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Article

Evaluating Bundled Discounts

Thomas A. Lambert[†]

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

1. Other commentators refer to such discounts as "multi-product discounts," see Daniel A. Crane, *Multiproduct Discounting: A Myth of Nonprice Predation*, 72 U. CHI. L. REV. 27 (2005), and the economics and marketing literature frequently term the discounting strategy "price bundling," see, e.g., Dilip Soman & John T. Gourville, *Transaction Decoupling: How Price Bundling Affects the Decision to Consume*, 38 J. MARKETING RES. 30 *passim* (2001).

2. See, e.g., Ward Hanson & R. Kipp Martin, *Optimal Bundle Pricing*, 36 MGMT. SCI. 155 (1990); Bari A. Harlam et al., *Impact of Bundle Type, Price Framing and Familiarity on Purchase Intention for the Bundle*, 33 J. BUS. RES. 57 (1995); Michael D. Johnson et al., *The Effects of Price Bundling On Consumer Evaluations of Product Offerings*, 16 INT'L J. RES. MARKETING 129 (1999); Andrea Ovans, Briefings from the Editors, *Make a Bundle Bundling*, HARV. BUS. REV., Nov.-Dec. 1997, at 18, 20 (referencing Mercer Management study of "100 companies that use bundling as a major component of their corporate strategy"); Soman & Gourville, *supra* note 1, at 30 ("[T]he practice of price bundling is widespread."); Stefan Stremersch & Gerald J. Tellis, *Strategic Bundling of Products and Prices: A New Synthesis for Marketing*, 66 J. MARKETING 55, 55 (2002) ("Bundling is pervasive in today's markets."); Manjit S. Yadav, *How Buyers Evaluate Product Bundles: A Model of Anchoring and Adjustment*, 21 J. CONSUMER RES. 342 (1994); Manjit S. Yadav & Kent B. Monroe, *How Buyers Perceive Savings in a Bundle Price: An Examination of a Bundle's Transaction Value*, 30 J. MARKETING RES. 350, 350 (1993) ("[B]undling is ubiquitously applied in both consumer and industrial markets." (citing Thomas Nagel, *Economic Foundations for Pricing*, 57 J. BUS. 3, 18 (1984))).

3. Gary Young, *\$519 Million Antitrust Judgment: Hill-Rom Claims Verdict Will Not Stand*, NAT'L L.J., Oct. 7, 2002, at A9. After threatening to appeal, Hill-Rom settled the case for \$250 million. Sue Reisinger, *Dueling Bed*

have recently filed several lawsuits against medical device manufacturers that have been accused of violating antitrust laws by granting bundled discounts to hospital buying groups.⁴ The most prominent challenge to the legality of bundled discounts came in *LePage's Inc. v. 3M*.⁵ The Third Circuit, sitting en banc, condemned a bundled discount program, and upheld a \$68 million antitrust judgment against defendant 3M Corporation, even though the discounted prices 3M offered were above its costs and therefore not predatory.⁶ Not surprisingly, the en banc decision caused quite an uproar in the business community.⁷

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

Manufacturers Find Peace in Settlement, CORP. LEGAL TIMES, Apr. 2003, at 58.

4. See *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770 MRP, 2004 U.S. Dist. LEXIS 26916 (C.D. Cal. June 10, 2004) (order denying defendant's motion for summary judgment); Complaint, *Conmed Corp. v. Johnson & Johnson, Inc.*, (S.D.N.Y. filed Nov. 6, 2003) (No. 03-CV-8800) (on file with author); Complaint, *Applied Med. Research Corp. v. Johnson & Johnson, Inc.*, (C.D. Cal. filed Sept. 5, 2003) (No. CV-03-1329) (on file with author).

5. 324 F.3d 141 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004).

6. *Id.* at 147. In general, a seller's prices are "predatory" only if they are set below its costs. See *infra* notes 57-62 and accompanying text.

7. See Mike Meyers, *One Big, Sticky Mess*, STAR TRIB. (Minneapolis), Nov. 10, 2003, at D1 ("[C]ompanies nationwide are glued to the case."). The following businesses and trade groups (represented by, among other well-known attorneys, Kenneth Starr, Robert Bork, and A. Douglas Melamed, former head of the Department of Justice's Antitrust Division) joined amicus briefs asking the Supreme Court to reverse the decision: BellSouth Corp.; Boeing Co.; Brunswick Corp.; the Business Roundtable; Caterpillar Inc.; the Coca-Cola Co.; Eastman Kodak Co.; Honeywell International Inc.; Hormel Foods Corp.; Intel Corp.; Johnson & Johnson, Inc.; Kimberly-Clark Corp.; Morgan Stanley; the National Association of Manufacturers; Nokia Inc.; Northwest Airlines, Inc.; the Procter & Gamble Co.; Schering-Plough Corp.; Staples, Inc.; Verizon Communications; and Xerox Corp.

8. *3M v. LePage's Inc.*, 540 U.S. 807 (2003).

9. Brief for the United States as Amicus Curiae, *3M v. LePage's Inc.*, 124 S. Ct. 2932 (2004) (No. 02-1865), available at 2004 WL 1205191.

10. *Id.* at 14 n.11 ("The Third Circuit declined to apply *Brooke Group* primarily because it thought that 'nothing in the decision suggests that its dis-

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

This Article aims to address, in part, the scholarship deficit noted in the government's *LePage's* brief. The Article analyzes the various frameworks courts and commentators have proposed for evaluating the legality of bundled discounts, and it posits an alternative evaluative approach. Recognizing that a bundled discount that results in an above-cost price for the bundle (an "above-cost bundled discount")¹⁵ could, in some cir-

cussion of the [price-cost test] is applicable to a monopolist with its unconstrained market power.' But this Court's language plainly applies to a monopolist." (citation omitted). See generally Supplemental Brief for Petitioner at 2-3, *LePage's Inc.* (No. 02-1865), available at 2004 WL 1283785 (cataloguing four errors government's brief identified in Third Circuit's opinion).

11. Brief for the United States as Amicus Curiae at 12 n.9, *LePage's Inc.* (No. 02-1865) (noting that "[t]he practice of bundled rebates has received far less judicial and scholarly scrutiny than predatory pricing," that "[o]nly two other litigated cases . . . have squarely focused on such practices" (citations omitted)); *id.* at 14 ("There is insufficient experience with bundled discounts to this point to make a firm judgment about the relative prevalence of exclusionary versus procompetitive bundled discounts."); *id.* at 18 ("[T]he meager case law addressing bundled rebates offers little assistance in determining how alternative standards might work in practice."); *id.* at 19 ("[A]t this juncture, it would be preferable to allow the case law and economic analysis to develop further and to await a case with a record better adapted to development of an appropriate standard.").

12. *Id.* at 12 n.9.

13. *Id.* at 15-16.

14. *3M v. LePage's Inc.*, 124 S. Ct. 2932 (2004).

15. The term "above-cost bundled discount" is ambiguous. It might signify that the price of the bundle exceeds the bundle's cost (i.e., the sum of the costs of the products within the bundle). See 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 749(a), at 509-12 (2d ed. 2002) (describing this sort of "above-cost" bundled discount). Alternatively, the term could de-

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

Part I of the Article clarifies what bundled discounts are and sets forth the primary anticompetitive concern such discounts raise. In particular, Part I demonstrates how bundled discounts—unlike discounts conditioned upon purchasing a specified quantity of a single product—may injure competition by excluding rivals that are as efficient as the discounter.

Part II then considers and critiques five approaches courts and commentators have proposed for determining the legality of above-cost bundled discounts.¹⁶ One proposed approach would deem such discounts per se legal. Part II.A rejects that approach because it fails to adequately account for the ability of above-cost bundled discounts to exclude equally efficient rivals. Part II.B considers and rejects an approach that would ban bundled discounts that unjustifiably raised rivals’ costs, for procompetitive conduct frequently raises rivals’ costs, and the approach would likely thwart much procompetitive, consumer-friendly discounting. Part II.C critiques the approach employed by the *LePage’s* majority, which focused on the breadth of the discounter’s product line vis-à-vis that of its competitors. That approach may force consumers to forego lower prices to protect less efficient rivals and will discourage even procompetitive bundled discounting by forcing discounters to justify their reduced prices by pointing to adequate cost savings. Part II.D considers an approach that would require a plaintiff to prove that it is an equally efficient rival but would be excluded by the bundled discount at issue. That approach would create intractable administration difficulties and would likely result in

scribe a bundle where *each product* within the bundle is priced above cost, even after the entire amount of the discount is attributed to that single product. See Crane, *supra* note 1, at 29. This Article uses the term in the former sense: a bundled discount is “above cost” if the discounted price of the bundle exceeds the sum of the costs of the products within the bundle. Bundled discounts where the price of each product is above cost even after the entire amount of the discount is attributed to that product should be per se legal, for the reasons stated by Professor Crane. See *id.* at 30–48.

16. See *supra* note 15.

suboptimal deterrence of truly exclusionary bundled discounting. Finally, Part II.E criticizes the approach proposed by the leading antitrust treatise because it would preclude discount cross-subsidization, which frequently reflects vigorous competition and benefits consumers.

Having rejected the evaluative approaches that have been suggested thus far, the Article proceeds, in Part III, to outline an alternative approach for evaluating above-cost bundled discounts. The proposed approach would presume the legality of the discounts, but would permit plaintiffs to rebut that presumption by proving easily ascertainable facts that would ensure that competitive options had been exhausted and would demonstrate that the discount could exclude a rival that was, or was likely to become, at least as efficient as the discounter. Specifically, the plaintiff would have to show that it could not stay in business by lowering its price(s) on the competitive product(s), entering new markets to create its own bundle, collaborating with other sellers to offer a competitive bundled discount, or becoming a supplier to the discounter. If the plaintiff made such a showing, the discounter could still avoid liability by proving that it rejected the plaintiff's supply offer because the offer simply was not good enough (i.e., because the plaintiff could not produce the competitive product as efficiently as the discounter).

I. WHAT ARE BUNDLED DISCOUNTS, AND WHY ARE THEY TROUBLING?

Bundled discounts come in a variety of forms. The simplest form is the "package discount," in which a seller charges a lower price for a group of disparate goods sold together than for the same collection of goods purchased separately.¹⁷ A more complicated form of bundled discount occurs when a seller charges a lower price on all its products, or pays a rebate on all of a buyer's purchases from it, if the buyer meets certain purchase targets in multiple product lines measured by volume, dollar value, or percentage of the buyer's requirements. This was the sort of bundled discount at issue in *LePage's*, where defendant 3M offered sizable discounts on all purchases from it,

17. For example, a manufacturer of shampoo and conditioner might charge \$2.00 per bottle of shampoo and \$4.00 per bottle of conditioner, but might sell the two products together for \$5.00. See *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996); see also *infra* notes 25–27 and accompanying text.

but only if buyers met purchase targets in several of 3M's varied product lines.¹⁸ It is also the sort of bundled discount that is currently creating antitrust problems for manufacturers of medical devices.¹⁹ The defining characteristic of bundled discounts is that they are multi-product, purchase target discounts—they are conditioned upon purchasing some quantum of goods from multiple product markets.

The term "bundled discount" therefore excludes straightforward volume discounts, what might be termed "single-product purchase target discounts," pursuant to which a seller offers a reduced price or pays a rebate on all purchases of a single product as long as the buyer purchases a certain quantity from the seller.²⁰ From a competitive standpoint, what distinguishes the two types of discounts is their ability to exclude rivals that are at least as efficient as the discounter.²¹ An above-cost single-product volume discount may always be matched by an equally efficient competitor, for if the discounter's final prices are profitable (i.e., above cost), then any equally or more

18. See *LePage's Inc. v. 3M*, 324 F.3d 141, 154 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004). The bundled discounts at issue in *LePage's* are discussed in detail below. See *infra* notes 118–22 and accompanying text.

19. U.S. GEN. ACCOUNTING OFFICE, GAO-03-998T, GROUP PURCHASING ORGANIZATIONS 13–14 (2003); see *supra* note 4 (citing case materials in which this sort of bundled discount is being challenged).

20. That sort of discount was at issue in *Concord Boat Corp. v. Brunswick Corp.*, in which the Eighth Circuit held that Brunswick, a manufacturer of boat motors, did not monopolize the market for inboard and stern driven boat motors by giving boat builders discounts pegged to their purchases of minimum percentages of their requirements. 207 F.3d 1039 (8th Cir. 2000). Brunswick offered discounts of approximately 3% off the price to boat builders who purchased at least 70% of their motor needs from Brunswick. *Id.* at 1044. It also gave an additional 1% or 2% discount to builders that agreed to maintain those shares for two or three years. *Id.* While the discounted prices were above Brunswick's cost, the plaintiffs, a group of boat dealers, claimed that the market share discounts had allowed Brunswick to dominate the market. *Id.* at 1045–46. The Eighth Circuit held that Brunswick's above-cost market share discounts did not violate the antitrust laws. *Id.* at 1062–63. Noting that above-cost discounts enjoy a "strong presumption" of legality, the court distinguished the practices at hand from discounts conditioned on purchases of a bundle of different products. *Id.* at 1061–62. Thus, the court recognized that single-product volume discounts and bundled discounts are different competitive animals. *Id.*

21. PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW (Supp. 2003) ¶ 749, at 84 [hereinafter AREEDA & HOVENKAMP SUPP. 2003] (noting that "multi-product discounts . . . are typically quite distinguishable from single-product discounts or rebates" because "[a]ssuming that the fully discounted price on a single product is profitable to the defendant, an equally efficient rival should always be able to match it").

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

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

23. As discussed below, a number of commentators have noted that single-product volume discounts may be anticompetitive, even if they cannot exclude equally efficient rivals, because they may *cause* a rival to be less efficient than the discounter by denying the rival economies of scale. See *infra* notes 71–85 and accompanying text; see also Willard K. Tom, David A. Balto & Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 *ANTITRUST L.J.* 615, 627–30 (2000); Einer Elhauge, *The Exclusion of Competition for Hospital Sales Through Group Purchasing Organizations* 18 (June 25, 2002), at http://www.law.harvard.edu/faculty/elhauge/pdf/gpo_report_june_02.pdf ("By denying rivals access to the market share they would need to achieve their minimum efficient scale, exclusionary agreements can thus raise rivals' costs."); *id.* at 24 n.68 ("Professor Hovenkamp argues that an equally efficient rival can always match the [single-product purchase target] discount . . . but this is not true if . . . economies of scale exist because the exclusionary scheme will restrict the market share of the rival and thus deprive it of the economies of scale it needs to match the discounted price.").

24. See, e.g., *LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc), *cert. denied*, 124 S. Ct. 2932 (2004) ("The principle anticompetitive effect of bundled rebates . . . is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer."); *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1062 (3d Cir. 1978) (holding that defendant's bundled discount on pharmaceutical products violated the Sherman Act because plaintiff, which sold a narrower product line, would have to match total dollar value of discount on a much smaller collection of products); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 463 (S.D.N.Y. 1996) (explaining how above-cost bundled discounts may exclude more efficient rivals); AREEDA & HOVENKAMP *SUPP.* 2003, *supra* note 21, ¶ 749, at 83–84 (distinguishing single-product from multi-product purchase target discounts because as long as the former is above cost "an equally efficient rival should always be able to match it," but with multi-product discounts, "even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce").

To understand how this may occur, consider a manufacturer (*A*) that sells both shampoo and conditioner and competes against another manufacturer (*B*) that sells only shampoo.²⁵ *B* is the more efficient shampoo manufacturer; it can produce shampoo for \$1.25, while it costs *A* \$1.50 to do so. *A*'s cost of producing conditioner is \$2.50. If sold separately, *A* charges \$2.00 for shampoo and \$4.00 for conditioner, a total of \$6.00, but if a consumer purchases both shampoo and conditioner, *A* will sell the combination for \$5.00. That amount is \$1.00 less than the price charged if the products were purchased separately but \$1.00 greater than *A*'s cost for the two products. Thus, the following situation is presented:²⁶

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

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

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

26. This example may appear unrealistic, for it is unclear why manufacturer *A* would persist in producing shampoo when it could presumably negotiate a favorable supply agreement in which manufacturer *B* would supply *A* with shampoo for some price greater than *B*'s cost of \$1.25 per bottle but less than *A*'s cost of \$2.00 per bottle. The parties' ignorance of their relative efficiencies might account for such a situation. Regardless of its plausibility, the example is presented because it is very similar to an example presented in the case law. See *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 467.

though *A* charges a price greater than the marginal cost of its shampoo/conditioner combination.²⁷

The courts that have considered the legality of bundled discounts have recognized that the primary anticompetitive concern they present is that a monopolist who sells in multiple product markets will use the discounts to exclude equally efficient rivals who do not sell as broad a line of products (and thus have fewer products on which to give up margin). So, for example, the court in *SmithKline Corp. v. Eli Lilly & Co.*²⁸ condemned a bundled discount offered by defendant Eli Lilly because the bundle included products not sold by plaintiff SmithKline, which could not compete without offering huge (and presumably below-cost) discounts on its narrower product line.²⁹ Similarly, the *LePage's* court reasoned that plaintiff

27. PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749, at 179 (Supp. 2004) [hereinafter AREEDA & HOVENKAMP SUPP. 2004] offers a more complicated example of how an above-cost multi-product purchase target discount could exclude a rival that was more efficient than the discounter:

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

Id.

28. 575 F.2d 1056.

29. Defendant Eli Lilly had, among others, two cephalosporin products, Keflin and Keflex, on which it faced no competition, and one product, Kefzol, on which it faced competition from plaintiff SmithKline's product, Ancef. *Id.* at 1059. Lilly offered a higher rebate of 3% to companies that purchased specified quantities of any three of Lilly's cephalosporin products—an offer that, practically speaking, required combined purchases of Kefzol, Keflin, and Keflex. *Id.* at 1060–62. Although hospitals were free to purchase SmithKline's Ancef with their orders of Keflin and Keflex from Lilly, the practical effect of that decision would be to deny the Ancef purchaser the 3% bonus rebate on all its cepha-

LePage's could not compete with defendant 3M's bundled discounts, which incorporated up to six product lines, without drastically discounting the one product (transparent tape) it sold in competition with 3M.³⁰ And in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*,³¹ the court recognized the theoretical possibility that the plaintiff might be a more efficient rival than the defendant discounter but might nevertheless be driven from the market by the defendant's bundled discount, which rewarded purchasers with discounts on products the plaintiff did not sell.³²

The fact that bundled discounts may make it difficult for less diversified rivals to compete should not warrant their automatic condemnation, however. After all, bundled discounts are, first and foremost, discounts. They always benefit consumers in the short term.³³ Any legal rule that condemned bundled discounts without a showing that they would exclude rivals

losporin products. *Id.* at 1061–62. The court reasoned that Lilly's arrangement would force SmithKline to pay rebates on one product equal to rebates paid by Lilly based on sales volume of three products. *Id.* at 1062. Because of Lilly's volume advantage, to offer a rebate of the same net dollar amount as Lilly's, SmithKline would have had to offer companies large rebates, ranging from 16% for average size hospitals to 35% for larger volume hospitals, for their purchase of Ancef. *Id.* This presumably would have forced SmithKline to price below its costs.

30. *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004), is discussed extensively below. See *infra* notes 118–37 and accompanying text.

31. 920 F. Supp. 455.

32. Plaintiff Ortho manufactured three blood tests that competed with three of five blood tests manufactured by defendant Abbott. *Id.* at 459. Abbott provided a discount on all of a purchaser's blood test purchases if the purchaser would buy at least four types of tests from Abbott, and it offered a higher discount to purchasers who purchased all five of its tests. *Id.* at 460. Ortho complained that the discount policy unfairly disadvantaged it because it could compete with Abbott only by offering the full value of Abbott's five-product discount on its own three-product selection. See *id.* at 461–62. While recognizing that Ortho could have been excluded from the market by Abbott's bundled discounts, even if Ortho were the more efficient competitor, the court refused to hold Abbott liable because Ortho did not demonstrate that Abbott was pricing its package of products below cost or that Ortho was as efficient a producer as Abbott but was unable to compete because of the discounting strategy. *Id.* at 469. *Ortho Diagnostic* and the test articulated therein are discussed in detail below. See *infra* notes 159–69 and accompanying text.

33. Professor Einer Elhauge argues that any bundled discount could reflect an “unbundled penalty,” so that the purported “discounting” scheme does not actually benefit consumers. See *infra* note 263 and accompanying text. As explained below, the sort of phony discount Professor Elhauge envisions could be rather easily distinguished from a genuine bundled discount. See *infra* notes 263–67 and accompanying text.

that were, or were likely to become, as efficient as the discounter would likely harm consumers by chilling all sorts of procompetitive discounts. What courts need, then, is an evaluative approach that will accurately identify anticompetitive bundled discounts without creating the sort of legal uncertainty (or risk of false positives) that causes understandably cautious firms, fearful of an inappropriately rendered treble damages award, from being overly conservative with respect to their discounting practices.³⁴ The remainder of this Article criticizes the attempts that have been made to construct an approach for evaluating bundled discounts and proposes an alternative evaluative approach.

II. COMPETING EVALUATIVE APPROACHES

As the government noted in its amicus brief urging the Supreme Court to deny certiorari in *LePage's*, the issue of how to evaluate bundled discounts has received scant attention in the case law and scholarly literature.³⁵ The few courts and commentators that have directly addressed the issue have disagreed as to the showing a plaintiff must make to establish a monopolization claim based on bundled discounts.³⁶ So far, five

34. See AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 183 (“The difficult question [with regard to bundled discounts] is the formulation of an administrable rule that does not overreach and condemn competitive conduct.”).

35. Brief for the United States as Amicus Curiae at 12 n.9, 3M v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865), available at 2004 WL 1205191; see *supra* notes 8–13 and accompanying text.

36. The case law has so far analyzed bundled discounts as potential monopolization in violation of section 2 of the Sherman Act, 15 U.S.C. § 15 (2000). See *LePage's Inc. v. 3M*, 324 F.3d 141, 146 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004); *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1062 (3d Cir. 1978); *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 465; *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770 MRP, 2004 U.S. Dist. LEXIS 26916 (C.D. Cal. June 10, 2004). Because bundled discounts generally involve contracts between buyers and sellers, they might also be deemed to violate section 1 of the Sherman Act, 15 U.S.C. § 1, which precludes concerted activity that unreasonably restrains trade. Regardless of the particular statutory provision invoked, however, the competitive analysis is likely to be the same. A plaintiff bringing a monopolization action would have to show that the discount amounts to anticompetitive conduct, rather than merely vigorous competition, see *United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966), while a section 1 plaintiff would have to show that the arrangement “unreasonably” restrains trade, see *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988). In either case, the determinative question will be whether the discount ultimately enhances or diminishes competition, and the evaluative approach proposed herein could address that question

basic approaches have emerged, ranging in terms of restrictiveness from a rule that would deem bundled discounts per se legal as long as they result in above-cost pricing,³⁷ to a rule that would condemn even single-product (i.e., unbundled) above-cost discounts if they would unjustifiably prevent competitors from achieving productive efficiencies.³⁸ Between these poles is an approach focused on the relative breadth of the parties' product lines,³⁹ and two approaches that would focus on the relative efficiency of the parties and would attempt to condemn only those bundled discounts that could exclude equally or more efficient rivals.⁴⁰ Examined closely, each of these five approaches proves inadequate.

A. PER SE LEGALITY

The least restrictive approach to bundled discounts would deem them per se legal as long as the discounted price of the bundle exceeds the aggregate cost of the constituent products.⁴¹ This is the approach urged by amici that filed briefs in support of the *LePage's* defendant's petition for writ of certiorari.⁴² Ad-

regardless of whether it was presented in a monopolization claim or as part of a section 1 action.

37. See *infra* Part II.A.

38. See *infra* Part II.B.

39. See *infra* Part II.C.

40. See *infra* Part II.D–E.

41. A less controversial position, with which the author agrees, is that bundled discounts should be per se legal when *each product* within the bundle is priced above its cost after the entire amount of the discount is attributed to that product. See Crane, *supra* note 1, at 42–43. The focus of this Article is the more perplexing issue of how to evaluate bundled discounts that are above cost, in the sense that the discounted price of the bundle exceeds the aggregate cost of the products within the bundle, see *supra* note 15, but do not satisfy the condition that each constituent product is priced above cost when discounted by the entire amount of the total discount.

42. See Brief for Amici Curiae Morgan Stanley et al. at 5, 3M v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865), available at 2003 WL 22428378 ("This Court has repeatedly recognized that low prices benefit consumers regardless of how those prices are set and that above-cost prices do not threaten competition regardless of the type of antitrust claim involved." (internal quotations, alterations, and citations omitted)); *id.* at 6–7 ("[D]epriving consumers of the immediate benefits of an above-cost price cut is not sound antitrust policy As long as the price remains above cost, an equally efficient competitor can match the discount and compete with the defendant to the benefit of consumers." (internal quotations, alterations, and citations omitted)); Brief for Amicus Curiae the Business Roundtable at 6, *LePage's Inc.* (No. 02-1865), available at 2003 WL 22428382 ("This Court, in an unbroken line of cases, has made clear that businesses are entitled—indeed, encouraged—to engage in

vocates of this per se legality approach maintain that it is compelled by Supreme Court precedent and is desirable as a policy matter.

In support of their claim that Supreme Court precedent mandates the per se legality approach, advocates cite a line of decisions culminating in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,⁴³ in which the Court broadly suggested that discounts are legal unless they result in below-cost prices.⁴⁴ In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,⁴⁵ for example, the Court recognized a danger in inferring exclusionary conduct from price cuts aimed at forcing competitors from the market or deterring new entrants.⁴⁶ “[C]utting prices in order to increase business often is the very essence of competition,” the Court explained, and the potential for “mistaken inferences” of exclusionary conduct may therefore “chill the very conduct the antitrust laws are designed to protect.”⁴⁷ While the Court declined to address the issue of whether exclusionary conduct could ever result from above-cost discounted prices,⁴⁸ it did indicate that predatory pricing claims generally require “pricing below some appropriate measure of cost.”⁴⁹ Similarly, in *Cargill, Inc. v. Monfort, Inc.*,⁵⁰ the Court noted that it would be a “perverse result”⁵¹ if the antitrust laws were

above-cost price-cutting without fear that those pro-competitive actions will subject them to antitrust liability.”); *id.* at 16 (“[E]ven if there were a rare instance in which a price cut would be anticompetitive, courts must always err on the side of no liability.”); Brief for the Boeing Company et al., as Amici Curiae at 13, *LePage’s Inc.* (No. 02-1865), available at 2003 WL 22428377 (“[A]bove-cost pricing practices challenged in any antitrust claim are entitled to an absolute safe harbor . . .”) (internal quotation omitted); Brief of Washington Legal Foundation and National Association of Manufacturers as Amici Curiae at 19, *LePage’s Inc.* (No. 02-1865), available at 2003 WL 22428379 (encouraging the Court to recognize “a safe harbor for all above-cost price competition, thereby providing producers with clear guidance regarding how to compete without running afoul of the antitrust laws”).

43. 509 U.S. 209 (1993).

44. See *id.* at 222–23. None of the Supreme Court precedents cited by per se legality advocates addressed multi-product discounts, so the persuasiveness of their broad dicta addressing discounts in general is debatable.

45. 475 U.S. 574 (1986).

46. See *id.* at 594.

47. *Id.*

48. *Id.* at 585 n.9.

49. *Id.* at 584–85 n.8. As to what “some appropriate measure of cost” means, see *infra* note 61.

50. 479 U.S. 104 (1986).

51. *Id.* at 116.

construed to preclude price cuts aimed at increasing market share, "for [i]t is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition."⁵² And in *Atlantic Richfield Co. v. USA Petroleum Co.*,⁵³ the Court reiterated the view that low but above-cost pricing could not give rise to the sort of injury the antitrust laws were designed to preclude.⁵⁴ Concluding that "in the context of pricing practices, only predatory pricing has the requisite anticompetitive effect,"⁵⁵ the Court observed (albeit in a discussion of single-product discounting) that discounted but above-cost prices cannot be anticompetitive "regardless of how those prices are set."⁵⁶

The Court's most direct statement of the rule that discounts must be below cost to create antitrust liability occurred in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*⁵⁷ The matter before the Court in that case was the legality of de-

52. *Id.* (alteration in original) (quoting Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050, 1057 (6th Cir. 1984)). The issue in *Cargill* was whether the plaintiff had adequately alleged antitrust injury in challenging a potential merger on the grounds that the new entity would "lower its prices to some level at or slightly above its costs in order to compete . . . for market share," thereby cutting into plaintiff's profits. *Id.* at 114. While the Court recognized that a claim based on below-cost pricing could give rise to antitrust injury, it held that plaintiff had waived any such claim and was instead complaining of above-cost, but discounted, prices, which could not give rise to antitrust injury. *Id.* at 117-22.

53. 495 U.S. 328 (1990).

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

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

Id. at 337-38 (alteration in original) (footnote and citations omitted). The Court explained that antitrust injury must arise from an anticompetitive aspect of the defendant's behavior. *See id.* at 339. The Court concluded that discounted prices cannot be anticompetitive unless they are below-cost because above-cost pricing cannot exclude equally or more efficient rivals who could always stay in business by lowering their prices below supracompetitive levels. *See id.* at 337-38 n.7 ("Rivals cannot be excluded in the long run by a non-predatory maximum-price scheme unless they are relatively inefficient.").

55. *Id.* at 339.

56. *Id.* at 340.

57. 509 U.S. 209 (1993).

fendant Brown & Williamson's sharp rebates on purchases of its generic cigarettes.⁵⁸ Before dissecting the details of the plaintiff's complicated theory of predation (and holding that the plaintiff had failed to establish harm to competition),⁵⁹ the Court addressed generally the subject of predatory pricing. Noting that some of its prior opinions had reserved the question of "whether recovery should *ever* be available . . . when the pricing in question is above some measure of incremental cost,"⁶⁰ the Court decided to put that question to rest once and for all. It stated unequivocally that "a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs."⁶¹ Above-cost discounting, the Court insisted, "is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting."⁶² Thus, the Court established a bright-line rule that courts should not entertain antitrust claims based on low prices (of a single product, at least), unless those prices are below the discounter's cost and could therefore drive out of business those firms that are as efficient as the discounter but do not possess the financial reserves necessary to sustain below-cost pricing.

As noted, *Brooke Group* and its progenitors addressed only single-product discounting.⁶³ Nevertheless, the per se legality advocates maintain that extending *Brooke Group*'s below-cost criterion to bundled discounts represents sound antitrust policy because any attempt to condemn some above-cost bundled discounts (those that could exclude equally efficient competitors) would involve a measure of uncertainty that would discourage proconsumer, nonexclusionary discounts.⁶⁴ Such a perverse re-

58. *See id.* at 230–31 (summarizing Liggett's theory of predation).

59. *See id.* at 230.

60. *Id.* at 223 (alteration in original) (quoting *Cargill Inc. v. Monfort, Inc.*, 479 U.S. 104, 117–18 n.12 (1996)).

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

62. *Brooke Group Ltd.*, 509 U.S. at 223.

63. *See supra* note 44 and accompanying text.

64. Brief for Amici Curiae BellSouth Corp. et al. at 6, *3M v. LePage's Inc.*, 124 S. Ct. 2932 (2004) (No. 02-1865), available at 2003 WL 22428381 ("[T]he

sult is likely, per se legality advocates argue, because the anti-trust laws provide for treble damages,⁶⁵ and antitrust tribunals are largely incapable of making the fine economic distinctions necessary to distinguish anticompetitive from procompetitive conduct.⁶⁶ Rather than risk a potential judgment requiring payment of treble damages, firms would be reluctant to offer discounts involving multiple products, even where those discounts were not at all exclusionary.⁶⁷ The possibility of exclusionary bundled discounting schemes does not trouble per se legality advocates. After all, *Brooke Group's* safe harbor for above-cost pricing is based not on some theory that above-cost discounted pricing can never be anticompetitive.⁶⁸ Rather, the

need for easily administered rules is particularly acute in this context because bundled pricing policies are characterized by fast-paced, trial-and-error experimentation, and firms cannot easily apply an indeterminate, multi-factor antitrust analysis every time they tweak a pricing policy to accommodate rapidly shifting market realities.” (footnote omitted)).

65. 15 U.S.C. § 159(a) (2000) (permitting antitrust plaintiff to recover “threefold the damages by him sustained”).

66. As then Judge (now Justice) Stephen Breyer explained:

[U]nlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve.

Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983).

67. The Business Roundtable recognized this point in its brief in support of defendant’s petition for writ of certiorari in the *LePage’s* case:

Rather than take the risk that a jury might condemn such practices with treble damages, and rather than hire a cadre of lawyers and economic consultants to attempt to justify every new proposed pricing scheme, firms will simply choose not to grant such discounts, and not to bundle products, at all. The result will be higher prices and economic inefficiencies, to the consumer’s ultimate detriment—precisely what antitrust laws seek to avoid.

Brief for Amicus Curiae the Business Roundtable at 14, *LePage’s Inc.* (No. 02-1865), available at 2003 WL 22428382.

68. An abundance of relatively noncontroversial economic scholarship shows that strategic single-product pricing can be anticompetitive even at prices above cost. See Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257, 312 (summarizing literature regarding possible anticompetitive effects of above-cost but discounted pricing). For example, businesses may use above-cost discounts to discourage entry, either by engaging in “limit” pricing or by building excess capacity and holding out the threat of dramatic price reductions. *Id.* (citing *E.I. DuPont de Nemours & Co.*, 96 F.T.C. 653 (1980) (final order)); F. M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 356–66, 405–06 (3d ed. 1990); Oliver E. Williamson, *Predatory Pricing: A Strategic and Wel-*

safe harbor is based on the ground that any consumer benefit created by a rule that permits inquiry into above-cost, single-product discounts, but allows judicial condemnation of those deemed legitimately exclusionary, would likely be outweighed by the consumer harm occasioned by overdetering nonexclusionary discounts.⁶⁹ Similarly, per se legality advocates warn, a legal rule that permits judicial condemnation of *some* above-cost bundled discounts would likely cause more harm than good.

In essence, per se legality advocates contend that the total costs of a rule restricting some bundled discounts (the administrative costs of the rule plus the costs resulting from wrong decisions and from deterrence of procompetitive behavior) would exceed the total benefits of such a rule (the benefits resulting from elimination of anticompetitive bundled discounts). But that claim assumes either (1) that above-cost bundled discounts are so unlikely to exclude equally or more efficient competitors that the search for exclusionary bundled discounts is not worth the effort, or (2) that there is no alternative evaluative approach that is easily administrable and is unlikely to overdeter proconsumer discounts. Both assumptions are probably untrue. First, as the aforementioned shampoo/conditioner example indicates, it is not difficult to imagine instances of multi-product sellers using bundled discounts to create or maintain monopoly power by driving less diversified rivals from the market.⁷⁰ Thus, it is doubtful that exclusionary bundled discounts are so rare that any effort to identify and condemn them is unjustified. Second, as Part III explains, there is an alternative evaluative regime that is both easily administrable and unlikely to overdeter proconsumer discounts and is therefore worth adopting.

fare Analysis, 87 YALE L.J. 284 (1977); Steven C. Salop, *Strategic Entry Deterrence*, 69 AM. ECON. REV. 335 (1979); David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894-1912*, 102 J. POL. ECON. 103 (1994). Alternatively, businesses might set low but above-cost prices so as to signal false information about costs, thus deterring rivals who cannot meet the apparent costs of the dominant firm, see JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* 367-74 (1999), or to reduce the cost of acquiring rivals, see Malcolm R. Burns, *Predatory Pricing and the Acquisition Cost of Competitors*, 94 J. POL. ECON. 266 (1986).

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

70. See *supra* notes 25-27 and accompanying text.

B. EXCLUSIONARY IF RIVAL'S COSTS ARE RAISED UNJUSTIFIABLY

1. The Approach

A second approach to bundled discounts focuses on whether the discounts unjustifiably increase the costs of the discounter's rivals.⁷¹ This "raising rivals' costs" approach lies at the opposite end of the spectrum from the per se legality approach, for it would go so far as to condemn certain above-cost, *single-product* purchase target discounts.⁷² Advocates of this restrictive approach reason that discounts conditioned upon purchasing a bundle, or even a specified amount of a single product, may foreclose marketing opportunities for the discounter's rivals, thereby raising the rivals' costs by denying them economies of scale.⁷³

To see how even a single-product purchase target discount might raise rivals' costs,⁷⁴ consider a manufacturer whose well-established brand enjoys such an inelastic consumer demand that retailers must carry about 60% of their requirements of the product in that firm's brand.⁷⁵ Suppose that, to achieve the economies of scale and other efficiencies necessary to be a viable producer of this product, a competing manufacturer needs

71. See Einer Elhauge, *Defining Better Monopolization Standards*, 56 *STAN. L. REV.* 253, 315 (2003) [hereinafter Elhauge, *Monopolization Standards*]; Tom, Balto & Averitt, *supra* note 23, at 636–38; Einer Elhauge, *Anti-trust Analysis of GPO Exclusionary Agreements* 38–39 (Sept. 26, 2003) [hereinafter Elhauge, *GPO Agreement Analysis*] (statement for DOJ-FTC Hearing on GPOs), at http://www.law.harvard.edu/faculty/elhauge/pdf/statement_ftc_doj.pdf.

72. See *supra* notes 20–23 and accompanying text. The prevailing view is that such discounts are legal, for they can always be matched by an equally efficient competitor and will therefore tend to exclude only relatively inefficient rivals. See, e.g., *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1061 (8th Cir. 2000); 3A AREEDA & HOVENKAMP, *supra* note 22, ¶ 768(b)(2), at 149 ("For single-item discounts, no matter how measured or aggregated, injury to an equally efficient rival seems implausible.")

73. See Tom, Balto & Averitt, *supra* note 23, at 622–27; Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 3–10.

74. The following example is taken from Tom, Balto & Averitt, *supra* note 23, at 627–29.

75. *Id.* at 627. Gerber brand baby food, which commands strong brand loyalty and is carried by almost all retailers that sell baby food, may be an example of this sort of product. See *F.T.C. v. H.J. Heinz, Co.*, 116 F. Supp. 2d 190, 193 (D.D.C. 2000) (noting that because "Gerber enjoys unparalleled brand recognition" and high brand loyalty, nearly all supermarkets must stock the product), *rev'd on other grounds*, 246 F.3d 708 (D.C. Cir. 2001).

to maintain about a 35% market share. Assume that the current market share of the dominant brand is 60% (reflective of consumer demand) and the competitor's share is 40%. If the dominant firm were to offer an above-cost discount of 6% (going back to the first purchase) to buyers purchasing at least 70% of their requirements from the firm, such a discount could impair the efficiency of the non-dominant competitor.⁷⁶ The modest "market share discount" could cause a major shift in purchasing among retailers, for the entire dollar value of the across-the-board 6% discount would be concentrated on the retailers' decisions to buy the incremental units between 60% and 70% of requirements.⁷⁷ As Willard K. Tom, David A. Balto, and Neil W. Averitt explain, "[T]he buyer faces a 'tax' or 'penalty' in the form of the loss of *all cumulative discounts* if it takes a [single] unit from an alternative supplier beyond 30% of its needs."⁷⁸ Thus, to compete with the dominant seller's 6% discount, the rival seller would have to give a discount on its smaller market share that was equal in absolute dollar value to the 6% discount the dominant supplier would provide on 70% of the purchaser's requirements. If prices were set close to marginal cost, the nondominant seller would not be able to provide such a discount, and its market share would probably fall below 30%, a level beneath the "minimum efficient scale" of 35%.⁷⁹ Thus, advocates of the restrictive approach assert any discount structured to usurp business from rivals—even an above-cost, single-product purchase target discount—may be used to raise rivals' costs and should therefore be subject to condemnation if the discount is not justified.⁸⁰

Professor Einer Elhauge, perhaps the leading proponent of this restrictive approach, has identified a number of ways above-cost purchase target discounts may raise rivals' costs.⁸¹ As the example above illustrates, purchase target discounts that result in foreclosure may bar rivals from marketing outlets

76. See Tom, Balto & Averitt, *supra* note 23, at 627.

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

78. *Id.* (emphasis added).

79. See *id.* at 627–28.

80. As explained below, the commentators recommending a raising rivals' costs approach have disagreed as to how to spot a discount that raises rivals' costs but should nonetheless be legal because it is justified. See *infra* notes 87–92 and accompanying text.

81. See Elhauge, *Monopolization Standards*, *supra* note 71, at 256, 283, 320–23; Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 4–10.

needed to sustain minimum efficient scale.⁸² Even when alternative marketing outlets are available, rivals' costs will be raised (and their efficiency reduced) if those alternative means of distribution are less cost-effective.⁸³ Moreover, to the extent marketing opportunities are foreclosed, rivals will find it more difficult to raise capital for research and development, for capital markets will provide less funding where expected payoffs are lower, and such payoffs will obviously be lower when available marketing opportunities are foreclosed.⁸⁴ In addition, purchase target discounts may decrease the efficiency of the discounter's rivals in industries where there are "network effects" (i.e., where the value to a consumer of a particular brand of product increases as more consumers purchase that brand); in such industries, discounts that take market share from rivals

82. Elhauge, *Monopolization Standards*, *supra* note 71, at 321; Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 4.

In most industries, there are economies of scale at low output levels, so that firms can lower their costs by expanding until they reach the output level that minimizes their costs, which is called the minimum efficient scale. If foreclosure prevents a competitive number of rivals from maintaining this scale, or from expanding their operations to reach it, then it impairs their efficiency.

Elhauge, *Monopolization Standards*, *supra* note 71, at 321; *cf.* *LePage's Inc. v. 3M*, 324 F.3d 141, 161 (3d Cir. 2003) (en banc) ("As a result [of defendant's bundled discounts, which expanded its market share], LePage's manufacturing process became less efficient and its profit margins declined. In transparent tape manufacturing, large volume customers are essential to achieving efficiencies of scale."), *cert. denied*, 124 S. Ct. 2932 (2004).

83. Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 5 ("Even if other means of distribution remain open . . . foreclosing rivals from the means of distribution that are the most cost effective will increase rival costs and thus their prices, hampering their ability to compete." (citing HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY* 431 (2d ed. 1999) (noting that "foreclosure theories of exclusive dealing become more robust if" they are "raising rivals' costs by relegating them to inferior distribution channels"))); *see* Elhauge, *Monopolization Standards*, *supra* note 71, at 321. The court in *LePage's* appears to have accepted this reasoning:

In the transparent tape market, superstores like Kmart and Wal-Mart provide a crucial facility to any manufacturer—they supply high volume sales with the concomitant substantially reduced distribution costs. By wielding its monopoly power in transparent tape and its vast array of product lines, 3M foreclosed LePage's from that critical bridge to consumers that superstores provide, namely, cheap, high volume supply lines.

324 F.3d at 160 n.14.

84. Elhauge, *Monopolization Standards*, *supra* note 71, at 322 ("If firms are foreclosed from a significant share of the market, then successful innovations will have a smaller payoff than they otherwise would have, which will discourage efficient investments in research and innovation.") Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 7.

impair those rivals by decreasing the value of their products to consumers.⁸⁵

So what does all this theorizing imply for the law governing bundled discounts? Should the law simply preclude discounts that win away market share from the discounter's rivals? Surely not, for practically *all* discounts do that. Indeed, Professor Elhauge acknowledges that any price-decreasing or product-improving innovation will permit the innovator to usurp business from rivals, and thus might have the effect of raising rivals' costs—and he recognizes that antitrust law should not discourage such innovations.⁸⁶ Thus, antitrust tribunals need some means of separating procompetitive from anticompetitive bundled discounts.

Former Federal Trade Commission (FTC) officials Tom, Balto, and Averitt, who have advocated a “raising rivals’ costs” approach, have recommended that antitrust tribunals engage in case-by-case analysis to determine whether above-cost purchase target discounts are legal.⁸⁷ Such an approach, the former regulators contend, “would let counselors and enforcers concentrate instead on the core questions that have long been central to antitrust—whether the restraints at issue tend to create or facilitate horizontal problems of collusion or exclusion” and would “focus [] on effect rather than on formalistic line drawing.”⁸⁸ The problem with this open-ended approach, of course, is that it offers virtually no guidance to businesses. In practice, it would require antitrust counselors to predict whether a judge (or, worse yet, a jury) would conclude that an above-cost purchase target discount was merely “competition

85. Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 6. “Network effects” exist when a “seller’s product is more valuable to buyers the more that other buyers have purchased the same good from that seller.” *Id.*

86. Elhauge, *Monopolization Standards*, *supra* note 71, at 265 (“[P]erfectly desirable competitive behavior can ‘foreclose competition’ and ‘destroy a competitor,’ such as when a firm figures out how to make a better or cheaper product and thus takes away market sales from rivals and drives them out of the market.”).

87. Tom, Balto & Averitt, *supra* note 23, at 638 (“Where the pricing structure, rather than the price level, is used to secure an anticompetitive result, the cost test of predatory pricing does not automatically apply. Instead, one must conduct a case-by-case analysis of the actual effects of the particular practice to determine whether anticompetitive outcomes are likely.”). When their article was published, Tom, Balto, and Averitt were, respectively, the deputy director of the FTC’s Bureau of Competition, the bureau’s assistant director for policy and evaluation, and an attorney within the bureau.

88. *Id.* at 638–39.

on the merits" or was likely to be so successful (i.e., to win so much business from rivals) that it would harm competition by reducing rivals' efficiencies. The crystal ball nature of this inquiry, coupled with the fact that a mistaken prediction could result in treble damages, would likely overdetter by chilling many proconsumer discounts.

Recognizing the danger inherent in a case-by-case balancing of competitive effects,⁸⁹ Professor Elhaug has proposed a more structured inquiry. Under his suggested approach, the antitrust tribunal would ask whether the discounting behavior would enhance the discounter's market power regardless of whether it enhanced the discounter's efficiency.⁹⁰ If so, then the discount is anticompetitively exclusionary, and there is no need to weigh its procompetitive benefits.⁹¹ If not (the discounting behavior could not enhance the discounter's market power without creating some efficiencies for the discounter), then the discounting behavior is procompetitive and should be deemed legal per se, even if the discounting did cause some foreclosure of marketing opportunities for rivals.⁹²

Under Professor Elhaug's approach, a purchase target discount that had the effect of decreasing the market share of the discounter's rivals and thereby increasing their costs would

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

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

Elhaug, *Monopolization Standards*, *supra* note 71, at 266–67.

90. *See id.* at 315.

91. *Id.* at 315–16.

92. *See id.* Professor Elhaug maintains that antitrust law should eschew "an open-ended rule of reason balancing test" and should instead employ [] two rules to sort out when to condemn conduct that helps acquire or maintain monopoly power. One rule makes such conduct per se legal if its exclusionary effect on rivals depends on enhancing the defendant's efficiency. The other rule makes such conduct per se illegal if its exclusionary effect on rivals will enhance monopoly power regardless of any improvement in defendant efficiency.

Id. at 330.

be legal *only if* selling the product as a bundle (in the case of a bundled discount) or in the quantities required to earn a volume discount (in the case of a single-product purchase target discount) created efficiencies for the discounter.⁹³ Moreover, the discount presumably could be no greater than required to attain those efficiencies, for any incremental discount in excess of that amount would effectively be raising rivals' costs and enhancing the discounter's market power "regardless of any improvement in [the discounter's] efficiency."⁹⁴ So, for example, a firm with a 70% market share charging supracompetitive prices could not offer volume discounts if all available economies of scale could be exploited at a level of production equal to 50% of the market and there were no distributional or other efficiencies created by selling the larger volume. Nor could a firm that could obtain productive or distributional efficiencies by increasing total production or the size of individual orders offer a discount greater than that necessary to induce the increased demand needed to achieve the growth in production or order size. Consider, for example, a firm that currently operates its factories at 70% capacity and could reduce its per unit costs from \$.10 per unit to \$.09 per unit by running the factories at 85% capacity. Running the factories above 85% capacity, however, would produce no net efficiency gain, for any incremental economies of scale would be offset by diseconomies occasioned by, for example, excessive wear and tear. Suppose that the firm could expand demand for its product sufficiently to warrant production at 85% capacity by paying a 10% rebate on purchases over 1000 units. Under Professor Elhauge's approach, the firm would be allowed to offer that rebate, but it could not offer a higher rebate (say, 12%) even if the post-rebate price was well above cost. The 2% excess discount would tend to reduce rivals' market shares, raise their costs, and enhance the discounter's market power regardless of whether it provided an efficiency gain. Thus, the excess discount would be "exclusionary," even if it resulted in above-cost pricing.

Put simply, Professor Elhauge's view seems to be that bundled discounts will be deemed exclusionary if they raise rivals' costs "unjustifiably," where "justifiable" means "as a by-product of a gain in productive or distributional efficiency."⁹⁵

93. *See id.*

94. *Id.*

95. *See id.*

Thus, in evaluating a purchase target or bundled discount, the antitrust tribunal would ask, "Is selling the product in this fashion somehow making the discounter more efficient, or is the discounter merely giving up margin?" If the latter, the discount would be illegal. If the former, the tribunal must ask a follow-up question: "Could the efficiencies be achieved by giving a smaller discount (or by structuring the discount in some other fashion that would win less business from rivals)?" If so, the "excess discount" (or the part of the structured discount whose efficiency-enhancing ends could be achieved in a manner that would raise rivals' costs less) would be anticompetitively exclusionary.

2. Evaluation of the Approach

Both versions of the "raising rivals' costs" approach (both the case-by-case approach advocated by the former FTC officials and Professor Elhauge's more focused approach) are problematic. As an initial matter, the claim that single-product purchase target discounts pose the same sort of competitive threat posed by bundled discounts is wrong. As explained above, the majority view is that an above-cost, single-product purchase target discount may be met by any equally efficient rival.⁹⁶ Professor Elhauge and the former FTC officials maintain that this argument misses the point, for such discounts may actually *cause* rivals to be less efficient by denying them the business needed to achieve all available economies of scale.⁹⁷ But any potentially efficient rival willing to engage in vigorous competition could maintain the market share necessary to achieve economies of scale and thus need not be excluded by an above-cost, single-product purchase target discount.

96. See *supra* notes 20–23 and accompanying text.

97. See Tom, Balto & Averitt, *supra* note 23, at 621–23, 636–38; Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 33–34 ("[T]he claim that rivals can avoid foreclosure by just matching the exclusionary discount assumes away the very anticompetitive harm of interest. For one reason that equally efficient rivals cannot match the discounts is that the marketwide foreclosure has impaired their efficiency."); Elhauge, *supra* note 23, at 24 n.68.

Professor Hovenkamp argues that an equally efficient rival can always match the discount . . . but this is not true if . . . economies of scale exist because the exclusionary scheme will restrict the market share of the rival and thus deprive it of the economies of scale it needs to match the discounted price.

Elhauge, *supra* note 23, at 24 n.68 (citations omitted).

To see this point, consider again the situation where the discounter has a larger market share than its rival, is able to offer an above-cost purchase target discount, the total dollar value of which the rival could not meet (given its smaller market share) without pricing below cost, and is thus able to win enough market share from the rival to prevent it from obtaining all available economies of scale.⁹⁸ Professor Elhaug and the former FTC officials assume that the rival has no way of competing with the discounter. But a rival firm ought to be able to raise the capital necessary to meet (or beat) the discount as long as the rival firm (1) produces a product of equal or better quality, and (2) could produce the product as cheaply as the discounter after achieving all economies of scale. By raising the capital necessary to meet (or beat) the discount, the rival firm would be able to expand its market share.

As the old saying goes, one must spend money to make money. Every business makes investments to achieve the market share required to obtain minimum efficient scale. Businesses must, for example, build productive facilities of the requisite size, produce marketing and advertising materials, give away free samples to generate consumer interest, and incur all sorts of other start-up costs. Start-ups finance these expenditures, of course, by convincing investors and lenders that their product is superior to competing products and will eventually command enough consumer loyalty to warrant production at the level required to attain all available economies of scale. When they in fact have a “better mousetrap” and plausible plans for efficiently producing that mousetrap, they should have little trouble raising start-up funds.⁹⁹

Just as a business must incur costs early on to establish the market share required to achieve minimum efficient scale, it might—if its margins were not great enough to fund a competitive discount—have to incur similar costs to recover market

98. Recall the example offered by the former FTC officials: *A* has a 60% market share; *B* has a 40% market share; the market share required to attain all available scale efficiencies is 35%; *A* offers a 6% discount on all purchases conditioned on the buyer taking at least 70% of its requirements from *A*; *B*, therefore, would have to meet that total dollar discount on its smaller (40%) market share; *B* could not do this without pricing below cost and will therefore lose enough market share to fall below minimum efficient scale. See *supra* notes 74–80 and accompanying text (discussing an example presented by Tom, Balto & Averitt, *supra* note 23, at 627).

99. See Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 929–30 (1979).

share from a discounting rival and thereby protect or enhance productive efficiencies. But the fact that it has to incur such costs does not mean it is being “excluded” from the market. If the disadvantaged rival’s product was as good as the discounter’s and could be produced as cheaply at minimum efficient scale, the rival should be able to raise enough capital to fund any discount necessary to grow its market share to the point necessary to achieve minimum efficient scale.¹⁰⁰ Its below-cost pricing for the period required to achieve such a scale would not amount to predation because there would be no likelihood of recoupment via supracompetitive pricing.¹⁰¹ Were a rival unable to achieve minimum efficient scale by pricing just below the discounter’s above-cost discounted price and thereby winning business from the discounter, it would be because the capital markets perceived the rival’s product to be inferior to the discounter’s, and the rival’s loss of business would thus be deserved.¹⁰² Accordingly, any above-cost, single-product purchase target discount should be deemed per se legal.

A second problem with the “raising rivals’ costs” position is that its adherents have failed to articulate a workable means of separating procompetitive from anticompetitive discounts. As noted above, and as recognized by Professor Elhauge, an evaluative approach involving an open-ended, case-by-case balancing of competitive effects is undesirable because it offers little guidance for businesses, subjects them to the possibility of

100. See 2A PHILLIP E. AREEDA ET AL., *ANTITRUST LAW* ¶ 421(b), at 67 (2d ed. 2002) (“If capital markets are working well, new investment will be made in any market earning anything above competitive returns—a term defined to include sufficient profit to attract new capital—regardless of the absolute cost of entry.”); GEORGE J. STIGLER, *THE ORGANIZATION OF INDUSTRY* 67–69 (1968); Harold Demsetz, *Barriers to Entry*, 72 *AM. ECON. REV.* 47, 49–53 (1982); Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 *J. L. & ECON.* 1, 4 (1973). *But see* Richard R. Nelson, *Comments on a Paper by Posner*, 127 *U. PA. L. REV.* 949, 950 (1979) (“The Chicago proposition that scale economies don’t serve as a barrier to entry hinges on explicit or implicit assumptions about perfect capital markets and no adjustment lags or costs.”).

101. See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222–24 (1993) (positing the likelihood of recoupment via future monopoly pricing as prerequisite to a valid predation claim).

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

inappropriate treble damages judgments, and is therefore likely to overdeter proconsumer bundled discounts.¹⁰³ But what about Professor Elhaug's more focused approach? That approach is similarly deficient for at least three reasons.

First, the approach, which would "make[] [any] conduct per se illegal if its exclusionary effect on rivals will enhance monopoly power regardless of any improvement in defendant efficiency,"¹⁰⁴ would have the perverse effect of preventing price cutting by any monopolist that had achieved all available economies of scale and was unable to achieve additional distributional efficiencies by discounting. Consider, for example, a widget monopolist that commands a 70% market share and sells widgets for \$2.00, a 100% markup over its per unit cost of \$1.00. Suppose all available economies of scale are achievable at a production level reflecting a 50% market share and that there are no distributional efficiencies to be gained by increasing market share via a straight price cut. If the monopolist decided to cut its price to \$1.75, it would sell more widgets, impairing its rivals' efficiencies. That price cut would therefore enhance the widget seller's monopoly power even without improving its efficiency and would, under Professor Elhaug's test, be exclusionary and illegal. A rule that precludes monopolists from cutting their supracompetitive prices, unless such price cuts are necessary to achieve productive efficiencies, is inconsistent with the very goal of antitrust law, which is to protect consumers from supracompetitive prices.¹⁰⁵

In addition, the approach is fundamentally inconsistent with the Supreme Court's *Brooke Group* decision, which held that an antitrust violation could not arise from a price cut that leads to above-cost pricing.¹⁰⁶ There is great debate as to whether *Brooke Group* reaches structured discounts—either single-product purchase target discounts or bundled discounts.¹⁰⁷ But there can be no question that the case reaches a

103. See *supra* note 89 and accompanying text.

104. Elhaug, *Monopolization Standards*, *supra* note 71, at 330.

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

106. 509 U.S. at 222–23.

107. Compare *LePage's Inc. v. 3M*, 324 F.3d 141, 147 (3d Cir. 2003) (en

straightforward price cut. If such a price cut results in a price above cost, the price cut is legal per se. Professor Elhauge's approach would condemn discounting single products to above-cost price levels when the discounting increases the price-cutter's market share (and thus reduces rivals' efficiencies) without also increasing the price-cutter's efficiency.¹⁰⁸ *Brooke Group* would not countenance that result.

Finally, even if the approach were consistent with anti-trust policy and precedent, it would still be deficient because it is difficult to administer, would require fact finders to engage in rather sophisticated economic analysis, fails to offer discounters a reliable safe harbor, and thus is likely to chill pro-consumer discounting. As noted, Professor Elhauge's approach would require a fact finder to determine whether a discounting policy increased the efficiency of the discounter *and* whether the policy somehow went beyond what was necessary to achieve those efficiency benefits.¹⁰⁹ Thus, any business that offered a bundled discount would face a risk that a jury would conclude either that the discounting program did not create productive or distributional efficiencies *or* that the efficiencies that were created could have been achieved by offering a smaller discount or by requiring fewer purchases to qualify for the discount. A jury could award treble damages if convinced that the defendant was giving up surplus (to consumers, incidentally) not because doing so was necessary to achieve some productive or distributional efficiencies but because doing so would win market share from rivals, thereby reducing their efficiencies. The possibility of an adverse treble damages judgment and the lack of any reliable safe harbor would likely deter proconsumer bun-

banc) (rejecting the view that *Brooke Group's* holding regarding prerequisites to liability for predatory pricing applies to bundled discounts), *cert. denied*, 124 S. Ct. 2932 (2004), with Brief for Amici Curiae Morgan Stanley et al. at 10, *LePage's Inc.* (No. 02-1865), available at 2003 WL 22428378 ("Because the bundled rebates did not rise to the level of an illegal tie or otherwise violate Section 1 [sic] whether they would harm competition by unjustifiably excluding even equally efficient competitors from the market had to be determined in accordance with the pricing principles most recently articulated in *Brooke Group.*"), and Brief for Amicus Curiae the Business Roundtable at 9-10, *LePage's Inc.* (No. 02-1865), available at 2003 WL 22428382 (arguing that *Brooke Group's* below-cost pricing requirement applies to bundled discounts).

108. See *supra* notes 89-94 and accompanying text.

109. See *supra* note 94 and accompanying text.

dled discounts¹¹⁰ and constrain the size of bundled discounts that were offered.¹¹¹

In sum, an evaluative approach that determines the legality of bundled discounts based on whether rivals' costs have been raised unjustifiably is unworkable. The problem with the approach is that much (perhaps most) procompetitive conduct raises rivals' costs,¹¹² and it is difficult to provide an easily administrable, but not overly proscriptive, means of determining when such cost raising is "justifiable." If the justifiability of raising rivals' costs is determined on a case-by-case basis, as Tom, Balto, and Averitt suggest, then business planners will be left with no definitive guidelines or safe harbors and will therefore be deterred in their discounting by the prospects of a treble damages award based on a mistaken jury finding.¹¹³ If justifiability is determined, as Professor Elhauge suggests, by asking whether the discounting creates productive or distributional efficiencies for the discounter, then the approach (in addition to being excessively difficult to administer) will be overly proscriptive, for it will condemn desirable pricing practices that have been expressly approved by the Supreme Court.¹¹⁴ Perhaps it would be possible to articulate an easily administrable, and not overly proscriptive, test for determining whether rivals' costs are being raised "unjustifiably." The approaches proposed so far, however, are deficient.

110. See *infra* notes 143–51 and accompanying text (discussing the efficiency benefits of bundling and bundled discounts).

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

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

113. See *supra* notes 87–89 and accompanying text.

114. See *supra* notes 104–08 and accompanying text.

C. EXCLUSIONARY IF BUNDLED DISCOUNTS COVER PRODUCTS NOT SOLD BY RIVALS, AND THE DISCOUNTER FAILS TO PROVE AN ADEQUATE BUSINESS JUSTIFICATION FOR THE DISCOUNTING

A third approach for evaluating bundled discounts—the approach followed in several recently litigated cases—focuses on the extent to which the discounter bundles products not sold by its rivals.¹¹⁵ As discussed above, the primary concern with bundled discounts is that a discounter that bundles multiple products and funds the total discount by giving up some margin on each of those products may be able to usurp business from an equally or more efficient rival that does not sell as broad a product line, has fewer products on which to give up margin, and thus must provide the entire value of the bundled discount on its narrower product offering.¹¹⁶ Accordingly, some courts have reasoned that a seller engages in exclusionary conduct when, without an adequate business justification, it offers a bundled discount that covers products not sold by its rivals.¹¹⁷

Consider, for example, the en banc decision in *LePage's*.¹¹⁸ Plaintiff *LePage's* was a manufacturer of transparent tape, which it sold as “private label” tape—tape that retailers such as Wal-Mart and OfficeMax labeled with their own brand name.¹¹⁹ Defendant 3M manufactured Scotch brand transparent tape, by far the leading brand, as well as private label tape, Post-it

115. See *LePage's Inc. v. 3M*, 324 F.3d 141, 155–57 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004); *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770 MRP, 2004 U.S. Dist. LEXIS 26916 (C.D. Cal. June 10, 2004); see also Complaint, *Conmed Corp. v. Johnson & Johnson, Inc.*, (S.D.N.Y. filed Nov. 6, 2003) (No. 03-CV-8800) (on file with author); Complaint, *Applied Med. Research Corp. v. Johnson & Johnson, Inc.*, (C.D. Cal. filed Sept. 5, 2003) (No. CV-03-1329) (on file with author).

116. See *supra* notes 24–32 and accompanying text.

117. See *LePage's Inc.*, 324 F.3d at 155 (“The principal anticompetitive effect of bundled rebates . . . is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.”); *Masimo Corp.*, No. CV 02-4770 MRP, 2004 U.S. Dist. LEXIS 26916, at *26–30 (relying on *LePage's* in denying defendant’s summary judgment motion where defendant “bundled its oximetry products with non-oximetry markets, thereby creating an inducement to buy from [defendant] that [plaintiff] could not match because [plaintiff] only offers oximetry”); see also *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1065 (3d Cir. 1978) (condemning bundled discount because defendant linked a product on which it faced competition from plaintiff with products plaintiff did not sell), discussed in note 29, *supra*.

118. 324 F.3d 141.

119. *Id.* at 144.

Notes, and other packaging, home care, and leisure products.¹²⁰ Beginning in 1993, 3M began rebate programs that rewarded retailers for purchasing packages of 3M products.¹²¹ The size of available rebates was dependent upon the number of product lines in which customers met specified purchase targets, and the rebates covered purchases from six of 3M's product lines.¹²² LePage's sued, contending that 3M, which admittedly possessed monopoly power in the transparent tape market,¹²³ was monopolizing that market because customers could not meet 3M's growth targets without eliminating LePage's as a supplier.¹²⁴ The jury found for LePage's on its monopolization claim.¹²⁵ On appeal, a divided panel of the Third Circuit reversed the jury's monopolization verdict, holding that LePage's had failed to present proof of anticompetitive conduct.¹²⁶ The majority based its holding on the fact that LePage's "did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled re-

120. *See id.* at 144, 154.

121. *See id.* at 154.

122. *Id.* The evidence at trial focused on three different rebate programs.

Under [the first, the Executive Growth Fund] "EGF," 3M negotiated volume and growth targets for each customer's purchases from the six 3M consumer product divisions involved in the EGF program. A customer meeting the target in three or more divisions earned a volume rebate of between 0.2–1.25% of total sales. Beginning in 1995, 3M undertook to end the EGF test program and institute a rebate program called Partnership Growth Fund ("PGF") for the same six 3M consumer products divisions. Under this PGF, 3M established uniform growth targets applicable to all participants. Customers who increased their purchases from at least two divisions by \$1.00, and increased their total purchases by at least 12% over the previous year qualified for the rebate, which ranged from 0.5% to 2%, depending on the number of divisions (between two to five divisions) in which the customer increased its purchases and the total volume of purchases.

In 1996 and 1997, 3M offered price incentives called Brand Mix Rebates to two tape customers, Office Depot and Staples, to increase purchases of Scotch brand tapes. 3M imposed a minimum purchase level for tape set at the level of Office Depot's and Staples's purchases the previous year, with "growth" factored in. To obtain a higher rebate, these two customers could increase their percentage of Scotch purchases relative to certain lower-priced orders.

Id. at 170–71 (Greenberg, J., dissenting).

123. *Id.* at 146.

124. *See id.* at 160–61.

125. *Id.* at 145.

126. *LePage's Inc. v. 3M*, 2002 WL 46961, at *9 (3d Cir. Jan. 14, 2002), *vacated by* 277 F.3d 365 (3d Cir. 2002), *rev'd en banc*, 324 F.3d 141, *cert. denied*, 124 S. Ct. 2932 (2004).

bates.”¹²⁷ The Third Circuit vacated the panel opinion and granted rehearing en banc.¹²⁸ On rehearing, the court rejected the panel’s reasoning and conclusion and upheld the jury’s determination that 3M’s structured discounts amounted to anti-competitive conduct.¹²⁹

Of interest here is the evaluative approach the en banc court used in considering the legality of 3M’s bundled discounts.¹³⁰ The court first emphasized that the principal anti-competitive danger of bundled discounts is that they can be used to disadvantage competitors that sell narrower product lines and therefore must offer, across a smaller range of products, discounts that are at least equal in absolute dollar value to the discounter’s total discounts across all products.¹³¹ The court did not require, however, that LePage’s prove that it could not meet the discount without pricing below cost.¹³² Nor did the court require LePage’s to prove that it produced trans-

127. *Id.*

128. *LePage’s Inc.*, 277 F.3d 365.

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

130. I am using the term “bundled discounts” to include rebates conditioned upon purchasing the constituent parts of a bundle. The challenged conduct in *LePage’s* consisted of bundled rebates. *See id.* at 154. Rebates, of course, are nothing more than discounts provided after the purchase requirements are met.

131. *Id.* at 155 (“The principle anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.”).

132. The dissent recognized this point in distinguishing the majority’s reasoning from that employed in *SmithKline v. Eli Lilly & Co.*, 575 F.2d 1065, 1065 (3d Cir. 1978):

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

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

parent tape as efficiently as 3M.¹³³ All LePage's was required to prove was that the bundle 3M's customers had to buy to secure the discounts included products that LePage's did not sell,¹³⁴ and that this fact made it difficult for LePage's to compete with 3M.¹³⁵ Once LePage's made that showing, the burden shifted to 3M to prove that its bundled discounts were "justified" by cost savings of some sort.¹³⁶ Because 3M failed to present proof that selling its products in a bundled fashion reduced costs by an amount equal to or exceeding the amount of the total bundled discount, its bundled discounts were deemed unjustified and thus exclusionary.¹³⁷ Accordingly, *LePage's* appears to hold that (1) bundled discounts are presumptively exclusionary if the discounter is bundling products not sold by its rivals and is winning business from those rivals, but (2) the presumption may be rebutted if the discounter proves a "business reasons justification" for the bundled discounts, meaning that the bundling saves costs approaching the amount of the total discount.¹³⁸

133. The dissent recognized this point in distinguishing the majority's reasoning from that employed in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, 920 F. Supp. 455, 469 (S.D.N.Y. 1996). See *LePage's Inc.*, 324 F.3d at 177 (Greenberg, J., dissenting). Whereas the *Ortho Diagnostic* court had required the plaintiff to show "either that (a) the [defendant] monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant's pricing makes it unprofitable for the plaintiff to continue to produce," *LePage's Inc.*, 325 F.3d at 177 (quoting *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 469), plaintiff LePage's "d[id] not contend that 3M priced its products below average variable cost," and "LePage's's economist conceded that LePage's is not as efficient a tape producer as 3M." *Id.*

134. *LePage's Inc.*, 324 F.3d at 155-57.

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

136. *Id.* at 163 ("It remains to consider whether defendant's actions were carried out for 'valid business reasons,' the only recognized justification for monopolizing."); *id.* at 164 ("The defendant bears the burden of 'persuad[ing] the jury that its conduct was justified by any normal business purpose.'") (alteration in original).

137. The court explained:

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

Id. at 164.

138. There appears to be substantial momentum in the direction of the

The *LePage's* approach is problematic for at least two reasons. First, the approach may force consumers to subsidize less efficient competitors and thus runs counter to a policy of vigorous competition in which firms succeed or fail based solely on their relative efficiencies. Given that the *LePage's* approach eschews consideration of the relative efficiency of the plaintiff (or any other rival)¹³⁹ and instead focuses on product line breadth, any plaintiff could successfully challenge a bundled discount simply by showing that its product line does not include products within the discounter's bundle. The plaintiff could enjoin the bundled discounts, and receive treble damages, even if it were a less efficient producer of whatever product(s) it sells in competition with the discounter.¹⁴⁰ Thus, the *LePage's* approach may essentially force consumers to "subsidize" less efficient competitors by foregoing discounts that otherwise would be available.¹⁴¹

evaluative approach employed in *LePage's*. Other courts have adopted the approach, see, e.g., *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV 02-4770 MRP, 2004 U.S. Dist. LEXIS 26916 (C.D. Cal. June 10, 2004), and plaintiffs have recently filed lawsuits claiming exclusion from the market by virtue of the fact that defendants offered bundled discounts covering products plaintiff did not sell. See *Complaint, Conmed Corp. v. Johnson & Johnson, Inc.*, (S.D.N.Y. filed Nov. 6, 2003) (No. 03-CV-8800) (on file with author); *Complaint, Applied Med. Research Corp. v. Johnson & Johnson, Inc.*, (C.D. Cal. filed Sept. 5, 2003) (No. 03-CV-1329) (on file with author).

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

140. Consider, for example, the hypothetical shampoo manufacturers discussed *supra* notes 25–27 and accompanying text, but instead assume that the bundled discounter is the more efficient producer. The discounter produces shampoo at a cost of \$1.25/bottle and conditioner at a cost of \$2.50/bottle, sells the shampoo and conditioner separately for \$2.00 and \$4.00, respectively, and sells the package for \$5.00. The plaintiff rival sells only shampoo, which costs it \$1.50/bottle to produce. Under these facts, the plaintiff would be "excluded" by the above-cost, \$5.00 price (representing a \$1.00 bundled discount), for it would have to lower its shampoo price to \$1.00/bottle—well below its cost—to compete. Thus, under the *LePage's* approach, the defendant's bundled discount would be presumptively exclusionary, and the defendant could avoid liability (and treble damages) only by showing that its \$1.00 effective price cut was justified by cost savings occasioned by selling the products in a package. If the defendant was worried about making that showing—or, more likely, was concerned that a fact finder might not be persuaded by its evidence of cost savings—it would likely forego, or at least reduce the size of, the discount. Thus, the *LePage's* rule would discourage discounts whose only effect (besides lowering prices for consumers) would be to make it difficult for a less efficient rival to compete.

141. See AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 183 ("Requiring the defendant's pricing policies to protect the trade of higher cost rivals is overly solicitous of small firms and denies customers the benefits of

Indeed, one need not manufacture hypotheticals to demonstrate this possibility, for this is precisely what happened in *LePage's*. As the dissent emphasized, an economist hired by *LePage's* admitted that *LePage's* was a less efficient producer of transparent tape than 3M.¹⁴² Thus, 3M was punished for charging lower prices to consumers, and was ordered to stop doing so to ensure that an admittedly less efficient competitor could stay in business. *LePage's* itself therefore shows that the evaluative approach adopted in the decision may ultimately prop up less efficient rivals at the expense of consumers.

A second problem with the *LePage's* approach is that its focus on product line breadth threatens to chill bundling, a business practice that frequently creates efficiencies and provides benefits to consumers. On the sellers' side, bundling and bundled discounts may reduce costs by creating economies of scope¹⁴³ (i.e., "decreases in costs per unit of two or more products due to producing or marketing them together instead of separately"¹⁴⁴) or by facilitating output increases so as to achieve economies of scale.¹⁴⁵ The practices may also lower costs by reducing uncertainty about aggregate demand,¹⁴⁶ reduce overhead and marketing expenses by economizing on the quality-signaling benefits of well-known brands,¹⁴⁷ and facilitate efficiency-enhancing differential pricing.¹⁴⁸ There is also

the defendant's lower costs.").

142. *LePage's Inc.*, 324 F.3d at 177 (Greenberg, J., dissenting).

143. See, e.g., THOMAS T. NAGLE & REED K. HOLDEN, *THE STRATEGY AND TACTICS OF PRICING: A GUIDE TO PROFITABLE DECISION MAKING* 306–07 (3d ed. 2002); Yannis Bakos & Erik Brynjolfsson, *Bundling Information Goods: In Pricing, Profits, and Efficiency*, 45 MGMT. SCI. 1613, 1619 (1999) ("Bundling can create significant economies of scope even in the absence of technological economies in production, distribution, or consumption."); Stremersch & Tellis, *supra* note 2, at 68.

144. Stremersch & Tellis, *supra* note 2, at 68.

145. See, e.g., NAGLE & HOLDEN, *supra* note 143, at 3; Asim Ansari et al., *Pricing a Bundle of Products or Services: The Case of Nonprofits*, 33 J. MKTG. RES. 86, 86–93 (1996).

146. Yannis Bakos & Erik Brynjolfsson, *Bundling and Competition on the Internet*, 19 MKTG. SCI. 63, 64–65 (2002).

147. See, e.g., Michael A. Salinger, *A Graphical Analysis of Bundling*, 68 J. BUS. 85, 87–97 (1995).

148. See NAGLE & HOLDEN, *supra* note 143, at 246 ("Rather than cutting prices to price-sensitive customers, the value-added bundler instead offers them an additional value of a kind that less price-sensitive buyers do not want. With that strategy, a company can attract price-sensitive buyers without reducing prices to those who are relatively price insensitive."); see also William J. Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 J.L. & ECON. 49, 65–67 & n.17 (1996) (noting circumstances in which economic

evidence that bundled discounts stimulate consumer demand for the bundler's products.¹⁴⁹ On the buyers' side, bundled discounts reduce supracompetitive prices, at least in the short run, and buyers (especially retailers) frequently prefer purchasing in bundles because doing so reduces the number of vendors with whom they must deal.¹⁵⁰ For both buyers and sellers, pre-announced bundled discounts reduce the transaction costs associated with negotiating multi-product purchases.¹⁵¹ In short, there are many procompetitive, or at worst competitively neutral, reasons for bundling and thus for offering bundled discounts. The *LePage's* approach would discourage such discounts, for firms offering them would be subject to antitrust suits by competitors that sell some, but not all, of the bundled products.

An advocate of the *LePage's* approach would contend, of course, that the approach will not inhibit procompetitive bundled discounting because discounters are afforded the opportunity to justify their behavior by proving that their bundled discounts generate cost savings.¹⁵² But that argument ignores the real-world effect of placing the burden of justification on the

efficiency requires the use of differential pricing).

149. See Soman & Gourville, *supra* note 1, at 42–43. Soman and Gourville demonstrate that bundled discounts can be used to influence the consumer's decision to consume, thus permitting marketers to stimulate demand for their products and to manage consumption of prepaid products and services. *Id.* at 32–42.

150. See, e.g., Philip B. Evans & Thomas S. Wurster, *Strategy and the New Economics of Information*, 75 HARV. BUS. REV. 70, 79–80 (1997); Robert J. Vokurka, *Supplier Partnerships: A Case Study*, 39 PROD. & INVENTORY MGMT. J. 30 (1998). In competing for the business of retailers, multi-product vendors increasingly find it necessary to offer proconsumer bundled product discounts. See, e.g., Gary D. Eppen et al., *Bundling—New Products, New Markets, Low Risk*, 32 SLOAN MGMT. REV. 7, 7–12 (1991); Ovans, *supra* note 2, at 20 (quoting the author of one study of 100 companies using bundles for the proposition that bundling reduces information and transaction costs for consumers: “When done correctly, bundling provides customers with simplicity and order in an otherwise chaotic world.”); Stremersch & Tellis, *supra* note 2, at 70 (“We find that product bundling of existing products may be optimal because it creates added value for consumers, saves costs, and creates differentiation in highly competitive markets.”).

151. See NAGLE & HOLDEN, *supra* note 143, at 245.

152. See *LePage's Inc. v. 3M*, 324 F.3d 141, 163–64 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004). Under *LePage's*, once a plaintiff established that the defendant was offering discounts on bundles that included products its rivals did not sell, the defendant's bundled discount would be deemed exclusionary unless the defendant could prove, to the satisfaction of a jury, that the amount of the discount did not exceed the efficiency benefits created by selling the products in a bundle. See *id.*

discounter. Any business considering whether to offer a bundled discount covering products not sold by some rivals would have to ensure in advance that it could convince a jury that the discount created cost savings at least equal to the amount of profit sacrificed.¹⁵³ For example, any monopolist participating in multiple product markets would be reluctant to offer a discount on any product bundle that included its monopoly product—the very product for which it is most likely to charge a supra-competitive price—because its rival(s) presumably could not replicate the bundle.¹⁵⁴ Similarly, a multi-product firm that competed with similarly diversified firms would be dissuaded from engaging in consumer-friendly bundle-to-bundle competition. Suppose, for example, that firm *A*—like its four chief rivals, *B*, *C*, *D*, and *E*—sells products 1, 2, and 3 and believes that it could win business from those rivals by offering a package discount on the three products. If tiny emergent rival *F* sells only product 1, *A* is unlikely to offer the package discount, even if it could be matched by rivals *B–E* (assuming their equal efficiency) and would reflect consumer desires for package pricing.¹⁵⁵ These results follow from the *LePage*'s approach's insis-

153. See *id.* at 164 (rejecting 3M's business reasons justification because 3M did not prove that "the savings stemming from [selling the products in a bundled fashion] approach[ed] the millions of dollars 3M returned to customers in bundled rebates").

154. The monopoly product presumably would not be sold by rivals competing with the monopolist in other product markets.

155. The medical device bundling cases involve challenges to this sort of bundle-to-bundle competition. Both Johnson & Johnson, Inc. (parent company of Ethicon Endo-Surgery, Inc. and Ethicon, Inc.) and Tyco (parent company of United States Surgical Corp.) sell broad lines of sutures (stitches) and endo-mechanical surgical devices used in minimally invasive laparoscopic surgery. See HOOVER'S, INC., *United States Surgical Corporation*, in HOOVER'S IN-DEPTH COMPANY RECORDS (2005) (discussing "fierce rivalry" between United States Surgical Corp. and Johnson & Johnson, Inc. subsidiaries and noting that such rivalry resulted in a "fierce price war for both sutures and laparoscopic products"), at 2005 WLNR 4491141. In an attempt to win the business of large hospital purchasing organizations, both companies have offered substantial discounts on bundles of sutures and endo-mechanical devices. See *Hospital Group Purchasing: Has the Market Become More Open to Competition?: Hearing Before the Subcomm. on Antitrust, Competition Policy & Consumer Rights of the S. Comm. on the Judiciary*, 108th Cong. 189–204 (2003) [hereinafter *Hearing*] (statement of Said Hilal, President and Chief Executive Officer of Applied Medical Resources Corp.) (describing bundled discounts offered by large, diversified medical supply companies); Joanne M. Todd, *Market Memo: J&J, U.S. Surgical Maintain MIS Product Market Dominance*, HEALTH INDUS. TODAY (Aug. 1998) (describing how intense competition in the "minimally invasive surgery" market led Johnson & Johnson, Inc. and United States Surgical Corp. to offer bundled discounts to group purchasing organiza-

tence that bundled discounters with less diversified rivals prove that their discounts create cost savings in excess of any surplus transferred to consumers.

The burden here is misplaced. Given that an above-cost bundled discount *always* provides some procompetitive benefit (in that it drives prices closer to the level of costs, which is where they would be in perfect competition)¹⁵⁶ and *always* provides some immediate consumer benefit (lower prices), it seems perverse to burden the defendant with “justifying” its discount. The law instead ought to require the plaintiff to prove that the discounting scheme is designed to be exclusionary rather than procompetitive. Part III explains how the law could do this without requiring the plaintiff to produce, and the judicial tribunal to evaluate, amorphous “intent” evidence.

D. EXCLUSIONARY IF ACTUAL PLAINTIFF IS EQUALLY EFFICIENT AND IS UNABLE TO COMPETE

As noted, an evaluative approach focused on the relative breadth of the discounter’s bundle vis-à-vis its rivals’ product lines may condemn discounts that would exclude only less efficient rivals and may, as in *LePage’s* itself, force consumers to subsidize rivals that are less efficient than the discounter.¹⁵⁷ Accordingly, some courts have reasoned that a competitor complaining of an above-cost bundled discount should have to prove that it is at least as efficient a producer of the competitive product as the discounter.¹⁵⁸ Requiring such proof would, of course,

tions), at http://www.findarticles.com/p/articles/mi_m3498/is_1998_August/ai_54028824+U.S.+Surgical+Bundle&hl=en. A few tiny rivals, however, have sought to thwart this price competition on grounds that they do not sell as broad a line of products as Johnson & Johnson, Inc. and Tyco and therefore cannot offer competing bundles. See *supra* note 4 and accompanying text (discussing lawsuits brought by small medical device suppliers against Johnson & Johnson, Inc. and Tyco); cf. *Hearing, supra* at 199 (stating that Applied Medical Resources Corp. lost a major supply contract because it “did not have the rest of the products that Johnson & Johnson and Tyco bundled with the trocars”); Mary Williams Walsh, *New Scrutiny Aimed at Bundled Sale of Hospital Supplies*, N.Y. TIMES, July 17, 2003, at C1 (describing antitrust challenges to Johnson & Johnson, Inc.’s bundled discounts).

156. Cf. 2A AREEDA ET AL., *supra* note 100, ¶ 402(b)(2), at 6 (noting that in perfect competition, price will be driven to the level of marginal cost); 10 PHILLIP E. AREEDA, HERBERT HOVENKAMP & EINER ELHAUGE, *ANTITRUST LAW* ¶ 1758(f), at 334 (2d ed. 2004) (noting that a “package discount brings that price closer to the competitive level and increases output in both the tying and tied products”).

157. See *supra* notes 139–42 and accompanying text.

158. See *LePage’s, Inc. v. 3M*, 2002 WL 46961, at *9–10 (3d Cir. Jan. 14,

prevent less efficient competitors from using the law to create a “price umbrella” that would shield them from vigorous price competition.

This approach is best exemplified by the *Ortho Diagnostic* opinion.¹⁵⁹ The issue before the court in that case was whether defendant Abbott, which sold five types of (noninterchangeable) blood tests, had violated section 2 of the Sherman Act¹⁶⁰ by providing discounts on packages of its different types of blood tests.¹⁶¹ The plaintiff, Ortho, manufactured blood tests that competed with three of Abbott’s five tests.¹⁶² Abbott provided a discount on all of a purchaser’s blood test purchases if the purchaser bought at least four types of tests from Abbott, and it offered a higher discount to purchasers who bought all five of its tests.¹⁶³ Ortho complained that the discount policy unfairly disadvantaged Ortho because it could compete with Abbott only by offering the full value of Abbott’s five-product discount on its own three-product selection.¹⁶⁴ Ortho did not demonstrate that Abbott was pricing its discounted package below cost or that Ortho was as efficient a producer as Abbott but was unable to compete because of the discounting strategy.¹⁶⁵

The court rejected Abbott’s claim that its discounting should be deemed per se legal because it resulted in above-cost prices. The court first observed that the “below-cost” requirement for predatory pricing “is a vehicle designed to identify cases in which the defendant has priced its product at a level that creates the risk of depriving consumers of the benefits of competition from firms at least as efficient as the defendant.”¹⁶⁶ The court then concluded that the below-cost test might be underinclusive when bundled discounts are at issue, for even

2002), *vacated by* 277 F.3d 365 (3d Cir. 2002), *rev’d en banc*, 324 F.3d 141, *cert. denied*, 124 S. Ct. 2932 (2004); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 469 (S.D.N.Y. 1996).

159. 920 F. Supp. 455.

160. 15 U.S.C. § 2 (2000).

161. 920 F. Supp. at 458.

162. *Id.* at 459.

163. *Id.* at 460.

164. *Id.* at 461–62. In other words, Ortho would have had to discount each of its products more than Abbott did to offer a competitive discount to consumers. *See id.*

165. *Id.* at 469.

166. *Id.* at 466–67 (noting also that “below-cost pricing, unlike pricing at or above that level, carries with it the threat that the party so engaged will drive equally efficient competitors out of business, thus setting the stage for recoupment at the expense of consumers”).

above-cost bundled discounts may have exclusionary effects where the discounter participates in more product markets than its competitors and is therefore able to spread the total discount over all those product lines and to force competitors to provide the entire dollar amount of the discount on a smaller collection of products.¹⁶⁷

Having rejected the *per se* legality approach, the court did not ask whether the discounter's conduct unjustifiably "raised rivals' costs," nor did it presumptively condemn the bundled discounts simply because the bundle included products the plaintiff did not sell. Instead, the court attempted to articulate a test that would condemn only those bundled discounts that would exclude a plaintiff that was as efficient as the discounter. Recognizing that discounting is usually procompetitive, the court held that a plaintiff complaining of bundled discounts must show that the pricing strategy somehow threatens equally or more efficient firms.¹⁶⁸ To do so, the plaintiff must demonstrate either that the discounted bundled price is below the average variable cost of the bundle *or* that the plaintiff is at least as efficient a producer of the competitive product as the defendant but cannot charge prices high enough to turn a profit because of the defendant's pricing.¹⁶⁹ In its ultimately vacated opinion, the panel majority in *LePage's* appeared to adopt a similar approach for evaluating bundled discounts.¹⁷⁰

167. *Id.* at 467–68. To illustrate this point, the court offered a version of the shampoo/conditioner example discussed above. See *supra* notes 25–27 and accompanying text.

168. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 469.

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

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

Id.

170. *LePage's Inc. v. 3M*, 2002 WL 46961, at *9 (3d Cir. Jan. 14, 2002), *vacated by* 277 F.3d 365 (3d Cir. 2002), *rev'd en banc*, 324 F.3d 141, *cert. denied*, 124 S. Ct. 2932 (2004). On rehearing, of course, the *en banc* majority rejected the approach. See *LePage's Inc.*, 324 F.3d at 175–77 (Greenberg, J., dissenting) (noting that the *en banc* court had lowered the quantum of proof required to establish exclusionary conduct).

While the *Ortho Diagnostic* approach avoids forcing purchasers to subsidize less efficient competitors by foregoing discounts, the approach creates serious administrability difficulties.¹⁷¹ Under the approach, a plaintiff would have to prove, and a judicial tribunal would have to determine, what the plaintiff's per unit production and distribution costs are and how those costs compare to the defendant's per unit costs. Ascertaining costs is notoriously difficult,¹⁷² and proving *another party's* costs is even more difficult, given that the relevant evidence is in that other party's control.

Of course, the difficulty of proving another's costs cannot, by itself, doom the *Ortho Diagnostic* approach, for well-established doctrine requires plaintiffs complaining of predatory pricing to make precisely such a showing.¹⁷³ But the burden the *Ortho Diagnostic* approach places on plaintiffs and judicial tribunals exceeds the burden in run-of-the-mill predatory pricing cases. First, the approach requires the plaintiff to make (and the tribunal to evaluate) two cost showings: the plaintiff must prove its own per unit costs as well as the defendant's. In a predatory pricing case, by contrast, the defendant's cost is compared to price, which is easily ascertainable. Second, determining the defendant's cost in a bundled discount case will likely be particularly complicated because there will always be joint costs—i.e., costs pertaining to two different products.¹⁷⁴

171. On the need for antitrust standards to be easily administrable, see *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (“[A]ntitrust rules are court-administered rules. They must be clear enough for lawyers to explain them to clients. They must be administratively workable and therefore cannot always take account of every complex economic circumstance or qualification.”); Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. CHI. L. REV. 147, 148 (2005) (“A workable definition of exclusionary conduct under Section 2 of the Sherman Act . . . must be administrable by a court, perhaps in a jury trial.”); Hovenkamp, *supra* note 68, at 269, 272–73; Fred S. McChesney, *Talking 'Bout My Antitrust Generation: Competition for and in the Field of Competition Law*, 52 EMORY L.J. 1401, 1414 (2003) (“Optimal minimization of error requires not just rules that are substantively sound, but also ones relatively easy for courts to apply correctly.”).

172. See 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 740, at 423–40; Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why Aspen and Kodak Are Misguided*, 68 ANTITRUST L.J. 659, 664 (2001) (noting that “it is well-known that calculating marginal costs from accounting data is difficult”).

173. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1992) (“[A] plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs.”).

174. AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 182 n.35.

Joint costs are inevitable in this context because every bundled discounter, unlike every predatory pricing defendant, produces multiple products and sells them together. Thus, the bundled discounter incurs, at a minimum, common marketing costs. Moreover, the discounter will generally incur common costs related to manufacturing, packaging, transportation, invoicing, and overhead. Determining how to allocate these common costs among the competitive product and the other products for which the costs were incurred (some of which might not even be included within the bundle) can be exceedingly difficult—arbitrary, in fact.¹⁷⁵ Proving a discounter's costs will therefore be particularly difficult when bundled discounts are involved. Thus, the *Ortho Diagnostic* approach, while properly focusing on whether an equally efficient rival is being excluded by a bundled discount, creates intractable difficulties of administrability and is likely to underdeter truly exclusionary bundled pricing, for plaintiffs will find it difficult to make the showing necessary to establish illegality. Moreover, if the plaintiff happens not to be the discounter's most efficient rival, it is possible that the plaintiff's legal challenge will not prevail (because the plaintiff is not an equally efficient rival) but that there are, or could in the future be, equally efficient rivals that would be excluded by the defendant's bundled discounts. Thus, the *Ortho Diagnostic* approach may require multiple lawsuits where the plaintiff is not the rival best able to match the discounter's productive efficiencies.

E. EXCLUSIONARY IF HYPOTHETICAL EQUALLY EFFICIENT RIVAL WOULD BE UNJUSTIFIABLY EXCLUDED

In light of the difficulties associated with *Ortho Diagnostic's* evaluative approach, the leading antitrust treatise, *Antitrust Law: An Analysis of Antitrust Principles and Their Application (Antitrust Law)*,¹⁷⁶ advocates an alternative approach

175. See generally 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 742, at 461 (discussing difficulty of allocating joint costs); 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758(f), at 335 ("Proving costs is always difficult and tracing them to particular products is even more difficult. Indeed, allocating joint costs among the products in a package is arbitrary even in theory.")

176. PHILIP E. AREEDA ET AL., *ANTITRUST LAW* (1978). The *Antitrust Law* treatise is so extensively relied on by antitrust lawyers and judges that "U.S. Supreme Court Justice Stephen Breyer once remarked that most lawyers would prefer to have on their side 'two paragraphs of Areeda on antitrust than four Courts of Appeals and three Supreme Court Justices.'" *Langdell's West Wing Renamed in Honor of Areeda*, HARV. GAZETTE (Apr. 25, 1996), *avail-*

that similarly seeks to ensure that only equally (or more) efficient rivals are protected but that would be easier to administer and less likely to underdeter or to require multiple lawsuits. Under the *Antitrust Law* approach, a court deciding whether an above-cost bundled discount is exclusionary¹⁷⁷ would ask not whether the particular plaintiff is as efficient as the discounter but instead whether the discount would, without reasonable justification, exclude a hypothetical equally efficient rival.¹⁷⁸ Thus, in the *LePage's* case, the approach “would not have required LePage’s to provide evidence that *it* could not compete against 3M’s multi-product discounts; rather, [the approach] would [have] require[d] it to show that a hypothetical equally efficient firm making only one of the products subject to the bundled rebate could not have competed successfully.”¹⁷⁹ The treatise maintains that “a requirement that the bundling practice be sufficiently severe to exclude an equally efficient single-product rival, and without an adequate business justification, seems to strike about the right balance between permitting aggressive pricing while prohibiting conduct that can only be characterized as anticompetitive.”¹⁸⁰

Antitrust Law's proposed approach would avoid several of the difficulties inherent in the *Ortho Diagnostic* approach. First, the former approach would be easier to administer because ascertaining whether an equally efficient rival would be excluded is simpler than determining whether the plaintiff itself is as efficient a producer of the competitive product as the

able at <http://www.news.harvard.edu/gazette/1996/04.25/LangdellsWestWi.html> (last visited Feb. 26, 2005).

177. A bundled discount resulting in a package price below the cost of the package would presumably be adjudged under the straightforward predatory pricing principles announced in *Brooke Group Ltd.*, 509 U.S. at 222. See 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 509–12.

178. AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 182 (“The relevant question is not necessarily whether a particular plaintiff was equally efficient, but whether the challenged bundling practices would have excluded an equally efficient rival, without reasonable justification.”).

179. AREEDA & HOVENKAMP SUPP. 2003, *supra* note 21, ¶ 749, at 83.

180. AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 182–83.

The treatise explains:

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

Id. ¶ 749, at 183 (citations omitted).

bundled discounter.¹⁸¹ In addition, the approach would avoid *Ortho Diagnostic's* problems of underdeterrence and multiple lawsuits. Relieved of the difficult burden of proving their equal efficiency, plaintiffs would be more likely to sue over truly exclusionary bundled discounts, and plaintiffs who turned out not to be as efficient as the discounter could still stop truly exclusionary discounts, thereby eliminating the need for others to sue, by proving that some other (actual or hypothetical) equally efficient rival would be excluded by the discounts.

But the *Antitrust Law* approach presents its own difficulties. As an initial matter, the approach conflicts with the treatise's treatment of package pricing—which is, of course, a form of bundled discounting.¹⁸² Recognizing that discounts on packages of disparate products are usually procompetitive because they reflect cost savings¹⁸³ and/or move supracompetitive prices toward costs,¹⁸⁴ the treatise suggests that challenges to package pricing ought to be difficult to mount.¹⁸⁵ Package pricing should not be condemned as predatory pricing, the treatise contends, as long as the price of the package exceeds the package's total cost.¹⁸⁶ In other words, a tribunal should not attribute the total amount of any package discount to a single product within the package and ask whether that product, as discounted, is

181. *Id.* ¶ 749, at 182 (contending that the proposed approach is preferable on grounds of administrability because, while “proving whether a hypothetical equally efficient rival is excluded by a multi-product discount is typically quite manageable. . . . [P]roof that the plaintiff is equally efficient can be quite difficult, particularly in cases where the defendant produces a larger product line than the plaintiff and there are joint costs”).

182. *See supra* note 17 and accompanying text.

183. 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758(d)(1), at 329–30 (noting that “[p]ackaging two products together often reduces costs” and that “[f]ailure to legitimize cost savings hospitably would overdeter the common, often procompetitive, and seldom anticompetitive package discount”).

184. 10 *id.* ¶ 1758(f), at 334 (“[T]he package discount brings that price closer to the competitive level and increases output in both the tying and tied products.”).

185. *See generally* 10 *id.* ¶ 1758, at 323–36.

186. 10 *id.* ¶ 1758(f), at 334 (“[W]e do not find predatory pricing so long as the package price exceeds the total relevant cost of the package.”); 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 509 (contending that “[c]ourts should not entertain claims that while a defendant's overall price is remunerative, the separate ‘price’ for one particular component is predatory”); *see also* 3 *id.* ¶ 749, at 510–11 (criticizing *Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal & Professional Publications, Inc.*, 63 F.3d 1540, 1549 n.7 (10th Cir. 1995), for finding predation by attributing the total amount of package discount to a single product within package and asking whether that product, as discounted, was priced below cost).

priced below cost; instead, it should ask whether the package price exceeds the sum of the costs of the products within the package.¹⁸⁷ If so, then the package pricing should be deemed legal as long as it does not amount to de facto tying.¹⁸⁸ Whether package pricing amounts to de facto tying, then, depends on whether the package discount has an effect similar to an outright refusal to sell the packaged products separately.¹⁸⁹ That

187. 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 510 (“[I]t is difficult to think of a more anticompetitive antitrust rule than one requiring that the full cost of each product improvement or increment must be accompanied by a price increase fully offsetting the costs.”).

188. AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 1807(c), at 285 (noting that if the package price is above the cost of the package, there can be no predatory pricing and that “[t]he real competitive harm, if any, comes from tying via a package discount of two or more different products”).

189. 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758(a), at 323 (noting that whether there is de facto tying depends on “whether the discount has an effect similar to an outright refusal to sell [the] tying product . . . separately”). *Antitrust Law* “reject[s], as have most courts, the two polar positions that every package discount proves a tie or that separate availability negates a tie.” 10 *id.* ¶ 1758(b), at 325. Deeming every package discount an illegal tie is improper because “package discounts might promote competition by bringing some package cost savings to consumers, by accommodating heterogeneous buyer preferences, or by helping undermine supracompetitive prices in the tying or tied market.” 10 *id.* Conversely, deeming voluntary package discounts to be per se not a tie “would eviscerate tying scrutiny . . . for any seller could tie with impunity simply by setting a sufficiently large package discount.” 10 *id.* ¶ 1758(b), at 326. A number of courts have similarly recognized that a sufficiently large package discount may constitute a de facto tie. *See, e.g.*, *United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 464 (1922) (noting that package discount might have an “effect . . . so onerous as to compel” the buyer to take the package but finding conflict in testimony about whether such effect was present); *Virtual Maint., Inc. v. Prime Computer*, 957 F.2d 1318, 1318 (6th Cir.), *vacated on other grounds*, 506 U.S. 910 (1992) (package discount a tie); *Am. Mfrs. Mut. Ins. Co. v. Am. Broad.-Paramount Theatres*, 388 F.2d 272, 284 (2d Cir. 1967) (observing that allowing defendant to avoid tying claim “merely by setting a pre-established price for each individual item—even if that price is rarely if ever charged and is, in relation to the package price, fanciful and unjustified by cost—would mean that the antitrust laws could be flouted at will”); *Nobel Scientific Indus. v. Beckman Instruments*, 670 F. Supp. 1313, 1324 (D. Md. 1986) (same (quoting *Ways & Means v. IVAC Corp.*, 506 F. Supp. 697, 701 (N.D. Cal. 1979))), *aff’d*, 831 F.2d 537 (4th Cir. 1987); *In re Data Gen. Corp. Antitrust Litig.*, 490 F. Supp. 1089, 1110–11 (N.D. Cal. 1980) (same); *Ways & Means v. IVAC Corp.*, 506 F. Supp. 697, 701 (N.D. Cal. 1979) (“[S]eparate availability will not preclude antitrust liability where a defendant has established its pricing policy in such a way that the only viable economic option is to purchase the tying and tied products in a single package.”), *aff’d*, 638 F.2d 143 (9th Cir. 1980); *see also Robert’s Waikiki U-Drive, Inc. v. Budget Rent-A-Car Sys., Inc.*, 491 F. Supp. 1199, 1208 (D. Haw. 1980) (noting that a package discount might be a tie if no one would buy the tying product separately), *aff’d*, 732 F.2d 1403 (9th Cir. 1984).

question, the treatise maintains, should be answered by focusing on the “proportion of separate purchases”—that is, the percentage of purchases of “tied” product *B*, by purchasers who buy both the defendant’s “tying” product *A* and any seller’s product *B*, that are outside the defendant’s package.¹⁹⁰ The treatise suggests that if separate purchases exceed 10%, there should be no illegal tie.¹⁹¹ In addition, the treatise posits three “safe harbors” where a tie should not be found *even if* separate purchases are less than 10%.¹⁹² The upshot of this analysis is that a plaintiff attacking package pricing must prove either (1) that the package price is less than the sum of the costs of the products within the package (in which case the package pricing is predatory), or (2) that the “proportion of separate purchases” is less than 10% and none of the three safe harbors applies (in which case the package pricing constitutes *de facto* tying).

In contrast, *Antitrust Law*’s approach to bundled discounting would require a plaintiff to show merely that “the challenged bundling practices would have excluded an equally efficient rival.”¹⁹³ A plaintiff could do so by showing that attrib-

190. 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758(b), at 325–28. For example, if there are 100 purchasers who buy tied product *A* from the defendant and tied product *B* from anyone (the defendant or anyone else), and sixty of those purchasers take *B* as well as *A* from the defendant, the “proportion of separate purchases” is 40%.

191. 10 *id.* ¶ 1758(b), at 328; 10 *Id.* ¶ 1756(b)(2), at 300.

192. See 10 *id.* ¶ 1758(e), at 332–33. Given that the concern of tying law is “that the price for the tying product separately has been so artificially inflated that it is not realistically available separately,” 10 *id.* ¶ 1758(e), at 332, the treatise maintains that courts should decline to find a tie when either (1) the separate price of tying product *A* is less than or equal to the market price of *A*, 10 *id.*, (2) the package price of tied product *B* (i.e., the price of the package less the separate price of tying product *A*) exceeds or equals the market price of *B*, 10 *id.* ¶ 1758(e), at 332–33, or (3) the package price of *B* exceeds or equals the marginal cost of rivals’ *B*, 10 *id.* ¶ 1758(e), at 333 (noting that “[t]his excess means that any inducement to take the defendant’s package results from its rivals’ insistence on charging supracompetitive prices for the tied product”). In the first two situations, there can be no legitimate concern that the defendant has raised the separate price of tying product *A* to induce buyers to purchase the package. In the third, there is no injury to competition because the defendants’ rivals could compete by reducing their prices to competitive levels. 10 *id.* ¶ 1758(e), at 332–33.

193. AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 182. This exclusionary effect must occur, according to the treatise, “without reasonable justification.” *Id.* Presumably, that means that the defendant would be permitted to show some efficiency justification for the bundled discounting. As explained above, see *supra* notes 152–56 and accompanying text, this rebuttal opportunity would not be sufficient to prevent the chilling of procompetitive bundled discounting.

uting the entire amount of the bundled discount to the competitive product results in an effective price for that product that is below the defendant's cost, so that an equally efficient single-product seller could not match, and thus would be excluded by, the bundled discount. That, however, is *precisely* the showing the treatise says is insufficient to prove that package pricing is predatory.¹⁹⁴ Moreover, there is no requirement that the plaintiff establish tying (actual or de facto), which the treatise elsewhere says is the "real competitive harm" occasioned by package pricing.¹⁹⁵

To see the tension in the treatise's disparate treatment of package pricing¹⁹⁶ and bundled discounts,¹⁹⁷ consider a situation where a defendant offers a discount on a package consisting of products *A* and *B*, and its rival (the plaintiff) sells product *A* but not product *B*. Suppose that, when the total amount of the discount is allocated to product *A*, that product is priced below the defendant's cost, but that the discounted price of the *A-B* package exceeds the sum of the defendant's costs of *A* and *B*. Suppose further that only 70% of purchasers who buy both *A* and *B*, and buy at least one of the products from the defendant, partake of the discount by also buying the other product from the defendant.¹⁹⁸ If viewed as package pricing, the treatise would approve this scheme, for it is neither predatory pricing (because the package cost does not exceed the package price)¹⁹⁹ nor tying (because the "proportion of separate purchases" exceeds 10%).²⁰⁰ If viewed as a bundled discount, however, the treatise would presumptively condemn the scheme, for a hypothetical competitor that was equally as efficient as the defen-

194. See *supra* notes 186–88 and accompanying text.

195. AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 1807(c), at 285. Cf. 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 510 ("Of course, the bundling of the car and the stereo may foreclose rival stereo makers, but that concern results from tying, not from predatory pricing.").

196. See generally 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758; AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 1807(c), at 284–85.

197. See generally AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 174–84.

198. Put differently, the "proportion of separate purchases" is 30%. See *supra* note 190.

199. See 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 749, at 509–11; 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758, at 334–35; AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 1807(c), at 285.

200. See 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758(b), at 328. 10 *id.* ¶ 1756(b)(2), at 300.

dant but sold only product *A* could not stay in business.²⁰¹ Thus, *Antitrust Law's* approach to bundled discounting is inconsistent with its treatment of package pricing—which is really the same thing.

A more significant difficulty with the *Antitrust Law* approach is that it would reduce consumer welfare by preventing a multi-product seller from funding a discount on a bundle of its products by giving up margin on one or more supracompetitively priced products within the bundle. Suppose, for example, that the defendant discounter sells products *A*, *B*, and *C* in concentrated markets that are subject to oligopolistic pricing but are not actually cartelized (there are no actual agreements regarding price).²⁰² Assume that the plaintiff competes with the defendant in the market for product *A* but does not sell either product *B* or *C*. The defendant's cost of producing each of products *A*, *B*, and *C* is \$4 per unit. Sold separately, the defendant charges \$5 per unit for each of *A*, *B*, and *C*, but it sells the *A-B-C* package for \$13.50. This package pricing more closely aligns the defendant's prices and costs and will tend to destabilize the coordinated supracompetitive pricing in each of the *A*, *B*, and *C* markets.²⁰³ From the standpoint of consumers and competition,

201. See AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 182 (proposing that the legality of a bundled discount turn on “whether the challenged bundling practices would have excluded an equally efficient rival, without reasonable justification”).

202. Pricing in oligopolistic markets (markets in which a few large sellers account for the bulk of the output) tends to depart from the competitive norm of prices equal to marginal cost, even without actual price agreements among sellers. See 2A AREEDA ET AL., *supra* note 100, ¶ 404(b), at 10–14.

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

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

10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758, at 334–35. With respect to the “destabilizing-oligopolistic-pricing” benefit, the treatise

this is a good thing: prices have been pushed toward costs (where they would be in a perfectly competitive market), oligopolistic pricing has been disrupted (and nondiscounting rivals are likely to respond with discounts of their own), and consumers are paying less.²⁰⁴ The *Antitrust Law* approach, however, would condemn this arrangement because a hypothetical *A* seller whose per unit cost is \$4 (i.e., a “hypothetical equally efficient” *A* seller) would have to lower its *A* price to \$3.50 to compete and would thus be driven out of business.²⁰⁵ The approach may therefore condemn discount cross-subsidization that would be good for consumers and competition in the long run.

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

states:

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

10 *id.* ¶ 1758, at 335.

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

205. See *supra* notes 178–80 and accompanying text.

The *Antitrust Law* approach would impose liability based upon a mere “show[ing] that a hypothetical equally efficient firm making only one of the products subject to the bundled rebate could not have competed successfully.”²⁰⁶ This test could provide undue protection for firms that are inefficient with respect to scope (i.e., that do not produce an optimal mix of products), for in many cases a single-product rival could feasibly begin selling the other products in the bundle. Where entry into the other product markets is easy, the law should not condemn bundled discounts just so that rivals will not have to enter those markets. Entry would increase competition in those markets to the benefit of consumers and should be encouraged. Thus, a plaintiff challenging a bundled discount should have to show that entry barriers²⁰⁷ would preclude the “hypothetical equally efficient firm making only one of the products subject to the bundled rebate”²⁰⁸ from expanding its scope so as to compete with the bundle.

The plaintiff should also have to show entry barriers in the market for the competitive product (the product already sold by the hypothetical equally efficient rival), for the absence of such barriers would preclude future supracompetitive pricing by the discounter and would thus destroy the rationale for condemning a present discount.²⁰⁹ Suppose that allocating the entire amount of the discount to the competitive product results in below-cost pricing so that a hypothetical equally efficient single-product rival would be excluded. Suppose further that there are low barriers to entry in the market for the competitive product. In such circumstances, even if the discounter were to drive out all competitors, it would not have the power to raise prices above competitive levels because other rivals would respond to the supracompetitive pricing by entering the market.²¹⁰ Thus,

206. AREEDA & HOVENKAMP SUPP. 2003, *supra* note 21, ¶ 749, at 83.

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

208. AREEDA & HOVENKAMP SUPP. 2003, *supra* note 21, ¶ 749, at 83.

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

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

the *Antitrust Law* approach is deficient in that it fails to require proof of some possibility of recoupment through monopolistic pricing.²¹¹ Before being allowed to enjoy a consumer-friendly discount, a plaintiff should have to demonstrate the likelihood of future supracompetitive pricing by showing that there are barriers to entry in the market for the competitive product.

III. AN ALTERNATIVE PROPOSAL: ABOVE-COST BUNDLED DISCOUNTS ARE PRESUMPTIVELY LEGAL, BUT A PLAINTIFF MAY REBUT THE PRESUMPTION BY PROVING FACTS THAT DEMONSTRATE GENUINE EXCLUSION OF A COMPETITIVE RIVAL

It seems, then, that each of these articulated approaches to bundled discounts is problematic; each approach would either overdeter, underdeter, or be overly difficult to administer.²¹² Antitrust tribunals instead need an evaluative approach that (1) will condemn those bundled discounts that are ultimately likely to harm consumer welfare, (2) will not chill bundled discounts that are not likely to cause long-run consumer harm, and (3) is easily administrable.²¹³ An approach that presumes

211. Cf. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1993) (holding that below-cost prices that would exclude rivals are not, by themselves, sufficient to establish anticompetitive harm; there must also be a likelihood of recoupment).

212. To review, the *per se* legality approach fails adequately to account for the ability of above-cost bundled discounts to drive out equally efficient rivals and is justified only if there is no administrable means of distinguishing between pro- and anticompetitive above-cost bundled discounts. See *supra* notes 62–70 and accompanying text. The “raising rivals’ costs” theory fails because much procompetitive conduct raises rivals’ costs, and there is no easily administrable test that will identify when raising rivals’ costs is unjustifiable and will not chill procompetitive behavior. See *supra* notes 103–14 and accompanying text. The *LePage’s* approach may force consumers to forego lower prices to protect less efficient rivals (such as *LePage’s* itself) and will discourage even procompetitive bundled discounting by improperly burdening discounters with having to justify their reduced prices by pointing to adequate cost savings. See *supra* notes 139–56 and accompanying text. The *Ortho Diagnostic* approach is difficult to administer, may lead to underdeterrence because the burden on plaintiffs is too great, and may require multiple lawsuits if the “right” plaintiff (the one best able to match the discounter’s efficiency) does not bring the lawsuit. See *supra* notes 171–75 and accompanying text. And the *Antitrust Law* approach would preclude discount cross-subsidization, which will frequently be procompetitive and beneficial to consumers, and would deter bundled discounts that could not lead to future supracompetitive pricing. See *supra* notes 202–11 and accompanying text.

213. As the *Antitrust Law* treatise puts it, “The difficult question [with re-

the legality of above-cost bundled discounts, but would allow a plaintiff to rebut that presumption by proving certain easily ascertainable facts indicating genuine exclusion of an efficient rival, would meet these criteria.

A. OBJECTIVES OF THE ALTERNATIVE APPROACH

Consistent with the general policy objectives of the anti-trust laws, the ultimate goal of the evaluative approach should be to promote consumer welfare by achieving the highest output and lowest price possible.²¹⁴ Given that goal, the approach should condemn bundled discounts that would drive out of business those rivals that are more efficient producers than the discounter, for those rivals would be able to produce—and thus to sell—their products more cheaply than the discounter. In addition, the approach should condemn bundled discounts that would drive out rivals that are *as* efficient as the discounter, for by reducing the number of such rivals, the discounter's conduct would reduce the competition that increases output and drives down prices. Finally (and more controversially), it would be desirable to condemn bundled discounts that would exclude rivals that currently are not as efficient as the discounter but would likely become so if given the opportunity to develop economies of scale.²¹⁵ If the label "competitive rival" is assigned to any rival that is, or is likely to become, as efficient as the dis-

spect to bundled discounts] is the formulation of an administrable rule that does not overreach and condemn competitive conduct." AREEDA & HOVENKAMP SUPP. 2004, *supra* note 27, ¶ 749, at 183.

214. See, e.g., *State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997) (noting that "the primary purpose of the antitrust laws is to protect interbrand competition," which frequently consists of "'cutting prices to increase business'" (quoting *Matsushita*, 475 U.S. at 594)); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 367 (1982) (Powell, J., dissenting) ("As we have noted, the antitrust laws are a 'consumer welfare prescription.'" (quoting *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979))); Thomas A. Piraino Jr., *The Antitrust Analysis of Network Joint Ventures*, 47 HASTINGS L.J. 5, 6 n.7 (1995) ("[T]he federal courts make it clear that the goal of the antitrust laws is to enhance consumer welfare by ensuring competitive markets that provide consumers with the maximum possible output of goods and services at the lowest possible prices.").

215. Compare, e.g., Elhauge, *GPO Agreement Analysis*, *supra* note 71, at 33–34 (arguing that antitrust law should seek to prevent exclusion of even less efficient rivals where the exclusionary tactic is preventing the rivals from attaining efficiencies), with POSNER, *supra* note 112, at 194–95 (defining the exclusionary conduct the antitrust laws should police as conduct that is "likely in the circumstances to exclude from the defendant's market an equally or more efficient competitor"). See generally Hovenkamp, *supra* note 171, at 153–55 (discussing debate over whether less efficient rivals should receive protection).

counter,²¹⁶ then an optimal evaluative approach should aim to condemn bundled discounts that would drive “competitive rivals” out of business.²¹⁷

Designing the approach to condemn such discounts is only part of the objective, however. The approach should also avoid improperly chilling procompetitive bundled discounts. It should therefore be easy to administer (i.e., it should not require an

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

217. A goal of protecting those rivals that are as efficient as the bundled discounter or are likely to become that efficient if afforded the opportunity to grow is largely consistent with the various competing views on what constitutes “exclusionary” unilateral conduct. Professor Hovenkamp has identified four such views. See Hovenkamp, *supra* note 171, at 151–62. One view, espoused by Judge Richard A. Posner, identifies exclusionary conduct as conduct that is “likely in the circumstances to exclude from the defendant’s market an equally or more efficient competitor.” *Id.* at 153 (quoting POSNER, *supra* note 112, at 194–95). The goal set forth here is largely consistent with that definition of exclusionary conduct, though it would call for condemnation of conduct that would exclude rivals not yet as efficient as the discounter but likely to become so if given the opportunity to grow. A second definition of exclusionary conduct is espoused by some members of the so-called “post-Chicago” school and maintains that conduct is exclusionary if it renders the discounter’s rivals less efficient. See Hovenkamp, *supra* note 171, at 158–59 (citing Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986); Steven C. Salop & David T. Scheffman, *Raising Rivals’ Costs*, 73 AM. ECON. REV. 267 (1983)). The goal proposed above is largely consistent with this “raising rivals’ costs” theory, for that theory cannot ultimately be concerned with protecting every rival, but only those likely to achieve comparable efficiency. A third definition of exclusionary conduct focuses on whether the defendant has sacrificed short-run revenues or profits in exchange for larger revenues anticipated to materialize later when the defendant’s monopoly power has been created or strengthened. See *id.* at 155. This “sacrifice-based” theory is largely consistent with the goal stated above because the ultimate point of the sacrifice test is to ensure that rivals that are equally efficient—or are likely to become so—are not driven from the market. Preventing the sacrifice of current profits is not an end in itself; rather, it is a means of determining whether a firm is engaging in conduct that could drive out rivals society would like to have remaining in the market. See Crane, *supra* note 1, at 41–42. Finally, the exclusionary conduct test stated in the *Antitrust Law* treatise asks whether the practice at issue (1) is reasonably capable of excluding rivals, (2) fails to provide adequate consumer benefit, and (3) can be easily identified and condemned by a judicial tribunal. See Hovenkamp, *supra* note 171, at 151–53 (discussing the exclusionary conduct test set forth in 3 AREEDA & HOVENKAMP, *supra* note 15, ¶ 651(a), at 72). The goal here is largely consistent with that definition because only discounts that would exclude equally efficient rivals, or those rivals likely to become so, would meet all three criteria.

amorphous and unpredictable “balancing” by a fact finder) and should include clearly defined safe harbors that could not exclude competitive rivals for bundled discounts.²¹⁸ Such safe harbors—like the safe harbor that exempts above-cost, single-product price cuts from predatory pricing challenges²¹⁹—would permit businesses to engage in approved forms of bundled discounting without fear of treble antitrust damages.

B. THE ALTERNATIVE APPROACH

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

(1) there are barriers to entry (a) in the product market(s) in which the plaintiff does not participate and (b) in the market for the competitive product;

(2) the plaintiff cannot practicably coordinate with other producers to create a competing bundle; and

(3) the plaintiff made a good faith offer to become a supplier to the discounter but was rebuffed.

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

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

218. Cf. Hovenkamp, *supra* note 171, at 148 (“A workable definition of exclusionary conduct under § 2 of the Sherman Act must satisfy two criteria. First, it must define anticompetitive exclusionary conduct with tolerable accuracy, in particular, without excessive false positives. Second, it must be administrable by a court, perhaps in a jury trial.”).

219. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222 (requiring, for predatory pricing liability, that “the prices complained of [be] below an appropriate measure of [the defendant’s] costs”).

cepts any mutually beneficial supply offers extended by its rivals.

1. The Plaintiff's Required Showing

Before a judicial tribunal thwarts a bundled discount (which provides immediate consumer benefit), the plaintiff should be required to prove that it has done all it can do to compete with the discounter by matching the discounter's offer. The conventional wisdom, of course, is that a rival with a less complete product line simply cannot compete with a bundled discount,²²⁰ unless it can lower the price of its competitive product(s) by the total amount of the bundled discount.²²¹ Indeed, the *LePage's* court asserted that the "principal anticompetitive effect" of bundled discounts is that "they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer."²²²

But this reasoning incorrectly assumes that a rival "who does not manufacture an equally diverse group of products . . . cannot make a comparable offer." In actuality, there are at least three ways a plaintiff facing a competitor's bundled discount could "make a comparable offer" and thus stay in business: (1) match the bundle itself by entering the product markets in which it does not currently participate and offering its own competing bundle; (2) collaborate with other sellers in the markets in which it does not participate to provide a competing bundle; or (3) become a supplier of the bundled discounter, thus effectively offering a competitive bundle consisting of its product and those of the discounter. A determined rival would pursue each of these options before conceding defeat, and the law should require such self-help before permitting judicial intervention to thwart immediate lower prices. The approach articu-

220. See AREEDA & HOVENKAMP SUPP. 2003, *supra* note 21, ¶ 749, at 83–84 ("Depending on the number of products that are aggregated and the customer's relative purchases of each, even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce.").

221. If the total amount of the bundled discount is less than the rival's margin on the product or products it sells in competition with the bundle, then the rival could stay in business by simply lowering the price of its competitive product or products by the amount of the bundled discount. See Crane, *supra* note 1, at 34–38.

222. *LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004).

lated above provides courts with a mechanism for ensuring that judicial intervention is a last resort that is employed only after the plaintiff has established that it has no viable means of staying in business by competing more vigorously.

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

A determined rival's most obvious option for competing with a bundled discount that exceeds the rival's total margin on the products it sells in competition with the bundle²²³ is to expand its scope by entering the market(s) for the bundled product(s) it does not sell. For example, if a diversified medical supply company were offering discounts on bundles of trocars (devices used in endoscopic surgery) and sutures (stitches),²²⁴ a trocar manufacturer might be able to enter the sutures market and offer its own competitive bundle. Of course, such entry might be difficult for a host of reasons—e.g., the existence of sutures patents, regulatory hurdles, long-term contracts, or natural monopoly.²²⁵ Indeed, most monopolization cases based on bundled discounting would presumably involve a monopolist cross-subsidizing its discount on the competitive products by giving up margin on the monopoly product.²²⁶ The mere pres-

223. For a bundled discount whose total amount could be attributed to each bundled product without driving the price of that product below cost, a competitive rival's most obvious option would be to lower the price of its product by the amount of the bundled discount. Since this response could only benefit consumers, this sort of bundled discount should be per se legal. *See Crane, supra* note 1, at 42–43.

224. *See, e.g.,* Complaint, *Conmed Corp. v. Johnson & Johnson, Inc.*, (S.D.N.Y. filed Nov. 6, 2003) (No. 03-CV-8800) (on file with author); Complaint, *Applied Med. Research Corp. v. Johnson & Johnson, Inc.*, (C.D. Cal. filed Sept. 5, 2003) (No. 03-CV-1329) (on file with author).

225. Importantly, the need to amass a large amount of capital to finance scope expansion is *not* generally a barrier to entry. As the *Antitrust Law* treatise explains:

If capital markets are working well, new investment will be made in any market earning anything above competitive returns—a term defined to include sufficient profit to attract new capital—regardless of the absolute cost of entry. . . . [W]e assume that capital markets are efficient in assembling groups of investors. At any rate, the plaintiff wishing to show that the absolute cost of entry serves as an effective barrier should be required to provide evidence that financing entry is very difficult or impossible, notwithstanding good prospects that entry, once it occurs, will be sufficiently profitable to pay investors a competitive rate of return.

2A AREEDA ET AL., *supra* note 100, ¶ 421(b), at 67.

226. This is the plaintiffs' theory in the *Johnson & Johnson, Inc.* cases.

ence of such monopoly profits would indicate that entry into the “other” market was difficult.²²⁷ One can imagine, though, bundled discount cases where the markets in which the challenger does not participate are not monopolized; indeed, *LePage’s* was apparently such a case.²²⁸ Thus, the plaintiff should have to show that barriers to entry would prevent it from expanding its scope so as to replicate the challenged bundle. In most cases, plaintiffs would probably have little trouble making this showing, but requiring them to do so would prevent a plaintiff from being able to avoid procompetitive scope expansion when such expansion is feasible.

The plaintiff also should be required to show barriers to entry in the market in which it participates. This showing, unlike the one above (and the others required by the proposed approach), is not designed to prove that the plaintiff has taken all steps to compete on the merits but instead seeks to ensure that the market in which the plaintiff participates (and which the defendant is purportedly attempting to monopolize) is actually susceptible to monopolization. The law should not preclude a bundled discount which provides a concrete and immediate consumer benefit to “preserve competition” in a market that is structurally incapable of being monopolized. Because barriers to entry are necessary for monopolization of a market,²²⁹ a plaintiff should be required to show that the market in which it competes is subject to such barriers.

Complaint, *Conmed Corp. v. Johnson & Johnson, Inc.* (No. 03-CV-8800); Complaint, *Applied Med. Research Corp. v. Johnson & Johnson, Inc.* (No. 03-CV-1329). In each case, the plaintiff claims that Johnson & Johnson, Inc. uses its supracompetitive profits in the sutures market to fund a discount on trocars, the product the plaintiff sells in competition with Johnson & Johnson, Inc.

227. See 2A AREEDA ET AL., *supra* note 100, ¶ 420(a), at 57–59 (noting that entry barriers are the reason for supracompetitive profits and that such profits cannot exist absent entry barriers).

228. 3M was a monopolist in the transparent tape market—the market in which *LePage’s* participated. See *LePage’s Inc. v. 3M Co.*, 324 F.3d 141, 146 (3d Cir. 2003) (en banc), cert. denied, 124 S. Ct. 2932 (2004) (“3M concedes it possesses monopoly power in the United States transparent tape market, with a 90% market share.”). But there was no indication that 3M had monopoly power in the markets for the other products covered by its bundled discounts. See generally *id.*

229. See 2A AREEDA ET AL., *supra* note 100, ¶ 420(a), at 58 (noting that absent barriers to entry, “the equilibrium price will be at long-run marginal cost, the competitive level, no matter how concentrated the market” and that “[w]hen these conditions are satisfied, no firm within a market can sustain monopoly pricing”).

b. *Collaborative Bundle Impracticable*

A determined rival that was unable, because of barriers to entry, to offer its own competitive bundle would seek to collaborate with other firms to create a competitive bundle.²³⁰ For example, if a firm selling products A, B, and C offered a reduced price on a bundle of those products, its rival that sold only product A could collaborate with sellers of products B and C to collectively offer a competitive bundled discount.²³¹ The sellers of products B and C would presumably be willing to collaborate with the seller of A, for they likewise would find themselves disadvantaged by the bundled discount and would be seeking a competitive offer.²³² Assuming that the rival sellers were as efficient as the discounter or would likely become so if they expanded their scale,²³³ they should be able to allocate the total

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

231. Consider, for example, a bundled discount on premium gin and vodka. As of late 1999, Diageo PLC’s Tanqueray brand gin commanded a more than 50% market share in the “imported premium gin” market. *Diageo PLC Final Results*, REG. NEWS SERVICE, Sept. 16, 1999, LEXIS, Company News Feed Formerly Regulatory News Service File. Diageo also sells a premium vodka called Tanqueray Sterling. See Adam Jones, *The Art of Killing a Name Softly*, FIN. TIMES, July 15, 2004, at 11. Suppose Diageo sought to grow its somewhat obscure Tanqueray vodka by offering a discount on bundled purchases of Tanqueray gin and vodka. Given the popularity of Tanqueray gin, competing vodka sellers would likely find this discount troubling; after all, purchasers that decided to buy less Tanqueray vodka and more of another premium vodka brand would find themselves losing a discount on popular Tanqueray gin. Those vodka sellers, though, would not be without recourse: they could collaborate with sellers of other brands of premium gin (e.g., Bombay) to offer a competitive bundle. It is highly unlikely, then, that the vodka sellers would be “excluded” by Diageo’s gin/vodka bundle.

232. Amici in the *LePage’s* case recognized this possibility for single-product competitors. See Brief for the Boeing Company et al., as Amici Curiae at 18, *3M v. LePage’s Inc.*, 124 S. Ct. 2932 (2004) (No. 02-1865), available at 2003 WL 22428377 (“LePage’s should have the opportunity to team up with 3M’s rivals in the other product markets to offer their own joint package deals to large retailers (after all, sellers in other product areas presumably do not wish to lose sales to 3M any more than LePage’s does).”).

233. Given efficient capital markets, rivals that are not currently as efficient as the discounter but probably could become so if their market share were expanded could likely obtain the financing necessary to fund a below-cost discount for long enough to expand market share enough to achieve the pro-

value of the bundled discount among themselves and to offer a competitive bundle. Thus, a plaintiff challenging a bundled discount should have to prove—prior to securing an order enjoining the discounts (or awarding treble damages)—that it could not have collaborated with sellers of products within the other product markets to offer a competitive bundle.²³⁴ The plaintiff could discharge this burden by proving either that there were no sellers in the other markets with whom it could collaborate or that it made a good faith collaboration offer to those sellers, including an offer to reduce revenue on its product to the level of its average variable cost,²³⁵ but was rebuffed by the other product sellers. Requiring such proof would ensure that the plaintiff had earnestly pursued procompetitive collaborations with sellers in the other product markets covered by the bundle, so that judicial condemnation of the discount was a last resort.

c. Good Faith Offer to Sell to Discounter

A determined rival who could neither enter the other product markets to offer its own competitive bundle nor collaborate

ductive efficiencies necessary to drive costs below price. *See supra* notes 100–02 and accompanying text.

234. Explicit coordination among firms competing in the various product markets represented by products within the bundle may be unnecessary if those firms reduce their prices from supracompetitive levels. Professor Crane has illustrated this point as follows:

Suppose, for example, that Multi-Firm makes five products—A, B, C, D, and E—and typically sells each for \$10, with a marginal cost of production of \$6 per unit. Multi-Firm decides to offer customers a new package discount—10 percent off of each product in its portfolio, but only if the customer purchases one unit of each product. Suppose further that Multi-Firm has five competitors, each of which produces only one of the five products and has the same price and cost structure as Multi-Firm. None of the five competitor firms can match Multi-Firm's entire package discount individually and remain profitable. . . . But if each of the five competitor firms lowers its price by \$1 on its own product, each can profitably sell the goods at the same effective price as Multi-Firm's package discount price.

In a market with reasonably good, low-cost information, and firms with reasonably equivalent strength, one would expect implicit coordination of price cuts by the five competitive firms, leading to across-the-board price cuts and something close to egalitarian absorption of the package discount by each of the five competitive firms.

Crane, *supra* note 1, at 31–32.

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

with other sellers to do so would still have at least one option for staying in the market: it could become a supplier to the bundled discounter.²³⁶ If the rival were at least as efficient as the bundled discounter, or would likely become so by expanding its scale,²³⁷ it could offer to supply the discounter for a price the discounter would find attractive (i.e., a price at or below the discounter's own cost of producing and distributing the product). Thus, any bundled discounter that was not in reality utilizing its discounts as a means of excluding rivals would be willing to accept a "competitive rival's"²³⁸ offer to become a supplier.²³⁹

To see how a rival disadvantaged by a bundled discount may remain in the market by offering to supply the discounter, consider what has happened with the small regional airlines that in recent years have found themselves unable to compete with the major air carriers. A significant impediment to these smaller airlines is the major carriers' ability to offer a type of bundled discount—a price for a "bundle" of flights going from departure point to hub to destination that is significantly lower than the sum of the prices of two flights, one from departure point to hub and the other from hub to destination.²⁴⁰ A smaller carrier that wanted to compete with this discount but flew only one leg of the journey (either between departure point and hub city or between hub city and destination, but not both) would have to absorb the entire amount of the package discount on

236. Cf. E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 184 (1994) (noting that "greater efficiency is an ideal way to overcome an 'entry barrier,'" for the more efficient, but foreclosed, rival may begin supplying the competitor responsible for the foreclosure).

237. If the rival were not yet as efficient a producer as the discounter but would likely become so if its scale were expanded, it could probably secure the financing necessary to fund a below-cost discount for long enough to expand its scale to achieve the productive efficiencies that would drive its costs below price. See *supra* note 100 and accompanying text.

238. See *supra* notes 216–17 and accompanying text (defining "competitive rival").

239. Cf. ROGER D. BLAIR & DAVID L. KASERMAN, ANTITRUST ECONOMICS 403–04 (1985) (observing that monopolist engaged in tying would purchase tied product from more efficient rivals).

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

the single leg it offered.²⁴¹ This requirement would frequently require the regional airline to price below its cost. The regional airlines, however, have not been driven out of business by the major carriers' bundled discounts but have instead remained in business (and have thrived, in fact) by becoming suppliers to the major carriers.²⁴² Similarly, single-product producers finding themselves hampered by a bundled discount may be able to stay in business, and thrive, by becoming suppliers of the discounter. A rival attacking a bundled discount therefore should be required to prove that it made a good faith offer to become a supplier of the discounter but was rebuffed. The discounter's rejection of the supply offer would provide prima facie evidence that the discount was being used to exclude a competitive rival.²⁴³

The Supreme Court recognized in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*²⁴⁴ that a refusal to cooperate with a rival may have such evidentiary significance. The defendant in that case (Ski Company) owned three of the four ski areas in the Aspen, Colorado area.²⁴⁵ It had for years cooperated with the plaintiff (Highlands), the owner of the fourth ski area, in jointly issuing a multiday, all-area lift ticket.²⁴⁶ After Highlands refused to accept a lower percentage of revenues from the joint ticket, Ski Company discontinued the ticket.²⁴⁷ Concerned that it would lose business without some sort of joint ski area offering, Highlands undertook several measures to recreate the package deal on its own, going so far as attempting to purchase ticket vouchers to Ski Company's skiing areas at retail price.²⁴⁸ After Ski Company resisted even that tactic, Highlands sued it for monopolization.²⁴⁹ Ski Company defended by arguing that it

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

242. See Eric Wieffering, *Engine of Change*, STAR TRIB. (Minneapolis), May 11, 2003, at 1D (documenting successful supply relationships between small regional and major air carriers and noting that "Northwest [Airlines] and most other major network carriers experienced a decline in traffic in 2002 but traffic on most regional carriers soared").

243. As explained below, the inference that the discounter was engaging in exclusionary conduct would be rebuttable. See *infra* Part III.B.2.

244. 472 U.S. 585 (1985).

245. *Id.* at 587-89.

246. *Id.* at 589-92.

247. *Id.* at 593.

248. *Id.* at 593-94.

249. *Id.* at 595.

had no duty to engage in joint marketing with a competitor.²⁵⁰ On that point, the Supreme Court concluded that Ski Company was “surely correct,” for “even a firm with monopoly power has no general duty to engage in a joint marketing program with a competitor.”²⁵¹ The Court emphasized, though, that refusal to participate in a cooperative venture could have “evidentiary significance,”²⁵² and it upheld the jury’s conclusion that Ski Company had engaged in exclusionary conduct.²⁵³ Just as the refusal to engage in a cooperative venture was evidence of exclusionary conduct in *Aspen Skiing*, a bundled discounter’s refusal to accept a rival’s offer to supply one of the bundled products at a price below the discounter’s cost would evince the exclusionary character of the discounter’s pricing scheme. Thus, the Supreme Court would likely approve an evaluative approach that drew evidentiary significance from the fact that a multi-product discounter was refusing to cooperate with a single-product rival that had extended an attractive supply offer.²⁵⁴

250. *Id.* at 600 (“In this Court, Ski Co. contends that even a firm with monopoly power has no duty to engage in joint marketing with a competitor . . .”).

251. *Id.*

252. *Id.* at 601.

253. *Id.* at 610–11.

254. While the Supreme Court recently characterized *Aspen Skiing* as being “at or near the outer boundary of § 2 liability,” *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 409 (2004), assertions the Court made in connection with that characterization indicate that the rationale of *Aspen Skiing* would apply here and that the Court would approve an inference of exclusionary conduct from a bundled discounter’s refusal to accept a supply offer from a more efficient rival. In defending *Aspen Skiing*’s holding, the Court noted that Ski Company’s refusal to cooperate with Highlands when doing so would increase its revenues, suggested that it was attempting to exclude Highlands in the hope of earning future monopoly profits that would offset the losses immediately incurred by its failure to cooperate with Highlands. *See id.* at 409 (noting that Ski Company’s “unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end,” and that Ski Company’s “unwillingness to renew the ticket *even if compensated at retail price* revealed a distinctly anticompetitive bent” and “suggest[ed] a calculation that its future monopoly retail price would be higher” (emphasis in original)). Similarly, a bundled discounter’s rejection of a profit-enhancing supply offer from a rival would suggest a willingness to forsake short-term profits to achieve an anticompetitive end (and future monopoly profits) and should therefore permit an inference of exclusionary conduct.

2. The Discounter's Rebuttal Opportunity

The first part of the proposed evaluative approach (the plaintiff's *prima facie* case) is designed to ensure that a judicial order thwarting a bundled discount is a last resort pursued only after the complaining plaintiff has exhausted all means of competing on the merits. It thus prevents judicial orders that would allow plaintiffs to shirk the difficulties of proconsumer competition. But a plaintiff's diligence in pursuing competitive options is not, by itself, sufficient to entitle that plaintiff to a court order precluding a bundled discount. As in any competition, trying is not enough; even those who try very hard sometimes deserve to lose. To permit a diligent but less talented competitor to be defeated is not to sanction anything anticompetitive. Indeed, vigorous competition implies that there will be losers—that less efficient firms will not be artificially propped up but will be driven out of business by those that are more efficient. Antitrust tribunals therefore need some means of identifying, within the class of firms that have pursued all competitive options, those rivals that are competitive with the discounter (i.e. those that are, or are likely to become, as efficient as the discounter²⁵⁵). The proposed evaluative approach would accomplish this “weeding” by allowing defendants a rebuttal opportunity.

If a plaintiff proves that it cannot compete with the bundled discount because (1) there are high entry barriers into the other product markets, (2) a collaborative bundle is impossible, and (3) the discounter rejected a good faith offer by the plaintiff to become a supplier, the discounter should still be able to avoid liability by proving that the plaintiff's best “supply offer,” which presumably would reflect the maximum efficiencies the plaintiff could attain after reaching minimum efficient scale,²⁵⁶ was not good enough. Specifically, the discounter could avoid liability by showing either that its costs were less than the price demanded by the plaintiff or that the plaintiff's product was inferior. If the discounter could make either showing, it

255. See *supra* notes 214–17 and accompanying text.

256. A plaintiff that could achieve productive efficiencies by expanding its scale would take account of those efficiencies in determining its offer price. The price offered might thus be below the plaintiff's current costs, but, given efficient capital markets, the plaintiff should be able to obtain financing to sustain a temporary below-cost price if such pricing would permit it to expand its scale to achieve productive efficiencies that would push its costs below the price offered. See *supra* note 100 and accompanying text.

could rebut the contention that the bundled discount was excluding a rival that was, or was likely to become,²⁵⁷ equally efficient.

The proposed approach thus ultimately involves comparing the cost structures of the complaining rival and the discounter. In that sense, the approach resembles the *Ortho Diagnostic* approach, which required a plaintiff challenging a bundled discount to prove that it is as efficient a producer of the competitive product as the discounter.²⁵⁸ But the proposed approach is superior to the *Ortho Diagnostic* approach in terms of administrability and reliability. The plaintiff's achievable cost²⁵⁹ would be established not by potentially self-serving testimony from the plaintiff's own witnesses, but by the plaintiff's actual supply offer—i.e., the lowest price for which the plaintiff would sell its products to the discounter. Presumably, the offer price would be neither below the plaintiff's actual cost (because the discounter might accept the offer, and the plaintiff would have to perform) nor significantly above it (because an inflated offer price might exceed the discounter's costs, permitting the discounter to refuse the offer with impunity).²⁶⁰ Thus, the proposed evaluative approach would force the plaintiff to reveal a close approximation of its true cost and would likely generate a more accurate cost figure than the *Ortho Diagnostic* approach, which would determine plaintiff's cost on the basis of possibly self-serving testimony from plaintiff's witnesses. In addition, the discounter's cost information would be produced more cheaply and reliably, for the burden to produce that information would be on the discounter itself, not on the plaintiff. As noted, ascertaining another party's costs is difficult;²⁶¹ the de-

257. See *supra* notes 233, 237.

258. *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 469 (S.D.N.Y. 1996); see *supra* notes 158–69 and accompanying text.

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

260. A plaintiff that believed it was a more efficient producer than the discounter might attempt to maximize its profits on a supplier contract by offering a price in excess of its own cost but below what it believed the defendant's cost to be. Doing so would be risky, however, for if the plaintiff overestimated the discounter's cost and offered a price in excess of that cost, the discounter could reject the offer with impunity. Thus, a plaintiff, likely ignorant of its discounting rival's costs, would probably make an offer approximating its own cost.

261. See *supra* notes 172–75 and accompanying text.

fendant discounter is in a much better position to produce evidence regarding its costs. Thus, the proposed approach, while resembling *Ortho Diagnostic* in terms of its ultimate focus (i.e., the relative efficiencies of the discounter and complaining rivals), is superior in terms of administrability.

In the end, the proposed evaluative approach would achieve each of the goals articulated above.²⁶² The approach would condemn bundled discounts that exclude competitors that had competed vigorously by pursuing all competitive options, and were, or were likely to become, as efficient as the discounter. The approach would *not* condemn bundled discounts if the complainant had not pursued all competitive options or was not likely to be able to match the discounter's efficiency. Moreover, the approach would facilitate procompetitive bundled discounting by providing a clear safe harbor: a bundled discounter could avoid antitrust liability by ensuring that it accepted any supplier's offer where the price offered was less than the discounter's own cost (an offer that would be in its economic interest to accept). Finally, the approach would be easily administrable, for the relevant facts are relatively easy to ascertain, and proof burdens are allocated so that the party with the burden of proof on a matter is most likely to have access to the relevant evidence.

C. POSSIBLE SHORTCOMINGS: "PHONY DISCOUNTS" AND COLLUSION BETWEEN DISCOUNTERS AND SUPPLIER RIVALS

There are, however, a couple of potential shortcomings that merit consideration. First, firms engaging in other types of potentially anticompetitive pricing practices might exploit the proposed evaluative approach to increase the difficulty of successfully challenging the practices. Recognizing that above-cost bundled discounts are usually beneficial to consumers, the proposed evaluative approach presumes their legality and places a somewhat heavy proof burden on rivals asserting legal challenges. Professor Elhaug has argued that affording special protection to bundled discounts may simply encourage creative firms to insulate anticompetitive bundling or tying practices by artificially inflating prices and then offering phony "discounts" off those higher prices.²⁶³ For example, a firm could engage in

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

263. Professor Elhaug writes:

[A]nything called a "discount" for agreeing to the loyalty or bundling

de facto tying by artificially increasing the separate price of the tied products and then offering a substantial bundled “discount” off that higher price.²⁶⁴ Under the proposed evaluative approach, a challenger would bear a heavier proof burden (because there is a bundled “discount”) than would a plaintiff challenging de facto tying that had not been made to resemble a discount.²⁶⁵ Accordingly, Professor Elhaug concludes, it would be unwise to provide special protection (e.g., a presumption of legality) to a pricing practice merely because it is labeled a bundled discount.

The possibility of phony discounts need not create concern, however, for the strategy, where plausible, could be easily identified. A phony discount could be accomplished by either artificially hiking prices prior to the discount, precluding prices from falling following the occurrence of some notable event that should have caused their decrease, or precluding prices from naturally falling in a slow and steady fashion. The first situation, a prediscount price hike, would be easy enough to demonstrate by pointing to historical price data. If prices were not actually increased prior to the discount but were instead artificially precluded from falling,²⁶⁶ the plaintiff could show

condition could equally be called a “penalty” on those who refuse to conform to that condition.

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

Elhaug, *GPO Agreement Analysis*, *supra* note 71, at 31 (quoting Elhaug, *supra* note 61, at 698 n.53).

264. While some courts have held that tying cannot occur if the tied products are available separately, *see* *Shop & Save Food Mkts., Inc. v. Pneumo Corp.*, 683 F.2d 27, 31 (2d Cir. 1982); *SmithKline Corp. v. Eli Lilly & Co.*, 427 F. Supp. 1089, 1112, 1114 (E.D. Pa. 1976), *aff'd on other grounds*, 575 F.2d 1056, 1061 n.3 (3d Cir. 1978); *Datagate, Inc. v. Hewlett-Packard Co.*, 1994-2 TRADE CAS. ¶ 70,827 (N.D. Cal. 1993), the majority view is that a sufficiently large discount for buying the products together may constitute de facto tying if it has coercive effects. 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758, at 323 (“[W]e join most courts in asking whether the discount has an effect similar to an outright refusal to sell tying product A separately.”).

265. A plaintiff alleging de facto tying would have to prove a low proportion of separate sales. *See supra* notes 188–92 and accompanying text (discussing test described in 10 AREEDA, HOVENKAMP, & ELHAUGE, *supra* note 156, ¶ 1758, at 323).

266. Professor Elhaug contends that one cannot merely look to historical

that there was no actual discount by producing evidence of whatever factor should have caused a notable decrease in prices (e.g., an abrupt reduction in the cost of an input). Absent both a prediscount price hike and a notable occurrence that should have caused a price decrease, artificial price inflation could occur only if the defendant artificially sustained the price above its profit-maximizing level for an extended time period (i.e., long enough for the difference between the actual price and the diminishing “natural” price level to grow to the amount of the discount). A rational seller would sacrifice profits in this manner²⁶⁷ only if it believed it could later offer a phony bundled discount, drive its rivals out of business, and recoup its losses by charging supracompetitive prices. The tactic would therefore require a good bit of faith on the part of a seller and is unlikely to be pursued. Thus, the strategic behavior with which Professor Elhaug is concerned either would be easy to identify (in the first two circumstances discussed above) or is implausible (in the third).

A second potential problem with the proposed evaluative approach is that it might not prevent consumer harm, even if it prevents foreclosure of competitive rivals, because it invites cooperation among competitors and thereby increases the risk of collusive output reduction.²⁶⁸ Consider, for example, a situation

prices (to determine whether there was a prediscount price hike) to determine whether prices have been artificially inflated, for the inflation may have been accomplished by stalling price reductions that otherwise would have occurred. He explains:

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

Elhaug, *GPO Agreement Analysis*, *supra* note 71, at 31–32.

267. Holding price constant when marginal cost has fallen will fail to maximize the seller’s immediate profit. “[S]ince the profit-maximizing price is determined by the intersection of the marginal revenue and marginal cost curves, any reduction in marginal costs shows up as a lower profit-maximizing price.” 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 103, at 44 n.21 (2d ed. 2002). Hence, during the period in which a seller artificially held price constant in the face of decreasing costs, its profits would be reduced from what they otherwise could be.

268. See *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398, 408 (2004) (“[C]ompelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion.”). See generally Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515 (2004) (arguing that a primary objective of antitrust law is, and should be, to create distrust between competitors).

where the bundled discounter accepts its single-product rivals' offers to become suppliers (so the rivals are not foreclosed) but then cuts its own production and charges a supracompetitive price for the products supplied by its rivals. The proposed evaluative approach would not condemn the bundled discount that motivated the rivals to become suppliers; yet, consumers would be harmed by the discounter's conduct.

But the proposed evaluative approach would not sanction this sort of consumer harm. As long as the supplier rivals are free to sell directly to the discounter's customers, their continued presence in the market should prevent the discounter from being able to cut its own production and raise prices above competitive levels. Should the discounter try that tack, its supplier rivals would increase their production and offer prices lower than the discounter's.²⁶⁹ But what if the discounter cut a deal with the rivals, offering to share its supracompetitive profits (e.g., to make some sort of side payment) if the rivals would not undersell it? That, of course, would be a price-fixing agreement that is per se illegal under section 1 of the Sherman Act.²⁷⁰ It would also be rather easy to identify, for output would fall, price would rise, and the seller would be unable to articulate a valid reason for its decision to cut production. Antitrust liability should attach to this agreement, once materialized, but there is no compelling reason to impose antitrust liability in anticipation of such an agreement.²⁷¹

CONCLUSION

Bundled discounts present a classic example of what Judge Frank H. Easterbrook calls "the puzzle of exclusionary conduct."²⁷² That puzzle exists because "competitive and exclu-

269. See generally Easterbrook, *supra* note 210, at 2 ("Monopoly prices eventually attract entry."); Christopher S. Yoo, *Vertical Integration and Media Regulation in the New Economy*, 19 YALE J. REG. 171, 209 (2002) (noting that "any attempt to increase price can often induce existing players to expand output as well as attract entry by new firms").

270. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223–24 (1940) (holding that an agreement among competitors to reduce output, like an agreement to fix prices, is per se illegal under section 1 of the Sherman Act, 15 U.S.C. § 1 (2000)).

271. Cf. Easterbrook, *supra* note 112, at 347 ("Instead of making predictions that are impossible to test—and will injure consumers if wrong—wait to see what happens. If monopolistic prices happen later, prosecute then.")

272. *Id.* at 345.

sionary conduct look alike,"²⁷³ and it is often difficult for courts to condemn the latter without discouraging the former. With respect to bundled discounts, it can be difficult to tell which are procompetitive (i.e., which ones reflect efficiencies and/or represent a whittling away of supracompetitive prices) and which are likely to injure consumers in the long run by driving out those rivals whose continued presence in the market is desirable. The "puzzle," then, is to develop an easily administrable evaluative approach that will identify and condemn only those bundled discounts that could injure consumers by excluding rivals that are, or are likely to become, as efficient as the discounter.

This Article has sought to solve that puzzle. The proposed evaluative approach would presume the legality of above-cost bundled discounts but would allow that presumption to be rebutted by a plaintiff that had exhausted all viable options for offering a competitive discount and was, or was likely to become, as efficient as the discounter. Specifically, the plaintiff would have to show that it could not stay in business by either lowering its price(s) on the competitive product(s), entering new markets to create its own bundle, collaborating with other sellers to offer a competitive bundled discount, or becoming a supplier to the discounter. If the plaintiff made such a showing, the discounter could still avoid liability by proving that it rejected the plaintiff's supply offer because the offer simply was not good enough (i.e., because the plaintiff could not produce the competitive product as efficiently as the discounter). When a plaintiff made the required prima facie showing and the defendant failed to justify its rejection of the plaintiff's supply offer, a court would be justified in concluding that the bundled discounting would exclude competitive rivals and was therefore anticompetitive on balance. When a plaintiff failed to make its prima facie showing (and thus failed to prove it had exhausted competitive options) or the defendant proved that acceptance of the plaintiff's supply offer would have been a bad business decision for the defendant (and thus established that the plaintiff was a less efficient producer), a court would not be justified in forcing consumers to forego the defendant's discounts to protect the plaintiff.

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