339 (distinguishing “bundled discounts” from “tying arrangements”).

29. *Evans & Salinger*, *supra* note 4, at 42.

30. *Id.* at 41.

31. *Id.*

appropriate level of scrutiny.³² Of these three practices, courts subject tying—as they should—to the highest level of scrutiny because tying impairs consumer choice the most.³³ A consumer who wants the tied product may not even want the other product that goes with it.³⁴

The Supreme Court has continued to hold that a monopolist company with substantial market power over the tying product³⁵—the product the consumer wants to purchase—violates the Sherman Act if the monopolist only offers the tying product as a bundle to consumers that are willing to purchase the tied product.³⁶ In holding that many tying arrangements violate the Sherman Act, the Supreme Court has repeatedly stated:

‘[T]ying arrangements serve hardly any purpose beyond the suppression of competition.’ . . . They deny competitors free access to the market for the tied product, not because the party imposing the tying requirement has a better product or a lower price but because of [the seller’s] power or leverage in another market. . . . [B]uyers are [also] forced to forego their free choice between competing products.³⁷

Based on the Supreme Court’s condemnation of tying,³⁸ it is easy to see how a court’s failure to properly categorize and distinguish bundled discounts from tying can lead to the erroneous condemnation of bundled discounts.³⁹

32. See *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 927 (9th Cir. 2007) (focusing on whether the condition a manufacturer attaches to a particular type of discount is coercive).

33. The courts have traditionally held that monopolistic tying is illegal per se. See *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 344 (1982) (arguing that tying constitutes an impermissible restraint on trade and is therefore illegal per se).

34. Bundled discounts restrict consumer choice less because they do not prohibit consumers from purchasing the products individually. A McDonald’s customer, for example, remains free to purchase french fries or a Big Mac separately, even though McDonald’s offers both products in a value meal. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 36 (1984) (recognizing that the practice of offering certain products or services together for a reduced price benefits consumers); Daniel L. Rubinfeld, *3M’s Bundled Rebates: An Economic Perspective*, 72 U. CHI. L. REV. 243, 244–45 (2005) (arguing that bundled discounts are procompetitive).

35. See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* 397–98 (3d ed. 2005). Courts vary in regard to what constitutes substantial or sufficient market power. *Id.* In *Jefferson Parish Hospital District No. 2 v. Hyde*, the Supreme Court did state that “30 percent [market foreclosure] was insufficient to meet this requirement on the facts of that case.” *Id.*

36. See *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 6 (1958) (explaining that monopolistic tying restrains competition in violation of the Sherman Act).

37. *Id.* (quoting *Standard Oil Co. v. United States*, 337 U.S. 293, 305–06 (1949)).

38. See *Crane*, *supra* note 5, at 427–28 (explaining that courts made numerous errors in the early days of tying analysis).

39. *Id.*

B. ANTITRUST PROVISIONS AND CASE LAW INTERPRETING THE SHERMAN ACT

Section 2 of the Sherman Act states that it is a felony to “monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of trade or commerce”⁴⁰ When examining a bundled discount, it is important to note that section 2 prohibits the *attempt* to form a monopoly.⁴¹ Unfortunately, the Sherman Act never defines the term “monopolize,”⁴² and the legislative history of the Sherman Act does little to illuminate the term.⁴³ In *United States v. E.I. du Pont de Nemours & Co.*, the Supreme Court did what Congress failed to do when it passed the Sherman Act: it defined “monopoly.”⁴⁴ Monopoly power is “the power to control prices or [to] exclude competition.”⁴⁵ In *United States v. Grinnell Corp.*,⁴⁶ the Court established the elements of the monopoly offense that constitute a violation of section 2.⁴⁷ Under section 2 of the Act, a plaintiff seeking to establish a monopoly offense must prove two elements: “(1) the possession of monopoly power in the relevant market and (2) willful acquisition or maintenance of that power as distinguished from

40. 15 U.S.C. § 2 (Supp. V 2005). Section 2 of the Sherman Act states:

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$100,000,000 if a corporation, or, if any other person, \$1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

Id.

41. *Id.*

42. See *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 386–88 (1956) (discussing the fact that the Sherman Act is couched in broad terms). Courts generally agree that the Sherman Act was designed to protect free enterprise and competition. *Standard Oil Co. v. United States*, 221 U.S. 1, 50–51 (1911); see 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION § 103d (3d ed. 2006) (explaining that the Sherman Act’s legislative history is particularly poor and scholars must glean meaning from judicial interpretation of the Act rather than the statute’s legislative history); ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 20 (Free Press 1993) (1978) (explaining that the Act was designed to attack Standard Oil’s predatory business tactics); HOVENKAMP, *supra* note 35, at 50–51 (explaining that the legislative history of the Sherman Act supports the contention that the Act was designed to protect consumers from high prices). Thus, courts, as will this Note, often use the term “procompetitive” to describe conduct that does not violate the Sherman Act.

43. See HOVENKAMP, *supra* note 35, at 50 (explaining the Sherman Act’s purpose).

44. *E.I. du Pont de Nemours & Co.*, 351 U.S. at 391 (defining monopoly).

45. *Id.*

46. *United States v. Grinnell Corp.*, 384 U.S. 563 (1966).

47. See *id.* at 570–71 (setting forth the elements an antitrust plaintiff must establish in order to prove that the defendant has a monopoly over a particular product or sector of the market).

growth or development as a consequence of a superior product, business acumen, or historic accident.”⁴⁸

In addition to prohibiting monopolization, the Sherman Act prohibits “attempted monopolization.”⁴⁹ In *Spectrum Sports, Inc. v. McQuillan*, the Court articulated a three-pronged test to determine whether a firm has attempted to monopolize a market.⁵⁰ “[T]o demonstrate attempted monopolization a plaintiff must prove (1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power.”⁵¹ An attempted-monopoly claim thus requires proof of specific intent to monopolize the market,⁵² while an actual-monopoly claim does not.⁵³ Due to the difficulties inherent in proving specific intent where the intended result—monopoly power over a particular product—has not yet occurred, plaintiffs alleging such a violation often have a difficult time succeeding.⁵⁴

The Sherman Act’s purpose is to exclude impermissible competition, not meritorious competition.⁵⁵ Consequently, proof that a defendant offering a discount has, or is attempting to gain, a monopoly over one of the products is necessary but not sufficient proof that the defendant is violating the Sherman Act.⁵⁶ A plaintiff must also prove that the defendant’s monopoly is the result of impermissible conduct and not simply attributable to the defendant’s ability to offer higher-quality products at lower prices.⁵⁷ Thus, for a section 2 claim, courts hold that a dominant company must take

48. *Id.* at 570–71; *see also* *Verizon Commc’ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004) (restating and applying the test); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 595–96 (1985) (same).

49. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 454 (1992).

50. *Id.* at 456.

51. *Id.*

52. *See* *Swift & Co. v. United States*, 196 U.S. 375, 396 (1906) (explaining that where the defendant has not succeeded in monopolizing the market, a plaintiff seeking to hold a defendant liable for antitrust violations must prove that the defendant has both specific intent to monopolize the market and a substantial probability of doing so).

53. *See* *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 432 (2d Cir. 1945) (holding that a plaintiff relying on the defendant’s actual monopoly is not required to prove the defendant’s specific intent to achieve monopoly control over a market).

54. *See* J. Thomas Rosch, Comm’r, Fed. Trade Comm’n, Address at the Conference on Current Topics in Antitrust and Competition Policy 2–3 (June 13, 2007), *available at* <http://www.ftc.gov/speeches/rosch/070613verticalrestraints.pdf> (explaining that antitrust plaintiffs in the tying context have historically experienced difficulty prevailing on section 2 claims if they could not prove that the defendant had monopoly power).

55. *See* 1 AREEDA & HOVENKAMP, *supra* note 42, § 100a (explaining congressional intent in regards to the purpose of the Sherman Act).

56. *See* Rosch, *supra* note 54 (explaining that antitrust plaintiffs in the tying context have historically experienced difficulty prevailing on a section 2 claim if they could not prove that the defendant had monopoly power).

57. *Id.*

affirmative, impermissible action that results in an impermissible exclusion of another company.⁵⁸ Impermissible exclusionary conduct is “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.”⁵⁹

C. VARIOUS BUNDLED-DISCOUNT USES

In order to protect consumer welfare,⁶⁰ courts must carefully distinguish between firms’ use of bundled discounts for procompetitive or competitive-neutral reasons⁶¹ and firms’ use of bundled discounts for anticompetitive reasons.⁶² Although bundled discounts are distinguishable from tying arrangements,⁶³ they share some of the same characteristics, including the potential for creating exclusionary effects.⁶⁴ Courts originally condemned tying practices that actually may have been procompetitive,⁶⁵ only to later learn the error of their ways.⁶⁶ In order for courts to avoid “creating liability rules [that are] hostile to a pervasive and generally

58. *Id.*

59. *Aspen Skiing Co. v. Highlands Skiing Corp.*, 472 U.S. 585, 605 n.32 (1985) (quoting 3 PHILLIP E. AREEDA & DONALD F. TURNER, *ANTITRUST LAW* 78 (1978)).

60. Consumer welfare is a term that is difficult to define. *See* Charles F. (Rick) Rule, Statement for the Hearing of the Antitrust Modernization Commission, Treatment of Efficiencies in Merger Enforcement 2–6 (Nov. 17, 2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Statement-Rule.pdf. Courts seem to think consumer welfare is maximized when consumers can get more for less. *Id.* at 5. Critics argue that antitrust theory should revert to the more nuanced definition of consumer welfare that Judge Bork advocated during the Reagan administration. *Id.* at 2. Bork’s definition of consumer welfare is based on the premise that consumer welfare is maximized by facilitating and promoting competition. *Id.*; *see also* Donald Dewey, *Antitrust and Economic Theory: An Uneasy Friendship*, 87 *YALE L.J.* 1516, 1516–17 (1978) (reviewing ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978)).

61. *See* U.S. DEP’T OF JUSTICE, *ANTITRUST ENFORCEMENT AND THE CONSUMER* 3, available at http://www.usdoj.gov/atr/public/div_stats/1638.pdf (last visited Feb. 9, 2009). The report notes:

An unlawful monopoly exists when only one firm provides a product or service, and it has become the only supplier not because its product or service is superior to others, but by suppressing competition with anticompetitive conduct. The Act is not violated simply when one firm’s vigorous competition and lower prices take sales from its less efficient competitors; rather, that is competition working properly.

Id.

62. *Id.*

63. *See supra* Part IIA.2 (explaining that bundled discounts require the consumer to purchase all of the products to receive the discount, whereas tying arrangements require the consumer who wants one product to purchase an additional product).

64. *Id.*

65. *See* Crane, *supra* note 5, at 424 (arguing that courts must carefully analyze bundled discounts in order to avoid hindering competitive practices that benefit consumers).

66. *Id.*

procompetitive practice,⁶⁷ the courts must carefully determine the rationale behind a company's decision to use bundled discounts.⁶⁸

1. Procompetitive Bundled-Discount Uses

There is substantial evidence to support the contention that bundled discounts are procompetitive.⁶⁹ The Antitrust Modernization Committee's ("AMC") 2007 report states that "virtually everyone . . . agree[s] that bundling is pro-consumer."⁷⁰ Scholars have identified three main reasons why bundled discounts are procompetitive: (1) they offer companies an opportunity to maximize cost efficiency;⁷¹ (2) they increase customer choice;⁷² and (3) they provide companies with a low-cost marketing alternative.⁷³

a. Maximizing Cost Efficiency

Companies use bundled discounts as a procompetitive tool to pass cost-efficiency savings from reduced transaction costs on to the consumer.⁷⁴ Transaction costs are the costs that the company incurs to deliver the product to the consumer.⁷⁵ If a consumer buys two products together, as a bundle, it generally costs less to deliver the two products as a package than it would to deliver the products separately.⁷⁶ The company is then able to pass some of these transaction-cost savings on to the consumer, and both parties benefit.⁷⁷

This phenomenon is best demonstrated by Amazon.com's practice of offering consumers who purchase one book the opportunity to purchase a second book at a lower price than it would cost to purchase the books

67. *Id.* at 429.

68. *Id.*

69. AMC REPORT, *supra* note 4, at 94–95 (explaining that bundled discounts reward efficiency and generally benefit consumers).

70. *Id.*

71. *See* Crane, *supra* note 5, at 431–32 (explaining that companies can save transaction costs by bundling).

72. *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIV., ROUNDTABLE ON BUNDLED AND LOYALTY DISCOUNTS AND REBATES 3 (2008), available at <http://www.usdoj.gov/atr/public/international/234014.pdf> (explaining the benefits of bundled discounts); *see also* Thorne, *supra* note 1, at 343 (arguing that bundled discounts benefit consumers because they allow for a consumer's optimal selection of goods).

73. *See* AMC REPORT, *supra* note 4, at 95 (discussing the procompetitive benefits of bundled discounts).

74. *See id.* (explaining how bundled discounts can reduce various transaction costs).

75. *Id.*

76. *Id.*

77. *Id.*

separately.⁷⁸ When an Amazon customer orders a book, an employee has to retrieve it, package it, mail it, and process the buyer's payment.⁷⁹ If a customer chooses to purchase more than one book at a time, an Amazon employee saves time because he or she only walks back to the warehouse once, packs and ships the goods together, and generates one invoice.⁸⁰ The customer then gets to pocket some of Amazon's cost savings.⁸¹

If Congress passed the Sherman Act to protect consumers, then courts should reward companies such as Amazon that create efficiencies that allow for bundled discounts.⁸² Courts that strike down bundled discounts continually state that bundled discounts are problematic because they have the potential to exclude an equally efficient rival.⁸³ To the extent that a bundled discount excludes a rival from the market because the rival failed to foresee consumers' demand for both products or failed to streamline its delivery systems, market-based efficiency suggests that the rival should not receive a court's sympathy.⁸⁴ Bundled discounts, such as those that Amazon offers, are based on efficient processing and are the type of procompetitive discounts the antitrust laws should reward.⁸⁵

b. Increasing Customer Choice

Another reason companies use bundled discounts is to increase customer choice⁸⁶ while minimizing transaction costs.⁸⁷ Unlike tying arrangements, where a consumer can only purchase one package for one set price (e.g., A and B together for \$5.00), bundled discounts increase a consumer's choice because he or she can purchase product A for \$3.00,

78. See *Crane*, *supra* note 5, at 431–32 (explaining how e-commerce companies such as Amazon.com use bundled discounts to reduce transaction costs and then pass on the savings to consumers).

79. *Id.* at 431.

80. *Id.*

81. *Id.* at 431–33.

82. See *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 895 (9th Cir. 2008) (arguing that bundled discounts provide significant transaction-cost savings and that courts should not condemn above-cost discounts).

83. See *LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc) (arguing that the potential exclusion of an equally efficient rival justifies the court's holding that an above-cost bundled discount may violate the Sherman Act).

84. See *id.* at 175–76 (Greenberg, J., dissenting) (arguing that a plaintiff's claim that an above-cost discount violates the Sherman Act merely because it has the *potential* to exclude an equally efficient rival should not succeed).

85. See *Crane*, *supra* note 5, at 431–32 (explaining the benefits of bundled discounts).

86. See *Thorne*, *supra* note 1, at 343 (arguing that bundled discounts benefit consumers because they allow for a consumer's optimal selection of goods).

87. See *Crane*, *supra* note 5, at 432 (discussing bundled discounts and transaction-cost savings).

product B for \$3.00, or products A and B together for \$5.00.⁸⁸ The bundles thus increase the constellations of potential product matches while decreasing the consumer's total cost to purchase them.⁸⁹ The story of the students at McDonald's in the introduction of this Note is an excellent example of how this plays out.⁹⁰ McDonald's practice of offering value meals gives the consumer more choices at lower prices while maximizing both the consumer's and McDonald's efficiency.⁹¹

c. Marketing

Scholars have recognized and applauded bundled discounts because they provide companies with low-cost marketing.⁹² New entrants to a market use bundled-discount marketing as a tool to attract new customers.⁹³ Established companies use the discounts to launch new products because consumers are more likely to buy a new product if it is packaged with a product they already use.⁹⁴ Firms' use of bundled discounts is also beneficial because the practice allows companies to take more risks when a new product is part of a bundled-marketing campaign.⁹⁵ The discounts allow companies to cast a wider net and capture more customers,⁹⁶ even if the company made an error in forecasting customers' desire for one of the bundled products.⁹⁷ The following hypothetical provides an example of this technique. Assume that Big Corporation sells products A and B. Big Corporation has two potential customers who both need to purchase A and B.⁹⁸ Customer 1 is willing to pay \$3.00 for A and \$3.00 for B.⁹⁹ Customer 2 is willing to pay \$4.00 for A, but only \$2.00 for B.¹⁰⁰ Big Corporation can offer A and B as a \$5.00 bundle, priced at the overlap, and capture both the

88. See Thorne, *supra* note 1, at 343 (discussing the benefits of bundles in comparison to tying arrangements).

89. *Id.*

90. See *supra* Part I (noting that McDonald's offers consumers bundled discounts—value meals that contain a sandwich, a drink, and an order of fries—for less than the sum of the prices of the constituent products).

91. See Thorne, *supra* note 1, at 342–43 (stating that “bundled discount programs . . . are beneficial to consumers and economically efficient” and listing the ways bundled discount programs make firms more efficient).

92. See AMC REPORT, *supra* note 4, at 95 (discussing the procompetitive benefits of bundled discounts).

93. *Id.*

94. *Id.*

95. See Hovenkamp, *supra* note 5, at 858–59 (explaining that bundled discounts allow companies to capture more consumers because they allow companies to have a wider margin of error when forecasting variability in consumer price discrimination).

96. *Id.*

97. *Id.*

98. See *id.* (discussing a similar hypothetical in further detail).

99. *Id.* at 858–59.

100. Hovenkamp, *supra* note 5, at 858–59.

customers.¹⁰¹ Big Corporation's use of a bundled discount allows it to maintain its cost-shifting ability between products A and B while simultaneously capturing two customers with divergent price ceilings.

2. Anticompetitive Bundled-Discount Uses

Unfortunately, companies can also use bundled discounts in an anticompetitive manner.¹⁰² Scholars have identified two main reasons why bundled discounts may be anticompetitive: (1) the discounts may constitute predatory pricing¹⁰³ and (2) companies can use the discounts to exclude new entrants to the market.¹⁰⁴

a. Predatory-Pricing Tool to Exclude Existing Rivals

Companies can use bundled discounts as a predatory-pricing tool to exclude an existing equally efficient rival.¹⁰⁵ Predatory pricing is a price "that is profitable only because of the added market power the predator

101. *Id.*

102. *See* Crane, *supra* note 5, at 443–48 (discussing anticompetitive uses of bundled discounts).

103. *See* AMC REPORT, *supra* note 4, at 95–96 (discussing anticompetitive uses of bundled discounts).

104. *Id.*

105. *See* Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 907 (9th Cir. 2007) (explaining that companies can use bundled discounts in a manner that hinders competition). Courts, including the Ninth Circuit, often refer to the following hypothetical, which the Southern District of New York originally set forth, to illustrate the contention that bundled discounts can be used to hinder competition:

Assume for the sake of simplicity that the case involved the sale of two hair products, shampoo and conditioner, the latter made only by A and the former by both A and B. Assume as well that both must be used to wash one's hair. Assume further that A's average variable cost for conditioner is \$2.50, that its average variable cost for shampoo is \$1.50, and that B's average variable cost for shampoo is \$1.25. B therefore is the more efficient producer of shampoo. Finally, assume that A prices conditioner and shampoo at \$5 and \$3, respectively, if bought separately but at \$3 and \$2.25 if bought as part of a package. Absent the package pricing, A's price for both products is \$8. B therefore must price its shampoo at or below \$3 in order to compete effectively with A, given that the customer will be paying A \$5 for conditioner irrespective of which shampoo supplier it chooses. With the package pricing, the customer can purchase both products from A for \$5.25, a price above the sum of A's average variable cost for both products. In order for B to compete, however, it must persuade the customer to buy B's shampoo while purchasing its conditioner from A for \$5. In order to do that, B cannot charge more than \$0.25 for shampoo, as the customer otherwise will find A's package cheaper than buying conditioner from A and shampoo from B. On these assumptions, A would force B out of the shampoo market, notwithstanding that B is the more efficient producer of shampoo, without pricing either of A's products below average variable cost.

Id. (referring to Ortho Diagnostics Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455, 467 (S.D.N.Y. 1996)).

gains from . . . inhibiting the competitive conduct of a rival.”¹⁰⁶ Exclusion of an equally efficient rival harms consumers because competition results in higher quality, lower-priced, and more innovative products.¹⁰⁷

Assume, for example, that most customers want to purchase both products A and B.¹⁰⁸ Both Big Corporation and Small Corporation offer A, but only Big Corporation offers A and B as a bundled discount.¹⁰⁹ Small Corporation, which only sells A, may be unable to compete effectively with Big Corporation because of the discount.¹¹⁰ If Big Corporation offers the discount for a substantial period of time, Big Corporation could permanently exclude Small Corporation from the market, even though Small Corporation is the most efficient producer of product A.¹¹¹ The following hypothetical illustrates this phenomenon.¹¹² Assume that it costs Big Corporation \$2.00 to make product A, but it only costs Small Corporation \$1.00 to make product A.¹¹³ Assume also that Big Corporation sells product B for \$3.00, but offers a bundle of product A and B for \$5.00. Assuming a \$1.00 markup on product A, Big Corporation could sell product A for \$3.00, but Small Corporation could only afford to sell A for \$2.00.¹¹⁴ If Small Corporation sells the product for more than \$2.00, it will lose most of its customers to Big Corporation, assuming customers still need to purchase products A and B in relatively equal quantities. If Big Corporation were not offering the bundled discount, consumers would reward Small Corporation’s efficiency and ability to offer a lower price by purchasing product A from Small Corporation, the most efficient manufacturer of product A.¹¹⁵ Unfortunately, since Big Corporation is offering the discount, Small Corporation will probably not be able to compete.¹¹⁶ Small Corporation will only be able to compete effectively if it can sell product A for a price that is not only lower than Big Corporation’s price for product A, but *also* allows consumers to purchase product B at the individual price from Big Corporation or another competitor.¹¹⁷

106. Christopher S. Ponder, *The Dubious Value of Hatch-Waxman Exclusivity*, 45 HOUS. L. REV. 555, 571 (2008).

107. Kimberly L. Herb, *The Predatory Pricing Puzzle: Piecing Together a Unitary Standard*, 64 WASH. & LEE L. REV. 1571, 1574 (2007).

108. See *Ortho Diagnostics Sys.*, 920 F. Supp. at 467 (setting forth a similar example).

109. *Id.*

110. *Id.* (explaining potential market inefficiencies that may result from the use of bundled discounts).

111. *Id.*

112. *Id.* (setting forth a similar example).

113. See *Ortho Diagnostics Sys.*, 920 F. Supp. at 467.

114. *Id.*

115. *Id.*

116. See AMC REPORT, *supra* note 4, at 95–96 (explaining the concept of de facto tying).

117. See Hovenkamp, *supra* note 5, at 858 (explaining potential inefficiencies that may result from the utilization of bundled discounts).

b. *Predatory-Pricing Tool to Exclude New Entrants*

Companies can also use a bundled discount to exclude new companies from entering the market.¹¹⁸ Assume, for example, that Big Corporation has a monopoly over product A, but not over related product B.¹¹⁹ Small Corporation wants to enter the product B market.¹²⁰ Big Corporation can potentially use a discount to exclude Small Corporation from the product B market.¹²¹ This can occur because Big Corporation can transfer some of its potential loss on product B to product A, its monopoly product.¹²² Small Corporation may not have a diversified product line and thus may not be able to absorb the cost of the discount in the same manner.¹²³ If Small Corporation does not have another way to subsidize the short-term loss, it may decide not to enter the market.¹²⁴

III. APPLICABLE CASE LAW

Lower courts' discussions about the legality of bundled discounts focuses on the implications of the Supreme Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*¹²⁵ In *Brooke Group*, the Court held that a pricing scheme is per se lawful as long as the single-firm discount remains above the defendant's average-variable cost.¹²⁶ Unfortunately, the *Brooke Group* parties agreed to use the average-variable-cost measure.¹²⁷ Thus, the Supreme Court did not have an opportunity to resolve the lower courts' struggles regarding the appropriate measure of an antitrust defendant's cost.¹²⁸

The parties in *Brooke Group* were involved in an oligopoly and the plaintiff brought its predatory-pricing claim under the Clayton Act.¹²⁹ As a result, lower courts have struggled to determine whether the *Brooke Group* rule should extend to bundled discounts, and if so, how the courts should

118. See AMC REPORT, *supra* note 4, at 95–96 (explaining anticompetitive uses of bundled discounts).

119. See *id.* at 96 (providing a similar example).

120. *Id.*

121. *Id.*

122. *Id.*

123. See AMC REPORT, *supra* note 4, at 96 (explaining anticompetitive uses of bundled discounts).

124. *Id.*

125. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). For cases discussing the Court's *Brooke Group* decision, compare *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 908–25 (9th Cir. 2007), with *LePage's Inc. v. 3M*, 324 F.3d 141, 147 (3d Cir. 2003) (en banc).

126. *Brooke Group*, 509 U.S. at 219–30, 243.

127. *Id.* at 222.

128. *Id.* at 222 n.1 (declining to discuss the appropriate measure of cost).

129. *Id.* at 216–20.

calculate the defendant's cost.¹³⁰ In fact, the lower courts have struggled to formulate any uniform, workable framework for analyzing bundled discounts.¹³¹ Although the lower courts agree that the purpose of the Sherman Act is to deter companies from using impermissible exclusionary conduct, the courts disagree as to whether the use of bundled discounts promotes or inhibits that goal.¹³² Courts that believe bundled discounts are a beneficial form of competition have used predatory-pricing rules similar to those the *Brooke Group* Court used to uphold bundled discounts.¹³³ Those courts that view bundled discounts as a form of anticompetitive, exclusionary conduct have used general section 2 standards to strike down bundled discounts.¹³⁴

Thus far, the Third and Ninth Circuits have weighed in on the bundled-discount debate and have come to different conclusions regarding antitrust liability. The Ninth Circuit held that courts should extend the Supreme Court's *Brooke Group* rule to bundled-discount cases that plaintiffs bring under section 2 of the Sherman Act.¹³⁵ The Third Circuit, with then-Judge Alito dissenting, held that courts should not extend the *Brooke Group* rule to bundled discounts.¹³⁶

The *Brooke Group* case is vital to understanding the circuits' disagreement as to what legal standard courts should use when analyzing bundled-discount cases. Accordingly, this Part will discuss the *Brooke Group* decision, the Third Circuit's *LePage's* decision, and the Ninth Circuit's recent decision in *Cascade Health*.

A. BROOKE GROUP LTD. V. BROWN & WILLIAMSON TOBACCO CORP.: THE SUPREME COURT HOLDS THAT ABOVE-COST PRICE REDUCTIONS ARE PER SE LEGAL

In *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,¹³⁷ the Court held that a predatory-pricing plaintiff must prove two elements in order to succeed in a Clayton Act claim.¹³⁸ First, the plaintiff must prove that the defendant's prices are below an appropriate measure of its costs.¹³⁹ Second,

130. See *supra* note 125 (setting forth the Supreme Court's decision and the subsequent circuit split).

131. *Id.*

132. See *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 906–14 (9th Cir. 2007) (discussing the lower courts' difficulty in determining the appropriate test).

133. *Id.*

134. See *LePage's Inc. v. 3M*, 324 F.3d 141, 144, 147 (3d Cir. 2003) (en banc) (holding that above-cost bundled discounts may violate the Sherman Act).

135. See *Cascade Health*, 502 F.3d at 913–14 (extending the *Brooke Group* rule to cases that plaintiffs bring under section 2 of the Sherman Act).

136. See *LePage's*, 324 F.3d at 147 (refusing to extend the *Brooke Group* rule to cases plaintiffs bring under section 2 of the Sherman Act).

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

138. See *id.* at 222–24 (setting forth the elements of a section 2 violation).

139. *Id.* (explaining the first prong of the test).

the plaintiff must prove that the defendant had a “dangerous probability” of recouping its lost profits.¹⁴⁰ The Court supported its inclusion of the second prong by reasoning that an antitrust defendant that has no probability of recouping below-cost prices is only hurting itself and has not committed a recognizable antitrust violation.¹⁴¹

Brooke Group, previously known as Liggett, is a cigarette manufacturer.¹⁴² The cigarette market operates as an oligopoly with six firms controlling the prices.¹⁴³ The cigarette market’s oligopoly structure is largely attributable to a 1908 district court’s determination that antitrust laws required the district court to split a family-owned company into four domestic companies and two foreign companies.¹⁴⁴ In the oligopoly, there was little price competition between the rival firms.¹⁴⁵ “[P]rices [that members of the oligopoly charge] increase[] in lockstep, twice a year . . . irrespective of the rate of inflation, changes in the cost of production, or shifts in consumer demand.”¹⁴⁶ In the 1980s, however, consumer demand for cigarettes decreased and the companies suffered losses; yet, due to the oligopoly, no firm was willing to be the first to reduce prices.¹⁴⁷

In 1980, Liggett broke step with the oligopoly and manufactured generic cigarettes that it sold for significantly less than the other companies’ brand-name cigarettes.¹⁴⁸ By 1984, Liggett captured approximately four percent of the total market.¹⁴⁹ Brown & Williamson, a company that held approximately twelve percent of the market, responded to Liggett’s success by offering its own lower-priced generics that were substantially similar to Liggett’s generics.¹⁵⁰ This forced Liggett to reduce the price of its generics in order to remain competitive.¹⁵¹ Finally, Brown & Williamson ended the price war by offering retailers significant volume rebates that Liggett could not match.¹⁵²

140. *Id.* at 224 (explaining the second prong of the test).

141. *Id.* (explaining that the market will eliminate an antitrust violator that prices below cost and is unable to recoup its investment).

142. *See Brooke Group*, 509 U.S. at 212–13 (explaining the historical function of the cigarette market).

143. *Id.*

144. *See* Daniel Crane, *Harmful Output in the Antitrust Domain: Lessons from the Tobacco Industry*, 39 GA. L. REV. 321, 327–30 (2005) (citing *United States v. Am. Tobacco Co.*, 164 F. 700 (S.D.N.Y. 1908), to explain the history of the tobacco industry).

145. *Brooke Group*, 509 U.S. at 213.

146. *Id.*

147. *Id.* at 214.

148. *Id.*

149. *Id.* at 209.

150. *Brooke Group*, 509 U.S. at 213–16.

151. *Id.* at 216.

152. *Id.* at 215.

Brooke Group later sued Brown & Williamson, alleging predatory pricing in violation of section 2(a) of the Clayton Act.¹⁵³ According to Brooke Group, Brown & Williamson designed its below-cost volume discounts to shift business from Liggett back to Brown & Williamson and to force Liggett to raise its price on generic cigarettes to avoid going out of business.¹⁵⁴ Brooke Group alleged that Brown & Williamson intended to recoup the losses Brown & Williamson suffered during Brown & Williamson's below-cost pricing by increasing its prices after Liggett left the market.¹⁵⁵

After a lengthy trial involving almost 3,000 exhibits, the jury returned a verdict for Brooke Group.¹⁵⁶ Subsequently, the district court granted Brown & Williamson's judgment as a matter of law on "three separate grounds: lack of injury to competition, lack of antitrust injury to Liggett [Brooke Group] and lack of a causal link between the discriminatory rebates and Liggett's alleged injury."¹⁵⁷ The Court of Appeals for the Fourth Circuit affirmed, finding that Brooke Group had no prospect of recouping the profits that it lost during the time it was selling below cost because there was no damage to competition.¹⁵⁸

The Supreme Court affirmed and held that Brown & Williamson was entitled to judgment as a matter of law.¹⁵⁹ The Court held that Brown & Williamson did not violate the Clayton Act, reasoning that "Congress[, when it enacted the Sherman Act,] did not intend to outlaw price differences that result from or further the forces of competition."¹⁶⁰ Although the Court based its holding on the Clayton Act, the Court stated that "it has become evident that [the] primary-line competitive injury under the [Clayton Act] is of the same general character as the injury inflicted by predatory pricing schemes actionable under § 2 of the Sherman Act."¹⁶¹ The Court recognized, however, that it is more difficult to prove that a predatory-pricing scheme violates section 2 of the Sherman Act because the Court requires that there be a "dangerous probability of actual monopolization" to sustain a violation under section 2, but under the Clayton Act it only requires that there be a "reasonable possibility of injury to competition."¹⁶²

Despite the noted differences between the Clayton Act and section 2 of the Sherman Act, the Court mentioned both statutes when stating the first

153. *Id.* at 216.

154. *Id.* at 217.

155. *Brooke Group*, 509 U.S. at 217

156. *Id.* at 218.

157. *Id.* at 219.

158. *Id.*

159. *Id.*

160. *Brooke Group*, 509 U.S. at 221.

161. *Id.* at 222.

162. *Id.* at 224.

prong of its test.¹⁶³ “[W]hether the claim alleges primary pricing under § 2 of the Sherman Act or primary-line price discrimination under the Robinson-Patman Act . . . the plaintiff must prove that the prices complained of are below an appropriate measure of its rival’s cost.”¹⁶⁴ Since both parties agreed that the appropriate measure of cost was “average variable cost,” the Court declined to aid the lower courts in their ongoing struggle to establish a formula for determining the appropriate measure of cost in predatory-pricing cases.¹⁶⁵

The Court then added a second prong to its test—a prong that has proved troublesome for lower courts.¹⁶⁶ The plaintiff must prove, in addition to proving that the defendant competitor was selling products at a price below its cost, that “under Section 2 of the Sherman Act” the defendant had a “dangerous probability of recouping its investment in below-cost prices.”¹⁶⁷ Under the second prong—the recoupment prong—the plaintiff must prove that the defendant’s anticompetitive tactics are likely to be successful in pushing the plaintiff out of the market or, alternatively, causing the plaintiff to raise its prices to a level that would be prohibitively expensive for consumers.¹⁶⁸

The Court, in determining that Brooke Group did not sustain its prong-two burden, examined the following factors: (1) the length of time the defendant allegedly priced below cost; (2) the structure of the market; (3) the defendant’s market power; and (4) the defendant’s potential to survive in the market long enough to recoup the profits it lost from pricing below cost.¹⁶⁹ In so holding, the Court focused heavily on the fact that the cigarette market operated as an oligopoly, and thus Brown & Williamson would continue to face stiff competition even if it pushed Liggett out of the market.¹⁷⁰

In holding that only above-cost discounts can violate the antitrust laws, the Supreme Court stated that low prices benefit consumers regardless of

163. *Id.* at 222.

164. *Id.*

165. *See Brooke Group*, 509 U.S. at 223 n.1 (declining to discuss the appropriate measure of the defendant’s cost).

166. *See Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 909 n.9 (9th Cir. 2007) (explaining that the Ninth Circuit requested amicus briefs because it had difficulty determining what the appropriate measure of the defendant’s cost should be under *Brooke Group*).

167. *Brooke Group*, 509 U.S. at 224.

168. *Id.*

169. *Id.* at 225–27 (explaining the second prong’s components).

170. *Id.* at 228–33 (focusing on the somewhat unique market structure present in the cigarette industry). Unfortunately, the Court’s focus on the oligopoly that existed in *Brooke Group* has led lower courts to conclude that the Court did not intend the *Brooke Group* rule to apply in cases that do not involve oligopoly structures. *See LePage’s Inc. v. 3M*, 324 F.3d 141, 151–52 (3d Cir. 2003) (en banc) (determining that the Supreme Court did not intend lower courts to apply the *Brooke Group* test to non-oligopoly markets).

how those prices are structured.¹⁷¹ The Court stated that above-cost prices reflect a firm's efficient structure and processes and thus constitute "competition on the merits."¹⁷² It was understandably reluctant to issue a holding that might chill conduct that ultimately benefits consumers.¹⁷³ Further, the Court justified its bright-line rule on the basis of the administrative difficulties and judicial inefficiency that would result from a contrary decision.¹⁷⁴

B. *LEPAGE'S INC. v. 3M: THE THIRD CIRCUIT HOLDS THAT THE BROOKE GROUP RULE DOES NOT APPLY TO BUNDLED DISCOUNTS*

In *LePage's Inc. v. 3M*,¹⁷⁵ the Third Circuit held that the Supreme Court's *Brooke Group* rule—that above-cost discounts are per se legal—did not apply to cases involving bundled discounts in markets that were not oligopolies.¹⁷⁶ The 3M Company, manufacturer of Scotch-brand tape and a self-admitted monopolist, controlled over ninety percent of the total transparent-tape market.¹⁷⁷ LePage's decided to enter the store-brand tape market, a relatively insignificant sector of the transparent-tape market that sells tape at a lower price than 3M's Scotch-brand tape.¹⁷⁸ LePage's successfully captured eighty-eight percent of the store-brand market; however, LePage's never captured more than fourteen percent of the total market.¹⁷⁹

3M responded to LePage's success by marketing its own discount store brand under the name Highland.¹⁸⁰ 3M also initiated a "multi-tiered bundled [discount] rebate" program.¹⁸¹ Under the program, 3M customers received a discount in the form of a rebate if they purchased Scotch-brand tape along with another 3M product, such as Post-It Notes, that LePage's did not offer.¹⁸² 3M's bundled discount required retailers such as Wal-Mart and Staples to meet sales goals across several of 3M's product lines to receive the

171. *Brooke Group*, 509 U.S. at 223 (setting forth the rationale for the Court's bright-line rule).

172. *Id.*

173. *Id.*

174. *Id.* (explaining that judicial tribunals do not have the experience required to differentiate between above-cost bundled discounts that foster competition and above-cost discounts that hinder competition).

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

176. *See id.* at 168–69 (holding that *Brooke Group*, a predatory-pricing case involving an oligopoly, does not apply to bundled-discount claims brought under the Sherman Act).

177. *Id.* at 144.

178. *Id.*

179. *Id.* at 144, 161, 165.

180. *LePage's*, 324 F.3d at 144.

181. *Id.* at 145.

182. *Id.*

discount.¹⁸³ In order to maximize 3M sales and maintain their eligibility for the rebate, some retailers stopped offering LePage's tape.¹⁸⁴ 3M also offered LePage's customers promotional allowances, including cash payments, if they stopped selling LePage's products and signed an exclusive contract with 3M.¹⁸⁵

After 3M became more aggressive in marketing both its Scotch-brand tape and its store-brand Highland tape, LePage's share of the store-brand market fell from eighty-eight percent to sixty-seven percent.¹⁸⁶ LePage's attributed its twenty-one-point reduction in market share to 3M's anticompetitive, exclusionary conduct that effectively restricted consumers' access to LePage's lower-priced tape.¹⁸⁷ LePage's claimed that it could barely survive despite the fact that it still controlled more than half of the store-brand tape market.¹⁸⁸

LePage's then sued 3M, asserting three claims: (1) unlawful restraint of trade under section 1 of the Sherman Act; (2) monopolization and attempted monopolization under section 2 of the Sherman Act; and (3) exclusive dealing under section 3 of the Clayton Act.¹⁸⁹ 3M filed a motion for summary judgment, in which it contended that under the Supreme Court's *Brooke Group* decision, 3M's bundled discount did not violate section 2 of the Sherman Act because 3M was not pricing below cost.¹⁹⁰ The district court held that LePage's had stated a valid claim because *Brooke Group*, a predatory-pricing case, did not apply to bundled discounts.¹⁹¹ The jury returned a verdict for 3M on LePage's first and third claims, but returned a verdict for LePage's on its section 2 claim.¹⁹² The court granted 3M's motion for judgment as a matter of law on the section 2 attempted-monopolization claim, but denied the rest of its motions.¹⁹³ The court awarded treble damages and 3M appealed.¹⁹⁴ On appeal, a majority of the Third Circuit panel—Judge Greenberg and then-Judge Alito—reversed the verdict.¹⁹⁵ However, the Third Circuit granted LePage's motion for an en banc hearing and vacated the panel's opinion.¹⁹⁶

183. *Id.* at 154.

184. *Id.*

185. *LePage's*, 324 F.3d at 145.

186. *Id.* at 180.

187. *Id.* at 145.

188. *Id.* at 144.

189. *Id.* at 145.

190. *LePage's*, 324 F.3d at 145.

191. *Id.*

192. *Id.*

193. *Id.*

194. *Id.*

195. *LePage's*, 324 F.3d at 145.

196. *Id.*

The Third Circuit en banc panel affirmed the district court, holding that *Brooke Group* did not apply to a section 2 claim based on a bundled discount.¹⁹⁷ Rather than analyzing 3M's bundled discounts in the context of *Brooke Group*'s predatory-pricing framework, the majority reasoned that 3M's discounts were analogous to a tie and had an "inherent anticompetitive effect."¹⁹⁸

In rejecting the *Brooke Group* test, the Third Circuit focused heavily on the fact that the parties in *Brooke Group* were in an oligopoly market and would still face competition even if one competitor left the market.¹⁹⁹ The Third Circuit argued that 3M, unlike *Brooke Group*, would not have any competitors if it successfully forced LePage's out of the market and would thus have an opportunity to recoup lost profits by raising prices.²⁰⁰

Judge Greenberg, Judge Scirica, and then-Judge Alito dissented.²⁰¹ The dissenters would have followed the court's original opinion and argued that the court should apply the *Brooke Group* rule to bundled discounts.²⁰² In arguing that discounts generally foster competition and benefit consumers, the dissenters carefully distinguished 3M's bundled discount from a tying arrangement.²⁰³ The dissenters recognized that there are legitimate, procompetitive reasons why companies such as 3M offer bundled discounts.²⁰⁴ "There is no doubt but that these programs created incentives for retailers to purchase more 3M products and enabled [3M] to have single invoices, single shipments and uniform pricing programs for various 3M products."²⁰⁵ The dissent scrutinized the facts set forth at trial to a much greater extent than the majority had and concluded that LePage's lost business for reasons other than 3M's alleged unlawful conduct.²⁰⁶

The evidence in the record suggested that LePage's market-share loss was probably attributable to its inability to negotiate properly and maintain relationships with its customers.²⁰⁷ K-Mart, for example, asked both LePage's and 3M to submit bids to determine what company K-Mart would look to as its primary supplier of transparent tape for the following year.²⁰⁸ LePage's had been K-Mart's primary supplier for quite some time and the company's

197. *Id.*

198. *Id.* at 155.

199. *See id.* at 151–56 (rejecting the *Brooke Group* test).

200. *Lepage's*, 324 F.3d at 151–56.

201. *Id.* at 169 (Greenberg, J., dissenting).

202. *Id.* at 176–77 (stating that the dissenters would have applied the *Brooke Group* rule).

203. *Id.* at 174 n.1 (noting that 3M's bundled discount was not analogous to a tie because customers remained free to purchase 3M's Scotch-brand transparent tape separately).

204. *Id.* at 170.

205. *Lepage's*, 324 F.3d at 170 (Greenberg, J., dissenting).

206. *Id.* at 173.

207. *See id.* at 171–74 (scrutinizing evidence set forth at trial and suggesting that LePage's losses resulted from its poor business practices).

208. *Id.* at 171–72.

CEO did not feel that it was necessary to put any real effort into the K-Mart negotiation.²⁰⁹ LePage's thought that K-Mart, one of its primary customers, was "too lazy to make a change, and that it would never put their eggs in one basket by giving all its business to 3M."²¹⁰ 3M took advantage of LePage's ambivalence, offered K-Mart a better price, and won the bid.²¹¹

The dissent argued that the court should support *Brooke Group's* bright-line rule that above-cost discounts are valid because, as the Supreme Court recognized, it is difficult for courts to distinguish procompetitive, legitimate discounts from anticompetitive, exclusionary discounts.²¹² Further, the dissent suggested that courts, when determining whether a discount is anticompetitive, should give great weight to a defendant's proffered business justification for offering the bundled discount.²¹³ Finally, the dissent argued that the majority's decision risked curtailing price competition and prohibiting discounts that benefit consumers.²¹⁴ The Ninth Circuit expounded on the dissent's argument in *Cascade Health Solutions v. PeaceHealth*,²¹⁵ the next major case to examine above-cost discounts.

C. CASCADE HEALTH SOLUTIONS V. PEACEHEALTH: THE NINTH CIRCUIT HOLDS THAT ABOVE-COST PRICE REDUCTIONS ARE PER SE LEGAL

1. *Cascade* Background

The Ninth Circuit was the next court to weigh in on the debate regarding the legality of bundled discounts. In *Cascade* the Ninth Circuit analyzed a bundled-discount system in the healthcare field.²¹⁶ There are three major players in the healthcare-delivery market: hospitals, insurers, and patients.²¹⁷ Hospitals sell services to insurance companies that in turn sell coverage to patients, the ultimate consumers in the healthcare

209. *Id.*

210. *LePage's*, 324 F.3d at 172 (Greenberg, J., dissenting).

211. *Id.*

212. *Id.* at 178–79. The dissent argued that the Eighth Circuit's decision in *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1043 (8th Cir. 2000), constituted an example of a court extending the *Brooke Group* rule to bundled discounts. *Id.* Although the *Concord* court did hold that above-cost discounts are generally valid, the *Concord* decision involved a volume discount rather than a bundled discount. *Concord*, 207 F.3d at 1043. Thus, commentators have largely ignored the Eighth Circuit's *Concord* decision in the debate over whether courts should apply the *Brooke Group* rule to bundled discounts.

213. *LePage's*, 324 F.3d at 172 (Greenberg, J., dissenting).

214. *Id.*

215. *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 901 (9th Cir. 2007).

216. *Id.*

217. *See id.* at 902 (explaining the healthcare-delivery market).

market.²¹⁸ In the transaction between the hospital and the insurance company, both parties agree to a reimbursement rate.²¹⁹

The reimbursement rate is the percentage of the hospital's list rate that the insurance company will reimburse the hospital when one of the consumers it has agreed to indemnify receives services from the hospital.²²⁰ The reimbursement rate that an insurance company pays is essentially a discount stated from the hospital's perspective.²²¹ If an insurance company agrees to a ninety-percent reimbursement rate, the insurance company has agreed to pay ninety percent of the hospital's list price.²²²

Cascade Health and PeaceHealth were the only providers of hospital-based healthcare in Lane County, Oregon.²²³ Cascade was a small, one-hospital system that provided primary and secondary care, but did not provide tertiary care.²²⁴ Cascade Health merged with Triad Health during litigation proceedings and subsequently offered primary, secondary, and tertiary care.²²⁵ PeaceHealth was a three-hospital system that provided primary, secondary, and tertiary care.²²⁶ For purposes of the antitrust suit, the relevant market—the market containing the competing products—was the market for primary and secondary care in Lane County, Oregon.²²⁷

PeaceHealth utilized its monopoly over tertiary services to its advantage by offering insurance companies bundled discounts.²²⁸ If an insurer would agree to utilize PeaceHealth as its preferred provider for primary and secondary care, PeaceHealth agreed to give the insurer a discount on tertiary care.²²⁹ Since PeaceHealth was the only hospital system that offered tertiary care, insurers had to either pay full price for tertiary care, or get all their services from PeaceHealth.²³⁰

Before Cascade entered the market, PeaceHealth incorporated the bundled discount into the reimbursement rate that it offered to insurers.²³¹ In 2001, for example, Regence Blue Cross Blue Shield of Oregon (“Regence”)—one of the two main insurance companies that serviced Lane County—considered adding Cascade Health to its preferred-provider

218. *Id.*

219. *Id.*

220. *Cascade Health*, 502 F.3d at 900, 902–03 (explaining reimbursement rates).

221. *See id.* at 902 (explaining reimbursement rates).

222. *Id.*

223. *Id.* at 901.

224. *Id.* at 902.

225. *Cascade Health*, 502 F.3d at 902.

226. *Id.*

227. *Id.*

228. *See id.* at 902–06 (explaining PeaceHealth's bundled discounts).

229. *Id.*

230. *Cascade Health*, 502 F.3d at 902–06.

231. *Id.*

plan.²³² When Regence’s contract with PeaceHealth came up for renewal, PeaceHealth told Regence that if it added Cascade to its preferred-provider plan it would have to pay five percent more for all services its members received from PeaceHealth.²³³ Regence succumbed to PeaceHealth’s threat and did not add Cascade to its preferred-provider plan.²³⁴ Later that year Regence’s competitor, Providence Health Plan (“Providence”), added Cascade to its preferred-provider plan and PeaceHealth charged Providence three percent more for any services its members received from PeaceHealth.²³⁵ Cascade then sued PeaceHealth, alleging numerous antitrust violations, including monopolization and attempted monopolization under section 2 of the Sherman Act.²³⁶ The district court entered a \$16.2 million award for the plaintiff.²³⁷ Both parties appealed.²³⁸ The Ninth Circuit declined to follow *LePage’s* and thus vacated the jury verdict because it was based on the Third Circuit’s holding that above-cost bundled discounts could violate section 2.²³⁹

2. Ninth Circuit Approves *Brooke Group* Test

When trying to determine whether PeaceHealth’s above-cost discounts violated the Sherman Act, the Ninth Circuit looked in vain to other courts for a useful test.²⁴⁰ The court discovered—as did the AMC—that the legal standards courts should use to analyze section 2 offenses “are not fully developed,” and that the legal standards applicable to bundled discounts are in desperate need of “[a]dditional clarity and improvement.”²⁴¹

Since the Supreme Court’s *Brooke Group* opinion was not on point, the judges first looked to the *LePage’s* decision.²⁴² Based on their analysis of the amicus briefs and the scholarly commentary, the Ninth Circuit determined that the Third Circuit’s framework was unacceptable for two primary reasons.²⁴³ First, the *LePage’s* test did not determine whether the plaintiff was

232. *Id.*

233. *Id.*

234. *Id.*

235. *Cascade Health*, 502 F.3d at 903–05.

236. *Id.* at 903–04.

237. *Id.* at 903.

238. *Id.* at 903–04.

239. *See id.* at 920–22 (declining to follow *LePage’s* and holding that above-cost discounts do not violate section 2).

240. *See Cascade Health*, 502 F.3d at 914–18 (examining other courts’ tests).

241. *See* AMC REPORT, *supra* note 4, at 82–83 (explaining the lack of clarity in section 2 jurisprudence).

242. *See Cascade Health*, 502 F.3d at 909–11 (criticizing *LePage’s*).

243. *Id.* Eight groups filed amicus briefs. Seven argued in favor of a cost-based test for bundled discounts. Daniel Crane filed a brief on behalf of a group of law professors that argued that the court should adopt a discount-reallocation test requiring the plaintiff to show that the defendant priced below its average-variable cost. Daniel Crane, *Bundled Discounts and Cascade*

engaging in competition on the merits.²⁴⁴ Second, the Third Circuit's test did not establish clear standards that would allow a company to determine *ex ante* whether a bundled discount violates the Sherman Act.²⁴⁵

Finding no other useful framework, the court returned to the *Brooke Group* test and noted that although the Court had not specifically addressed bundled discounts, it had recently encouraged the use of price-cutting techniques, and recent cases in other contexts focused on protecting consumers rather than competitors.²⁴⁶ The *Cascade* court thus expressly approved the *Brooke Group* test for courts' use in bundled-discount analysis.²⁴⁷ According to the *Cascade* court, it is better for a lower court to err on the side of reducing liability for antitrust defendants because an erroneous finding of liability has the potential to chill companies' discounting practices and result in higher prices for consumers.²⁴⁸

3. Ninth Circuit Considers Various Cost Measures

In order to utilize the *Brooke Group* rule, the court had to define the defendant's cost, an issue upon which the Supreme Court has not yet ruled.²⁴⁹ The *Cascade* court sought to balance its need for a simple method of calculating the cost of a bundled discount that would allow businesses to determine whether a discount violates section 2, with the need to weed out those discounts that violate the Sherman Act and ultimately harm consumers.²⁵⁰

The Ninth Circuit first considered and rejected the aggregate-discount rule, which holds that a bundled discount is impermissible only if the company offers the bundle at a price that is below its combined production cost for the constituent products in the bundle.²⁵¹ The *Cascade* court argued that the aggregate rule was too simplistic because it did not take into

Health Solutions v. PeaceHealth, GLOBAL COMPETITION POL'Y, May 3, 2007, <http://www.globalcompetitionpolicy.org/index.php?id=454&action=907>.

244. See *Cascade Health*, 502 F.3d at 909–10.

245. See *id.* at 910 (noting that the amicus briefs and the AMC Report also criticized *LePage's*).

246. See *id.* at 912 (noting that the Supreme Court has continually held that the Sherman Act should protect consumers, not competitors). The *Cascade* court also noted that the Supreme Court had recently applied the *Brooke Group* test to a predatory bidding claim. *Id.* (referring to *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069, 1078 (2007)). The Court also indicated an intent to focus on protecting consumer welfare in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007) (abandoning centuries-old precedent to hold that the rule of reason applies to vertical-price restraints).

247. See *Cascade Health*, 502 F.3d at 911 (adopting the *Brooke Group* rule).

248. See *id.* (explaining that courts must carefully avoid discouraging competitive conduct that benefits consumers).

249. See *id.* at 914 (examining potential tests for determining the appropriate measure of the defendant's costs).

250. See *id.* at 915 (examining and rejecting the aggregate-discount rule).

251. *Id.*

account a more diverse competitor's ability to exclude less-diverse rivals—therefore the aggregate rule would allow too many companies to escape antitrust liability.²⁵²

The court next analyzed and declined to follow the test that the Southern District of New York developed in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*²⁵³ The *Ortho* test is a relatively nuanced factor-based test.²⁵⁴ Under the *Ortho* test, a plaintiff must prove that the defendant priced the discount below its average-variable cost,²⁵⁵ or the plaintiff must prove that it is an equally efficient producer.²⁵⁶ The *Ortho* court argued that it should not allow a more diverse competitor to exclude equally efficient competitors simply because it can spread a discount over multiple products.²⁵⁷ The court determined that the *Ortho* test was unworkable for three primary reasons.²⁵⁸ First, like the *LePage's* test, the *Ortho* test did not provide businesses with clear standards.²⁵⁹ Second, the *Ortho* test was unhelpful because it required a potential plaintiff to calculate whether it was an equally efficient producer—a calculation that is impossible unless a company has access to its rival's process costs.²⁶⁰ Finally, the *Ortho* test could lead to a substantial increase in antitrust suits because the test required a case-by-case analysis of whether a *particular* plaintiff is as efficient as a *particular* defendant.²⁶¹ Therefore, an individual case would have almost no precedential value because virtually all plaintiffs will operate at a different efficiency level relative to each defendant.²⁶² This also runs the risk of subjecting each defendant to multiple suits. Given the high cost of antitrust litigation, most companies would simply not offer bundled discounts.²⁶³

Next, the *Cascade* court looked to the AMC's proposed test. The AMC set forth a three-prong bundled-discount test in its April 2007 report.²⁶⁴ Under the AMC's test, a defendant's bundled discount violates the Sherman Act if (1) after attributing the total discount to the product both companies are offering, the defendant sold the product below its cost; (2) the

252. See *Cascade Health*, 502 F.3d at 916 (rejecting the aggregate-discount rule).

253. See *id.* (rejecting the *Ortho* rule).

254. See *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996) (setting forth the court's test).

255. *Id.*

256. *Id.*

257. *Id.*

258. See *Cascade Health*, 502 F.3d at 915–16 (discussing and rejecting the aggregate-discount rule).

259. *Id.*

260. *Id.*

261. *Id.*

262. See *id.* (discussing and rejecting the aggregate-discount rule).

263. *Cascade Health*, 502 F.3d at 915–16.

264. See AMC REPORT, *supra* note 4, at 82 (discussing the bundled-discount test).

defendant will likely recoup its lost profits that it incurred from offering the discount; and (3) the bundled discount hinders competition.²⁶⁵

The *Cascade* court found that the AMC's second prong, while clearly applicable to and imported from single-product cases, was not helpful in bundled-discount cases because a defendant may not actually suffer a loss.²⁶⁶ A defendant, for example, may fail the first prong despite the fact that the package is priced above its actual incremental cost because the total discount is attributed to one product. The AMC's third prong, according to the Ninth Circuit, was unnecessarily redundant because any defendant that failed the first prong was, by necessity, adversely affecting competition.²⁶⁷

4. Ninth Circuit Adopts Discount-Attribution Cost Measure

Finally, the Ninth Circuit adopted the discount-attribution test—the AMC's first prong—as its method of determining the appropriate measure of the defendant's cost under *Brooke Group*.²⁶⁸ The discount-attribution test requires that the court attribute the total price savings of the bundled discount to the product both parties offer.²⁶⁹ If, after attributing the total discount to the product in dispute, the price remains above the defendant's cost to produce it, the bundled discount does not violate section 2.²⁷⁰

A hypothetical serves to solidify the *Cascade* court's cost-analysis test.²⁷¹ Assume A and B, two competing companies, sell hair-care products; A sells shampoo, but B does not. A's cost to produce shampoo is \$1.50, and its cost to produce conditioner is \$2.50. If a consumer buys the products separately, A's shampoo retails for \$3.00 and its conditioner for \$5.00; the bundle retails for \$5.25, which is a \$2.75 discount. The court then attributes the total discount (\$2.75) to the cost of shampoo (\$3.00) to arrive at the attributed-discount cost of \$0.25. Since this figure is below A's cost to produce the shampoo, the *Cascade* court would hold that A's bundled discount violates the Sherman Act.²⁷²

This test, the court argued, provides a clear standard that is based on a company's own cost information.²⁷³ This standard would help companies determine whether or not the contemplated discount would subject them to antitrust liability.²⁷⁴ According to the *Cascade* court, the discount-attribution test strikes the proper balance between prohibiting overly zealous

265. *Id.*

266. *Cascade Health*, 502 F.3d at 906.

267. *Id.* at 921.

268. *See id.* at 916 (adopting the discount-attribution test).

269. *Id.* at 916 n.15 (discussing a similar example).

270. *Id.* at 916.

271. *See Cascade Health*, 502 F.3d at 916 n.15 (discussing a similar hypothetical).

272. *See id.* at 916–21 (arguing in support of the discount-attribution method).

273. *Id.*

274. *Id.*

exclusionary discounts that push other companies out of the market, and still giving customers incentives to offer discounts that benefit consumers.²⁷⁵ The Ninth Circuit stated that it recognized that its discount-attribution test may “sweep [more] broadly” than the aggregate discount rule, but the court did not feel that it had adequate experience analyzing bundled discounts to formulate a more nuanced test.²⁷⁶

IV. ANALYSIS OF *CASCADE*'S IMPLICATIONS

The Third and Ninth Circuits' tests are wholly irreconcilable. Under the *LePage*'s test, a defendant that intends to exclude competitors by offering discounts may violate the Sherman Act even if the defendant never prices below cost.²⁷⁷ This ambiguous standard has resulted in commentators and practitioners vehemently criticizing the *LePage*'s case as “an utterly standardless decision that, without any guidance, declares bundled [discounts] unlawful whenever a smaller rival can't match the [discount] because it doesn't offer a comparable breadth of products.”²⁷⁸ Arguably, a defendant in the Third Circuit offering an above-cost discount can avoid antitrust liability by setting forth a legitimate business justification for offering the discount.²⁷⁹ Apparently, the *LePage*'s court did not believe that competing with one's rival was a sufficient justification, and did not shed light on what explanation, if any, would fall under the business-justification exception.²⁸⁰

The Ninth Circuit's rule that above-cost discounts are legal per se offered welcome guidance for courts and practitioners.²⁸¹ Since the parties in *Brooke Group* stipulated to the measure of cost that would apply, the Supreme Court did not rule on, or even discuss, how a court utilizing *Brooke Group* should calculate the defendant's cost.²⁸² Not only did the *Cascade* court set forth a clear rule, it established a cost-analysis test—the discount-attribution standard—that allows companies to use their own readily available figures, instead of a competitor's, to determine whether offering a

275. *Id.*

276. *Cascade Health*, 502 F.3d at 918.

277. *LePage's Inc. v. 3M*, 324 F.3d 141, 154–57 (3d Cir. 2003) (en banc).

278. Gary P. Zanfagna, *What's Next for the Supreme Court on Antitrust Issues?*, THE ANTITRUST SOURCE, Dec. 2007, at 1, <http://www.abanet.org/antitrust/at-source/07/12/Dec07-Zanfagna12-17.pdf>.

279. *See LePage's*, 324 F.3d at 152 (stating that a company with a valid business justification for offering a discount may escape section 2 liability, but failing to suggest what that justification may be).

280. *See id.* at 169 (Greenberg, J., dissenting) (arguing that competition on the merits should constitute a valid business justification).

281. *See Zanfagna*, *supra* note 278, at 2 (arguing that the Supreme Court should take up the issue and apply the *Cascade* rule).

282. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 212 (1993) (declining to address what the appropriate measure of cost should be).

particular discount will subject the company to antitrust liability.²⁸³ *Cascade* thus improved upon both the *LePage's* and the *Ortho* courts' tests. Interestingly, however, *Cascade* did not completely adopt the *Brooke Group* rule; it only adopted the first prong.²⁸⁴ The AMC's three-part test, on the other hand, used the second prong of the *Brooke Group* rule—the recoupment prong—as its second prong.²⁸⁵ By quickly proclaiming that this prong of the AMC's test was not useful because the defendant may not actually have any losses, the court severed the second part of the *Brooke Group* test and created further inconsistency in antitrust jurisprudence.²⁸⁶

Although scholars and commentators applauded the clarity of the Ninth Circuit's decision,²⁸⁷ the circuit split will likely create serious problems for national businesses.²⁸⁸ In order to avoid antitrust liability and the exorbitant damages that accompany it, businesses that operate in both the Third and the Ninth Circuits and desire uniform pricing, advertising, and sales must adhere to the Third Circuit's higher and more convoluted so-called "standard." Although numerous seminars have sprung up to assist practitioners in determining which bundled discounts are likely to raise red flags, a company may well conclude that bundled discounts are not worth the risk, and in the end consumers will suffer.²⁸⁹

The rampant confusion among courts and practitioners, and the high cost of litigating antitrust suits, has convinced numerous experts that the time is ripe for the Supreme Court to grant certiorari on the bundled-discount issue. Professor Daniel Crane, for example, has argued that "[t]he Ninth Circuit's explicit rejection of *LePage's* creates a strong possibility that the Supreme Court will grant certiorari to resolve the circuit split."²⁹⁰

283. See *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 917 (9th Cir. 2007) (adopting the discount-attribution standard).

284. See *id.* at 915 (failing to adopt *Brooke Group's* recoupment prong); see also AMC REPORT, *supra* note 4, at 82 (discussing the recommended test).

285. See AMC REPORT, *supra* note 4, at 82 (discussing the recommended test).

286. See Stoll & Goldfein, *supra* note 22 (discussing the increasing confusion regarding bundled discounts arising from the *Cascade* court's refusal to fully adopt the AMC's recommendations).

287. See Zanfagna, *supra* note 278, at 2 (urging the Supreme Court to replace *LePage's* with *Cascade*).

288. Although *Cascade Health* settled in August 2008, there is no indication that the Ninth Circuit would reach a contrary conclusion in future cases. Thus, the Supreme Court will eventually have to resolve the circuit split. *Cascade Health Solutions v. PeaceHealth*, 542 F.3d 668, 668 (9th Cir. 2008).

289. The ABA, for example, offered a seminar entitled "Don't Drop Your Bundle: The (New) Rules of the Game for Advising Global Companies on the Legality of Product Bundling." The description for the seminar notes that "[a]dvising companies on antitrust risks in connection with product marketing practices . . . can be a trap for the unwary." Am. Bar Ass'n, CLE Products, <http://www.abanet.org/abastore/index.cfm?section=main&fm=Product.AddToCart&pid=CET07DDYC> (last visited Oct. 17, 2008).

290. Crane, *supra* note 243.

Likewise, Gary P. Zanfagna, Chief Antitrust Counsel of Honeywell International, Inc., stated that bundled discounts are the first and only topic on his Supreme Court wish list.²⁹¹ The next Part proposes a test that the Supreme Court should consider adopting if it decides to grant Mr. Zanfagna's wish in the future.

V. FORMULATING A TEST FOR BUNDLED DISCOUNTS

The Ninth Circuit was correct to extend the *Brooke Group* rule—that above-cost bundled discounts are legal per se—to bundled discounts. The Supreme Court's post-*Brooke Group* antitrust doctrine provides clear evidence that the Court did not intend to limit the *Brooke Group* rule to oligopoly markets, as the *LePage's* court suggested.²⁹² Later Court decisions also indicate that the Court is increasingly willing to utilize the Sherman Act to protect consumers rather than competitors.²⁹³

In light of the Court's pro-plaintiff stance,²⁹⁴ the *Cascade* court should have taken its cost-based analysis a step further. The discount-attribution theory may not be the best method to maximize companies' incentive to offer discounts that ultimately benefit consumers. This Note proposes a test that encourages companies to capitalize on the time savings and other efficiencies that bundled discounts provide, while at the same time continues to prohibit companies from pricing below cost. A test that truly maximizes consumer welfare will serve three primary goals: (1) maximizing judicial efficiency; (2) maximizing companies' incentives to offer discounts; and (3) avoiding the likelihood that a company will use a temporary below-cost discount to either force an equally efficient rival to raise its retail cost to a prohibitively high level or push it out of the market entirely.

The discount-attribution theory does not adequately take into account the costs that discounters save when they offer discounts. Recall the Amazon example previously set forth in this Note.²⁹⁵ The example can be extrapolated to demonstrate the potential deficiencies inherent in the *Cascade* court's test. Assume Amazon offers a bundled discount where a customer can purchase books A and B separately for \$10.00 each, or as a bundle for \$15.00. Assume the cost to Amazon for each book is \$8.00, but Amazon saves \$3.00 in transaction costs when it ships out a bundle. Using the discount-attribution cost calculation, we attribute the \$5.00 savings that the discount offers to product A, the product in competition. This

291. See generally Zanfagna, *supra* note 278 (discussing the urgent need to resolve the circuit split).

292. See *supra* note 246 and accompanying text (discussing recent Supreme Court cases supporting price cutting).

293. See *supra* note 246 and accompanying text (noting such cases).

294. See *supra* note 246 and accompanying text (elaborating on the Court's position).

295. See *supra* Part II.C.1.a (setting forth the Amazon example).

calculation results in a price of \$5.00, three dollars less than it costs Amazon to produce the book.

If we stop here, Amazon cannot offer the discount under the *Cascade* test because it is pricing below its cost to produce the product. At this juncture, Amazon has no incentive to increase its employees' efficiency by saving them trips back to the warehouse. This ultimately harms consumers that need books A and B because it will cost them \$20.00 instead of \$15.00. If we add back the \$3.00 Amazon saved in transaction costs, however, the *Cascade* test would allow the discount because Amazon is no longer pricing below its cost and the well-read consumer can pocket the \$5.00 savings.

The proposed test is thus articulated as follows: if the price of the product in competition remains above the defendant's cost to produce it, after total discount and transaction savings are attributed to the product, the discount does not violate the Sherman Act. The plaintiff would initially have the burden of utilizing the discount-attribution standard to demonstrate that the defendant is pricing below cost. If the plaintiff can show by a preponderance of the evidence that the defendant is pricing below cost, then the court could presume that the defendant's bundled discount violates the Sherman Act. The burden would then shift to the defendant to put forth evidence showing that the total cost savings gained by its transaction efficiencies justify the discount.²⁹⁶

Admittedly, this test is not as easy to administer as the *Cascade* test because it does not offer a bright-line rule. The proposed test, however, is substantially easier than the *Ortho* test to administer.²⁹⁷ Like the *Cascade* test, it uses data that is freely available to businesses and will allow them to determine, in advance, whether offering a particular discount may put the company at risk for antitrust liability.²⁹⁸ Furthermore, in the bundled-discount situation, a company proposing a discount will likely use a similar methodology to decide what the appropriate price point is for the discount regardless of any potential antitrust implications. The proposed test thus meets the three previously stated goals: (1) it is relatively easy to administer; (2) it encourages companies to maximize efficiency by offering companies an add back for demonstrable transaction savings; and (3) it discourages companies from engaging in predatory pricing by prohibiting discounts that are below an appropriate measure of cost.

296. Perhaps the *LePage's* court would have upheld this as a sufficient business justification. See *LePage's Inc. v. 3M*, 324 F.3d 141, 163–64 (3d Cir. 2003) (en banc) (discussing the business-justification exception).

297. See *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996) (setting forth the court's test).

298. See *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 915–17 (9th Cir. 2007) (discussing the court's test).

VI. CONCLUSION

Bundled discounts are generally procompetitive. Courts must carefully distinguish between bundled discounts and other pricing arrangements in order to apply the proper standard. Courts can strike the proper balance between fostering competition that benefits consumers while preventing zealous monopolistic practices by applying the *Brooke Group* rule in conjunction with an add-back provision.