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Is There a Perfect Solution? The Court's Problems in Applying the Antitrust Laws to Bundled Discounts

Cheryl J. From*

"As freak legislation, the antitrust laws stand alone. Nobody knows what it is they forbid."

- Isabel Paterson

"The standard formulation on remedy is that it ought to cure past violations and prevent their recurrence. That's what antitrust is all about."

- Charles James

I. INTRODUCTION

Bundled discounts¹ are an important selling strategy for competing firms and are very common and practical in everyday life. When a consumer buys a hamburger combo that comes with fries and a drink, he has purchased a bundled discount.² While we have come to rely on these kinds of bundled discounts, other types can be extremely anticompetitive and serve no purpose other than running competitors out of business.³ Courts have only recently begun treating bundled discounts as a possible antitrust violation. *LePage's, Inc. v. 3M, Minnesota Mining and Manufacturing Co.*,⁴ decided in October, 2002, was one of the first appellate court cases to deal with bundled discounts. While there is much criticism of *LePage's*, many think the court's poor economic reasoning may have been corrected by the most recent appellate court case on bundled discounts, *Cascade Health Solutions v.*

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1. A bundled discount is a combined price for two separate items when the combined price is less than if each item were purchased separately. Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 EMORY L.J. 423, 425 (2006). Bundled discounts influence buyers to purchase both items at the combined price when they might have otherwise only purchased one item or purchased one of the items from a different seller. *Id.* ("Mixed bundling describes a pricing strategy where a seller offers a discount if separate items are purchased together as a package.").

2. *Id.*

3. *Id.*

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

PeaceHealth.⁵ Although many believe *Cascade* corrected the errors of the Third Circuit's decision in *LePage's*, the *Cascade* court may have created some problems of its own under both the antitrust laws and the non-economic areas of standing and awarding damages.

Section 2 of the Sherman Antitrust Act ("Sherman Act") provides that "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony. . . ."⁶ The United States Supreme Court has interpreted the Sherman Act as encompassing three specific and separate offenses: (1) monopolization, (2) attempted monopolization, and (3) conspiracy to monopolize.⁷ While these three offenses may seem fairly straightforward, applying legal standards to economic principles has proven over the years to be a daunting task.

Part II of this Comment describes the economics behind bundled discounts and some of the most important theories upon which our current antitrust laws are based.⁸ Part III describes the *LePage's* decision, one of the first appellate court decisions to apply the antitrust laws to bundled discounts.⁹ Part III also explains the criticism of the *LePage's* court due to its treatment of bundled discounts.¹⁰ Part IV summarizes *Cascade* and discusses the Ninth Circuit's analysis of the economics of bundled discounts.¹¹ Part V analyzes the *Cascade* decision, arguing it is a large improvement but may not correctly define the economics of illegal bundled discounts.¹² Part V also explains how the court may have created an impractical test because it conflicts with fundamental laws of standing and damages.¹³

II. ANTITRUST THEORIES AND BUNDLED DISCOUNTS

The antitrust laws based on the Sherman Act are unique compared to the rest of the legal system. When applying antitrust laws, it is im-

5. *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008), *amending* *Cascade Health Solutions v. PeaceHealth* 502 F.3d 895 (9th Cir. 2007) (while none of the amendments to the case affect this article, the opinion itself was reprinted as amended and all citations in this article will refer to the article as reprinted in 515 F.3d 883).

6. 15 U.S.C. § 2 (2004).

7. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 451 n.2 (1993).

8. *See infra* Part II.A-B.

9. *See infra* Part III.A.

10. *See infra* Part III.B.

11. *See infra* Part IV.A-C.

12. *See infra* Part V.A.

13. *See infra* Part V.B.

portant for courts to remember the significance and reasoning behind them. Many antitrust violations are illegal not because of a specific act; rather, they are illegal because of the effect the act has on consumer welfare. Thus, most antitrust laws focus on the result as opposed to the conduct itself. In order to fully understand the treatment of bundled discounts within the legal system, it is important to understand the reasoning behind the antitrust laws and the economics behind bundled discounts.

A. *Theories behind the Antitrust Laws*

Many of the United States antitrust laws, while based on the Sherman Act, have evolved and been improved through case law. Although the United States antitrust laws cover many different types of conduct, there are two overarching theories that the legislation, the courts, and the most talented economists have all used in creating, applying, and analyzing the antitrust laws.

The first of these theories is that antitrust laws protect competition, not competitors.¹⁴ If a dominant firm behaves in a way that causes a smaller competitor to go out of business, it is only a violation of the antitrust laws if consumer welfare has also been harmed.¹⁵ The antitrust laws do not protect individual firms from intense competition¹⁶ because it is a general assumption in our society that competition leads to better products, better service, and better firms becoming dominant. Competition creates lower prices. While some countries try to protect small business owners, the United States only tries to protect consumers.¹⁷

The second major theory underlying antitrust laws is that monopoly power is not always a bad thing.¹⁸ Although section 2 of the Sherman Act states that anyone who "shall monopolize . . . shall be deemed guilty of a felony. . . ,"¹⁹ it is a general antitrust principle that something more than monopoly power is necessary for a crime to have been committed.²⁰ In the United States it is not an offense to simply have monopoly status; it is how monopoly status is obtained or protected that can give rise to antitrust violations.²¹ This treatment of mo-

14. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977).

15. *Clorox Co. v. Sterling Winthrop, Inc.*, 117 F.3d 50, 57 (2d Cir. 1997).

16. *Id.*

17. *Id.*

18. See ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS, AND PROBLEMS IN COMPETITION POLICY* 563 (2002).

19. 15 U.S.C. § 2 (2004).

20. GAVIL ET AL., *supra* note 18, at 563.

21. See *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945).

nopoly power has arisen because, as a policy matter, American firms are encouraged to strive to be the best in the market and if they are rewarded for that effort then the rest of the market must deal with the consequences.²²

While there is still controversy over this second theory, Justice Scalia stated in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko LLP* that “[t]he mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system.”²³ Justice Scalia based this opinion on the assumption that monopolists play an important role in society and that some firms received their monopoly status because of superior conduct, better products, or because one firm is all that the market can support.²⁴ The United States recognizes these firms as benevolent monopolies.²⁵ Writing for the majority, Justice Scalia stated,

[t]he opportunity to charge monopoly prices – at least for a short period – is what attracts “business acumen” in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*.²⁶

Although not everyone in the antitrust community agrees with Justice Scalia, the vast majority feel that monopolies are necessary for our antitrust laws and capitalistic society to work as well as they do.

The monopolization offense in the United States has two separate elements.²⁷ The first, the status element, requires a firm to possess monopoly power.²⁸ Monopoly power is defined as a firm having a “substantial” degree of market power or the power to increase price above the competitive level.²⁹ As mentioned, monopoly power alone is not a crime; however, having a dominant or monopoly power can lead to antitrust violations, so determining whether a firm has monopoly power is the first step in finding a violation.

The second element of monopolization, the conduct element, defines anticompetitive conduct as the willful acquisition or maintenance of monopoly power which does not arise from a superior product, bus-

22. See *Verizon Comc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

23. *Id.*

24. *Id.*

25. *United States v. Pullman Co.*, 50 F.Supp. 123, 134 (E.D. Pa. 1943).

26. *Verizon*, 540 U.S. at 407.

27. GAVIL ET AL., *supra* note 18, at 564.

28. *Id.*

29. *Id.* at 565.

iness acumen, or any other benevolent reason.³⁰ Courts have found it implicit in the Sherman Act that no anticompetitive conduct arises when a valid business justification is given.³¹ An example of anticompetitive conduct is predatory pricing.³² Predatory pricing occurs when a firm prices goods or services below cost in order to force another, smaller firm out of the market and subsequently raises prices well above the competitive level to regain its losses.³³ Even this kind of anticompetitive behavior is difficult to prove in court because in order for a predatory pricing claim to succeed, there must be a "dangerous possibility" of recoupment.³⁴ To prove recoupment, the firm needs to price not only below their own cost, but also below their competitors more efficient costs.³⁵ The elements of predatory pricing show how problematic it can be to successfully bring a suit for monopolization based on section 2 of the Sherman Act.

The two theories discussed are critical to the overall structure of the antitrust laws and courts must consider them when applying the antitrust laws to possible violations. Thus, when analyzing the Sherman Act and how antitrust laws are applied in each case, it is important to remember: (1) antitrust laws are designed to protect competition (not competitors); and (2) monopoly power is not necessarily harmful and may even help the economy.

B. *The Economics of Bundled Discounts: Efficiency, Predatory Pricing, and Tying Arrangements*

A bundled discount occurs when a firm offers any set or group of items together for a cheaper price than they would be if all of the items were purchased separately.³⁶ Bundled discounts are common in everyday life.³⁷ For example, a cable company that offers cable and internet together for a cheaper price than if each was purchased separately is offering a bundled discount.³⁸ Another example is a hamburger combo that includes French fries and a drink, or when basketball teams offer season tickets for less than if tickets for each game

30. *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

31. GAVIL ET AL., *supra* note 18, at 880.

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

33. *Id.* at 222-24.

34. *Id.* at 224.

35. Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 709 (1975).

36. Crane, *supra* note 1, at 425.

37. *Id.*

38. *See generally id.*

were purchased separately.³⁹ Although courts are not frequently confronted with illegal bundled discount claims, two characteristics commonly arise when courts consider the legality of bundled discounts under antitrust laws. The first of these characteristics involves efficiencies within a firm and the second involves bundled discount predatory pricing.

1. Efficiency

Efficiency is an important competition concept.⁴⁰ A firm can be more efficient by using better machines, training workers, having bigger factories, or as a result of many other factors. If one firm is more “efficient” than another, it means the efficient firm has lower marginal costs, or lower costs per unit of output, and can price its products lower and bring in more business. There is an assumption under the antitrust laws that efficiency leads to lower prices and higher output, which is what the antitrust laws are all about.⁴¹

Bundled discounts do not always lead to greater efficiency. Bundled discounts are usually beneficial to consumers because prices are lowered for the combined bundle, and customers can choose whether to take the discount.⁴² There is debate, however, about whether bundled discounts lose their benefits over the long run because a firm offering a bundled discount can drive a more efficient firm out of the market.⁴³ Some economists argue bundled discounts can hurt consumer welfare because a firm that offers a bundled discount may be less efficient in creating a product than another firm.⁴⁴ Although a competing firm may be more efficient and have a lower variable cost per item, a firm offering the bundled discount may attract more business. Thus, in the long run, the less efficient firm will be the only one left and if it stops offering the bundled discount, the price of the item will be higher than it would have been if the competing firm remained in the market.

The best way to describe how bundled discounts can drive out a more efficient competitor is with an example. Assume Billy and Sara are neighbors and each has a lemonade stand on the sidewalk.⁴⁵ As-

39. See generally *id.*

40. See GAVIL ET AL., *supra* note 18, at 880.

41. *Id.* at 880-81.

42. See Neil W. Averitt & Robert H. Lande, *Using the “Consumer Choice” Approach to Antitrust Law*, 74 ANTITRUST L.J. 175, 175 (2007).

43. See Crane; *supra* note 1, at 464.

44. *Id.*

45. 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, POLICY AND PROCEDURE ¶ 749a, at 318-19 (Supp. 2006) (providing a similar example). This is a hypothetical situation that is used to show how an equally efficient firm can be forced out of the market by a less

sume the average variable cost per cup of lemonade is \$0.50 for Sara and \$0.30 for Billy.⁴⁶ This means Billy is the more efficient producer of lemonade on the sidewalk. Also assume Sara sells cookies, but Billy does not, and Sara's average variable cost per cookie is \$1.00. If Sara sells her lemonade for \$1.00 and her cookies for \$2.00, she could then offer a "package," or a bundled discount, in which the consumer gets lemonade and a cookie for \$2.25 (a discount of \$0.75). Sara could do this because she would still be making a \$0.75 profit on each "package." If a customer wants a cookie and lemonade, the only way Billy could get the customer to buy his lemonade instead of Sara's is to offer his lemonade for \$0.25.⁴⁷ He cannot charge more than \$0.25 because the customer is forced to buy a cookie from Sara (for \$2.00), and the customer could add lemonade and get Sara's "package" for only \$0.25 more. Although Sara is still making a profit, it costs Billy \$0.30 to make his lemonade so he would go out of business if he is forced to sell it for only \$0.25.⁴⁸ This example illustrates how a less efficient firm offering a bundled discount can run a more efficient firm out of business.

2. Predatory Pricing

In addition to the debate over efficiency and bundled discounts, a recent problem involves how to properly measure predatory pricing⁴⁹ in terms of bundled discounts. In *Brooke Group*, the United States Supreme Court held that if a plaintiff brings a suit based on a defendant's low pricing, the plaintiff must prove the low pricing is below the defendant's costs.⁵⁰ The Court wanted to ensure companies were not punished for being super competitive and lowering prices, as that is the type of behavior the antitrust laws are designed to protect.⁵¹ It is only illegal for a company's prices to be below its costs because there

efficient firm. There are many debates about whether or not this actually harms consumers in the long run even though consumers are given lower prices in the short run. Under antitrust principles, it is not certain whether consumer welfare should be measured based on the long run because many things can change between the time that an antitrust case is brought and the time it would take for consumer welfare to drastically decrease.

46. *Id.*

47. *Id.*

48. *Id.*

49. See *infra* Part II.A (providing that, "Predatory pricing is when a firm prices below cost in order to force another, more efficient, smaller firm out of the market and then raises price high above the competitive level in order to regain their loses. For a predatory pricing claim to succeed there needs to be a 'dangerous possibility' of recoupment. In order for this to work, the firm needs to price not only below their own cost, but also below their competitors more efficient costs.").

50. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993).

51. See *id.* at 224.

is no valid business justification for this action, other than harming rivals.

Under section 2 of the Sherman Act, not only must a company price below cost, but it must also have a “dangerous probability” of recouping the losses that occurred when the defendant was pricing below cost.⁵² The reason a plaintiff must prove recoupment is because the antitrust laws are not concerned about the smaller firm that was driven out of the market; they are only concerned with consumer welfare. If the firm cannot recoup the losses incurred when prices were below cost, then consumers enjoyed a benefit they will not have to pay for in the long run. Proving a “dangerous probability” of recoupment is extremely difficult and “below-cost pricing is not alone sufficient to permit an inference of probable recoupment and injury to competition.”⁵³

Predatory pricing claims are rarely successful because the requirements to prove a valid claim are so difficult.⁵⁴ Predatory pricing claims under a bundled discount theory are even harder to prove because there is more than one product. The problem that emerges with bundled discounts is whether the firm needs to price all of the items in the bundle below cost or just the most important item.⁵⁵ It is possible for a firm to create a profitable bundled discount, while still pricing one bundled component below cost. The following example will demonstrate how difficult it is to determine how to price each product in a bundle.

Assume a company, FirmComputer, develops a new handheld computer system that no one else is able to make.⁵⁶ Then assume FirmComputer and FirmSoftware both make typing software necessary for the computer system to function properly. It costs FirmComputer \$70 to make the computer system and \$5 to make the software. FirmComputer sells the computer system for \$100 and the software for \$10. Suppose FirmSoftware makes software of an equal quality, but it only costs the company \$3 to make the software so the company sells it for \$8. FirmSoftware is more efficient, and consumers would benefit the most by buying the computer for \$100 from FirmComputer and the software for \$8 from FirmSoftware. Now suppose FirmCom-

52. *Id.*

53. *Id.* at 226.

54. *See id.*

55. *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 903-04 (9th Cir. 2008).

56. This is a hypothetical situation that is used to show the different problems that come up when trying to apply the economics of predatory pricing to a bundled discount. While the prices and costs were made up, it is very common to see cheaper software being bundled with new technology and therefore this is a very possible situation.

puter makes a bundled discount of the computer system and the software for \$101. It is now cheaper for the consumer to buy the bundled discount, but will this harm the consumer in the long run?

The question in this scenario is whether FirmComputer is participating in illegal predatory pricing. FirmComputer is essentially charging \$1 for their software, which is far below cost. In traditional predatory pricing principles, this will drive FirmSoftware out of business and allow FirmComputer to later raise the price of the software and stop selling the items in a bundle. This would harm consumers, however, FirmComputer is not pricing below cost if they are essentially charging \$95 for the computer system and \$6 for the software. By offering the bundle, FirmComputer could be either pricing above cost or pricing below cost depending on how the money for the bundle is allocated. It is precisely this type of situation that causes courts problems in determining whether a firm using bundled discounts has engaged in predatory pricing.

3. Tying Arrangements

Selling multiple items together is not always a bundled discount. A tying arrangement is similar in theory but treated very differently under the antitrust laws. It is important to recognize the subtle differences between a tying arrangement and a bundled discount to properly distinguish the two. A tying arrangement involves offering at least two items together (possibly at a discount) which consumers cannot purchase separately.⁵⁷ Thus, the only difference between a bundled discount and a tying arrangement is that when a firm offers a bundled discount, the firm also sells the items separately. Tying arrangements are extremely anticompetitive and are a *per se*⁵⁸ violation of the Sherman Act.⁵⁹ The reason tying arrangements are treated so harshly is because they are inherently coercive; they force consumers to spend money on something they may not want or need.⁶⁰ In a typical anti-trust tying case, the plaintiff must prove coercion. The type of coercion in a tying arrangement is distinguishable from that in a bundled

57. GAVIL ET AL., *supra* note 18, at 693-94.

58. Some antitrust violations have been labeled as illegal *per se* meaning that there is no defense to them. Examples of a *per se* violation include price fixing and market share division, where, if proven to have happened at all, there is a violation whether or not there is an anti-competitive affect or a pro-competitive defense. *United States v. Columbia Steel Co.*, 334 U.S. 495, 521-22 (1948).

59. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 9 (1984) (holding that tying arrangements are *per se* illegal).

60. *Id.* at 12.

discount case because the plaintiff in a tying case need not prove the defendant priced below cost.⁶¹

Tying arrangements can be used by firms to drive other companies out of the market because it makes a product consumers might normally purchase elsewhere tied to a product consumers can only buy at a particular store.⁶² While bundled discounts can also be used to drive competitors out of the market, consumers are usually benefited so the market is working efficiently, not necessarily coercively. It is sometimes difficult to distinguish a bundled discount and a tying arrangement because the effect on the consumer is essentially the same in the short run. The difference, however, is whether there is a benefit in the long run. Consumers who want both products will receive a benefit from either a tying arrangement or a bundled discount, but a tying arrangement harms consumers who only want to purchase one of the products. As the majority opinion in *Jefferson Parish* stated, “every refusal to sell two products separately cannot be said to restrain competition. If each of the products may be purchased separately in a competitive market, [the bundled discount] imposes no unreasonable restraint on either market, particularly if competing suppliers are free to sell either [product] . . .”⁶³

III. PAST TREATMENT OF BUNDLED DISCOUNTS

Bundled discounts have only recently been considered a violation of antitrust laws, thus few courts have had the opportunity to consider whether such claims constitute a cause of action. One of the most controversial appellate court cases involving the issue of bundled discounts was the Third Circuit’s decision in *Lepage’s Inc. v. 3M*.⁶⁴ The Ninth Circuit disapproved of *Lepage’s* and is one of the most recent circuits to consider this issue in *Cascade Health Solutions v. PeaceHealth*.⁶⁵

A. *LePage’s Inc. v. 3M*

LePage’s was one of the first appellate court cases to apply antitrust laws to bundled discounts. The Third Circuit decided *LePage’s* in March, 2003 with a dissenting opinion by Justice Greenberg.⁶⁶ *Le-*

61. *Datagate, Inc. v. Hewlett-Packard Co.*, 60 F.3d 1421, 1423-24 (9th Cir. 1995).

62. GAVIL ET AL., *supra* note 18, at 693-94.

63. *Jefferson Parish*, 466 U.S. at 11-12 (citing *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 6 n.4 (1958)).

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

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

66. *Id.* at 143-44.

Page's involved a controversy between 3M and LePage's Inc, competing firms in the transparent tape market.⁶⁷ To attract customers, 3M offered bundled rebates to consumers who purchased tape and other products together.⁶⁸ The bundled rebates were an incentive to consumers to purchase multiple items from 3M (including tape), and not just the items that were cheaper. The bundled rebates discouraged customers from buying transparent tape from LePage's because if they did not buy the tape from 3M, they were not given any discounts.⁶⁹

Because of the bundled rebates, LePage's lost many customers and suffered huge operating losses from 1996 to 1999.⁷⁰ LePage's brought an antitrust claim asserting 3M used its monopoly power over its Scotch tape brand to force buyers to purchase other products from 3M as opposed to buying them from LePage's.⁷¹ LePage's also asserted 3M offered cash incentives to customers so they would enter into exclusive dealing arrangements with 3M.⁷² Market power was not an issue in the case because 3M conceded they possessed monopoly power and that they had over a 90% market share in the United States transparent tape market.⁷³

3M never argued it did not provide bundled rebates to clients. Instead, the company insisted that providing bundled rebates was not a violation of section 2 of the Sherman Act.⁷⁴ Relying on *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,⁷⁵ 3M claimed that "[a]bove-cost pricing cannot give rise to an antitrust offense as a matter of law, since it is the very conduct that the antitrust laws wish to promote in the interest of making consumers better off."⁷⁶ Both parties assumed that if 3M had priced items below cost, 3M would have committed an antitrust violation.

After reviewing prominent Sherman Act cases involving violations of section 2,⁷⁷ the *LePage's* court decided 3M had violated section 2 without any type of analysis into whether 3M priced any of its prod-

67. *Id.* at 144.

68. *Id.* at 144-45.

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

70. *Id.* at 144-45.

71. *Id.* at 145.

72. *Id.*

73. *Id.* at 146.

74. *LePage's*, 324 F.3d at 147.

75. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (*Brooke Group* is the main case dealing with predatory pricing; the Supreme Court stated the necessary standard in an antitrust violation is pricing below cost).

76. *LePage's*, 324 F.3d at 147.

77. *Id.* at 147-51.

ucts below cost.⁷⁸ The court held that 3M's action involved exclusionary dealing and stated *Brooke Group* did not change the law of monopolist exclusionary conduct.⁷⁹ The court also stated that the difference between this case and *Brooke Group* was that here, there was no allegation of predatory pricing.⁸⁰ The court decided a jury could reasonably conclude 3M's conduct was anticompetitive⁸¹ and rejected all of 3M's legal business justifications for its business practices.⁸² The court went on to say a dominant firm violates the Sherman Act when it offers a bundle that rivals cannot match and gives discounts on an "all or nothing" basis.⁸³ Here, LePage's, the rival firm, could not match 3M's bundles because the company only made transparent tape. In effect, the *LePage's* court held that bundled discounts are an unlawful practice for a dominant firm, and the court upheld the damage award proposed by the lower court.⁸⁴

B. Criticism of LePage's

As previously mentioned, antitrust laws are designed to protect competition, not competitors.⁸⁵ LePage's main argument was that its firm was harmed by 3M's bundled rebate practices.⁸⁶ While the *LePage's* analysis is necessary to determine damages and standing, antitrust laws should only be applied in the first place when it is proven that consumers, not just competitors, are actually harmed.

LePage's has been criticized for both its economic principles and legal principles. For example, the *Cascade* court stated, "the fundamental problem with [*LePage's*] is that it does not consider whether the bundled discounts constitute competition on the merits, but simply concludes that all bundled discounts offered by a monopolist are anticompetitive. . . ."⁸⁷ According to many studies, bundled discounts are economically beneficial because they lower the price of items for consumers that want both items.⁸⁸ The reason that bundled discounts are still efficient even if consumers only want one of the items is because they can shop around and purchase that one item wherever it is the

78. *Id.* 151-52.

79. *Id.* at 152.

80. *Id.* at 151.

81. *LePage's*, 324 F.3d at 157.

82. *Id.* at 163-64.

83. *Id.* at 159.

84. *Id.* at 166.

85. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

86. *LePage's*, 324 F.3d at 144-45.

87. *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 899 (9th Cir. 2008).

88. *Averitt & Lande*, *supra* note 42, at 233.

cheapest. In a purely competitive market, firms will drive out other firms because they are either more efficient at creating a product or they have something to offer a consumer that other firms cannot.⁸⁹ While some economists see bundled discounts as harmful to consumers because a more efficient firm is being forced out of the market, there is also a strong argument that bundled discounts only hurt other firms and benefit competition because lower prices will ultimately equal better competition.⁹⁰

There are also legal criticisms of the *LePage's* decision. In *Brooke Group*, the Supreme Court focused on the fact that monopolization itself is not a violation of section 2 of the Sherman Act.⁹¹ The Court specifically stated “[l]ow prices benefit consumers . . . so long as they are above predatory levels, they do not threaten competition.”⁹² It is an established principle of antitrust law that firms should look out for themselves and enthusiastically compete with other firms.⁹³ This anti-trust rationale was not carried over to the *LePage's* case. While the *LePage's* court decided not to apply *Brooke Group* because *LePage's* never claimed a predatory pricing violation,⁹⁴ the court overlooked important principles from the *Brooke Group* decision and focused primarily on whether or not predatory pricing was actually alleged. The Third Circuit failed to recognize that the Supreme Court's rationale applies to all antitrust issues and requires every court to analyze what competitive pricing entails.⁹⁵

Not only did the *LePage's* court fail to apply the correct economic standards, but the court created an unreasonable burden that effectively eliminated bundled discounts.⁹⁶ After *LePage's*, a bundled discount can only be created if all rival firms sell the same items and are able to create the same bundled discount.⁹⁷ Under *LePage's* rationale, hamburger restaurants cannot offer a “fries and a drink” combo meal unless every other competing hamburger restaurant in the market also sells fries and a drink and can compete by offering the exact same combo.

89. *See id.*

90. *See id.*

91. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993).

92. *Id.*

93. GAVIL ET AL., *supra* note 18, at 593.

94. *LePage's, Inc. v. 3M*, 324 F.3d 141, 151 (3d Cir. 2003).

95. Robert Ramirez, *Predatory Pricing and Bundled Rebates: The Ramifications of LePage's Inc. v. 3M For Consumers*, 17 Wash. U. J.L. & Pol'y 259, 281-82 (2005).

96. *See id.* at 282.

97. *See generally LePage's*, 324 F.3d 141.

Many within the antitrust community found it strange that even with all of the controversy surrounding *LePage's*, the United States Supreme Court refused to hear the case on appeal.⁹⁸ While the Supreme Court denying to hear a case does not mean anything substantively, many people took this as signifying a green light on the *LePage's* rationale and assumed the Supreme Court did not think *LePage's* was in conflict with its ruling in *Brook Group*.⁹⁹ It is because of this assumption that *LePage's* is so controversial and has never been overturned. There are many district courts, however, that refuse to follow the *LePage's* decision and have outright stated that it was decided incorrectly.¹⁰⁰ While *LePage's* is one of the few cases concerning bundled discounts, many economists and lawyers have expressed their disapproval of the outcome of the case.¹⁰¹

IV. CASCADE HEALTH SOLUTIONS V. PEACEHEALTH

After *LePage's*, there were no other appellate court decisions concerning bundled discounts until *Cascade Health Solutions v. PeaceHealth*.¹⁰² *Cascade* was decided on March 6, 2007 by the Ninth Circuit and introduced novel ideas about bundled discounts to courts.¹⁰³

A. Hospital Markets

In order to fully understand the antitrust issues in *Cascade*, an overview of hospital markets is necessary. There is an assumption in antitrust litigation that all groups or individuals pursue their own economic interests, and hospitals are no exception.¹⁰⁴ The three major participants in a hospital market are the hospitals themselves, insurers, and patients, and all three of these participants must act in their own economic best interest in order for the market to succeed.¹⁰⁵ Most patients do not pay for hospital care on their own, but instead pay for insurance.¹⁰⁶ Hospitals make elaborate contracts with insurance companies to get the best possible deals. Hospitals will often offer large discounts to insurance companies if they agree to force their

98. *LePage's*, 324 F.3d 141 (3d Cir. 2003), cert. denied, 542 U.S. 953 (2004).

99. See John H. Kilper, *A Bundle of Trouble: An Analysis of How The Lower Courts Have Handled Bundled Discounts Since LePage's, Inc. v. 3M*, 72 Mo. L. Rev. 1363 (2007).

100. *Id.* at 1382.

101. Ramirez, *supra* note 95, at 281-83.

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

103. See *id.*

104. *Id.* at 892.

105. *Id.* at 891-92.

106. *Id.* at 892.

patients to attend that specific hospital when they need hospital care.¹⁰⁷

There are four types of care that hospitals can offer patients.¹⁰⁸ Primary care involves the most basic form of care, for example, giving medicine, stitching wounds, and other outpatient procedures.¹⁰⁹ Secondary care is a little more sophisticated, but does not go beyond basic surgeries.¹¹⁰ This level of care would include continuing care for chronic conditions and the kind of care traditionally found in urgent care and birthing centers.¹¹¹ Tertiary care is the kind of care provided by most large city, main hospitals. This type of care includes high quality surgeries and unique types of treatments.¹¹² Tertiary care usually requires a prolonged hospital stay.¹¹³ The final type of care is quaternary care.¹¹⁴ The hospitals that offer this type of care are the most sophisticated hospitals in the world and have access to the latest technology.¹¹⁵ These types of hospitals serve patients from around the world.

B. *Background of Cascade*

In *Cascade*, McKenzie¹¹⁶ and PeaceHealth were the only two providers of hospital care in Lane County, Oregon.¹¹⁷ McKenzie was a small hospital that offered primary and secondary hospital care, and PeaceHealth was a larger hospital that offered primary, secondary, and tertiary health care.¹¹⁸ A major insurance company asked both of the hospitals for insurance bids in order to determine with which hospital the insurance company would enter into a contract.¹¹⁹ The insurance company asked for a bid for primary and secondary care together, plus a bid with primary, secondary, and tertiary care together.¹²⁰ Because McKenzie did not offer tertiary care, the insurance

107. *Cascade*, 515 F.3d at 892.

108. PETER M. GINTER ET AL., STRATEGIC MANAGEMENT OF HEALTH CARE ORGANIZATIONS 812 (4th ed. 2002).

109. ENCYCLOPEDIA OF HEALTH CARE MANAGEMENT 508 (Michael J. Stahl ed., 2004).

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. GINTER ET AL., *supra* note 108, at 812.

115. *Id.*

116. McKenzie is a hospital care provider that was later renamed Cascade after a merger. This article will refer to the hospital firm as McKenzie, as does the court in *Cascade*. See *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008).

117. *Id.* at 891.

118. *Id.*

119. *Id.* at 892.

120. *Id.*

company needed to get this from PeaceHealth no matter who had lower bids for the other two types of care. PeaceHealth decided to offer the insurance company discounts of 35-40% on tertiary care if they made PeaceHealth their exclusive provider for all three types of care.¹²¹ McKenzie was unable to match these discounts because they did not offer tertiary care.¹²²

McKenzie brought this claim of action, alleging its situation was similar to that discussed in *LePage's* because it was being harmed by a competitor who could offer a bundled discount McKenzie was unable to offer its consumers.¹²³ The District Court for the District of Oregon decided to follow the Third Circuit's analysis in *LePage's*.¹²⁴ Thus, the court held that PeaceHealth could not offer a bundled discount for all three types of health care because it was exclusionary and because McKenzie could not compete by offering a bundle with tertiary care.¹²⁵ PeaceHealth appealed this decision to the Ninth Circuit Court of Appeals.¹²⁶

C. *Different Ways to Analyze Bundled Discounts*

The Ninth Circuit decided there were different ways in which they could analyze PeaceHealth's bundled discount to see if it was below-cost pricing and therefore exclusionary under the antitrust laws.¹²⁷ However, before the court decided how to analyze below-cost pricing, it first had to determine whether to follow the reasoning in *LePage's*.¹²⁸ The court decided that in order for a bundled discount to be unlawful, it must in some way coerce a consumer into buying the bundle and that if customers have a legitimate choice, the discount is not an antitrust violation.¹²⁹ The court based this decision on the theories of Antitrust economists, Professor Areeda and Professor Hovenkamp, who stated that "[a] variation of the requirement that prices be 'below cost' is essential for the plaintiff to establish one particular element of unlawful bundled discounting—namely, that there was actually 'tying'—that is, that the purchaser was actually 'coerced' in this case, by lower prices into taking the tied-up package."¹³⁰ The Ninth Circuit

121. *Cascade*, 515 F.3d at 892.

122. *Id.* at 891.

123. *Id.* at 898.

124. *Id.* at 897.

125. *Id.* at 893.

126. *Cascade*, 515 F.3d at 893.

127. *Id.* at 903.

128. *Id.* at 900.

129. *Id.* at 900-01.

130. *Id.*

wanted to make sure that they were not over-condemning legal bundled discounts and rejected the *LePage's* decision right away.¹³¹

Having concluded a bundled discount was only exclusionary if it was priced below cost, the court next contemplated how it would measure the discount against the cost.¹³² The court discussed three different ways in which predatory pricing can be applied to bundled discounts. PeaceHealth urged the court to adopt the "aggregate discount" rule.¹³³ This rule measures below-cost pricing by making sure that the price of the discounted bundle is not lower than the incremental price of the whole bundle.¹³⁴ The "aggregate discount" rule¹³⁵ considers a bundled discount anticompetitive only in the rare cases when the whole bundle is priced below the whole cost.¹³⁶

Determining below-cost pricing using the "aggregate discount" rule is similar to the way courts determine single-product predatory pricing. The *Cascade* court decided against using the "aggregate discount" rule because the court held bundled discounts have a potentially greater threat than single-product pricing does.¹³⁷ This threat is that firms can use their monopoly status in one product market to exclude a rival in another product market.¹³⁸ The court reasoned that, under this rule, anticompetitive bundled discounts that harm competition could escape liability far too easily.¹³⁹

The second method the court considered using to analyze the bundled discount was derived from a New York district court opinion, *Ortho Diagnostic Systems v. Abbott Lab.*¹⁴⁰ This standard requires a plaintiff to show that it is as efficient as the defendant in creating the product in question. If the plaintiff successfully proves this and also that it cannot effectively compete with the bundled discount, then the

131. *Cascade*, 515 F.3d at 901.

132. *Id.* at 903.

133. *Id.* at 904.

134. *Id.*

135. In applying the "aggregate discount" rule to the example with Billy and Sara, Sara's bundled discount would not be considered anticompetitive. *See supra* notes 45-49 and accompanying text. This is because Sara's costs for both the lemonade and the cookie are \$1.50, and her bundled discount is being sold for \$2.25. Because the discounted bundle is still being sold above her total costs, Sara is not acting exclusionary under the "aggregate discount" rule. *Id.*

136. *Id.* (This would mean that either every product in the bundle was priced below cost or that one product of the bundle was priced so far below cost that the money cannot be made up by adding the other products).

137. *Id.*

138. *Id.*

139. *Id.*

140. *Cascade*, 515 F.3d at 905; *see also* *Ortho Diagnostic Sys. v. Abbott Labs, Inc.*, 920 F. Supp. 455, 469 (S.D.N.Y. 1996).

bundled discount is considered to be exclusionary.¹⁴¹ The *Ortho* standard¹⁴² can make an above-cost bundled discount anticompetitive if a plaintiff can prove that it is just as efficient.¹⁴³ Economically, the *Ortho* standard does a much better job at determining whether a bundled discount will cause harm to competition and to consumers.¹⁴⁴

The *Ortho* standard has a rather large disadvantage however. The disadvantage is that defendants may be unaware they are committing an antitrust violation until they are already on trial.¹⁴⁵ If it is possible for an above-cost bundled discount to be considered illegal, then the defendant should know what this bundle is before he or she commits the violation. It is impossible for the defendant to know, however, because competitors' costs and efficiency are generally unavailable to the defendant.¹⁴⁶

Another disadvantage of the *Ortho* standard is that multiple suits might be necessary to determine whether there is an antitrust violation.¹⁴⁷ If one firm brings a bundled discount suit, and the court finds the competitor is not as efficient, another firm might be able to challenge the defendant with another suit and show this second competitor is more efficient.¹⁴⁸ Not only does this standard encourage litigation, but the antitrust laws are supposed to focus on consumers and the *Ortho* standard turns the attention to the competitors.¹⁴⁹ Because of these disadvantages, the Ninth Circuit refused to adopt the *Ortho* standard and developed a new standard, the "discount attribution" standard.¹⁵⁰

Under the "discount attribution" standard of analysis, the court looks at the prices of each bundled object individually and then attributes the discount solely to the component of interest.¹⁵¹ After applying the entire discount to the item of interest, the court then

141. *Cascade*, 515 F.3d at 905.

142. The *Ortho* standard can be illustrated by considering the example with Billy and Sara and their lemonade stands. See *supra* notes 45-49 and accompanying text. If the *Ortho* standard was applied, Sara's bundled discount of lemonade and a cookie for \$2.25 would be considered exclusionary and anticompetitive even though Sara is not pricing under cost. This is because Billy was a more efficient producer of lemonade, yet he could not effectively compete with Sara because he did not also sell cookies. *Id.*

143. *Id.* (This could only occur if the defendant is able to sell in more product markets than the plaintiff and enables the discount to be spread over more products.)

144. *Cascade*, 515 F.3d at 905.

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Cascade*, 515 F.3d at 905.

150. *Id.* at 906.

151. *Id.*

determines whether the item is priced below cost. If the item is priced below cost, the pricing is anticompetitive and constitutes an antitrust violation.¹⁵² The *Cascade* court talks about how the “discount attribution” standard¹⁵³ is in fact a comparison to a hypothetical, equally efficient producer of the competitive product.¹⁵⁴ Like the *Ortho* standard, this method relies on efficiency. The difference between the *Ortho* standard and the “discount attribution” method is that the *Ortho* standard compares the defendant’s efficiency with the plaintiff’s, while the “discount attribution” method compares the defendant’s efficiency with a hypothetical, efficient firm.

Under the “discount attribution” standard, the equally efficient hypothetical firm is not a firm that produces all of the items in the bundle; it is a firm that produces only the component of interest as efficiently as the defendant.¹⁵⁵ Applying the entire discount to one item is the same as if the firm did not have a bundled discount and just priced that item lower, although not below the cost it takes to provide the item to consumers.¹⁵⁶ Because the District Court in *Cascade* followed the *LePage’s* decision and did not apply the “discount attribution” method, the Ninth Circuit vacated the jury’s verdict in favor of McKenzie on the attempted monopolization charge.¹⁵⁷

V. POTENTIAL PROBLEMS WITH *CASCADE*

In *Cascade*, the court determined a bundled discount can be illegal even if the plaintiff firm is less efficient.¹⁵⁸ The court reached this conclusion by applying the “discount attribution” standard and essentially comparing the defendant firm’s efficiency to that of a hypothetical firm.¹⁵⁹ While the court’s analysis is a large improvement from *LePage’s*, there are problems with the *Cascade* court’s application of the

152. *Id.*

153. The “discount attribution” standard can also be illustrated by using the example with Sara and Billy. See *supra* notes 45-49 and accompanying text. Sara sells her bundle of a cookie and lemonade for \$2.25. This is a discount of \$0.75 because separately the lemonade is \$1.00, and the cookie is \$2.00. Sara’s cost for lemonade is \$0.50. *Id.* The component of interest here is the lemonade because that is what Billy also sells. Applying the whole discount to the component of interest would mean that the discount of \$0.75 would be compared to the cost to produce the lemonade, which is \$0.50. Under the “discount attribution” standard, Sara has an anticompetitive bundle because the discount is more than the cost to produce the lemonade. *Id.*

154. *Cascade*, 515 F.3d at 906.

155. *Id.* at 907 (citing 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749a, at 322-23 (Supp. 2006)).

156. *Cascade*, 515 F.3d at 906.

157. *Id.* at 891.

158. *Id.* at 906.

159. *Id.*

“discount attribution” standard. First, the court failed to look at other factors, aside from efficiency, which might show, under certain circumstances, that consumers are not actually harmed by bundled discounts. Second, the legal ramifications of comparing the defendant firm to a hypothetical firm, instead of to the plaintiff, are problematic.

A. *Determining Below Cost Pricing: Analyzing Antitrust Economics*

The *Cascade* court made a couple of assumptions about the economics of consumer welfare which may be incorrect in certain bundled discount situations. The first assumption is that the possibility of there being a more efficient firm for one of the items automatically means consumers are being harmed. The second assumption is that a firm has no plausible justification for pricing items in a less profitable way. By analyzing these assumptions, it becomes apparent that the *Cascade* court’s test could condemn legal bundled discounts.

1. Are Consumers Actually Harmed?

A main assumption the *Cascade* court makes is that consumers are automatically harmed if there is potential in the market for a more efficient firm.¹⁶⁰ Efficiency between two firms is properly measured by assessing which firm can lower prices and increase output. However, just because there *could* be an equally or more efficient firm does not mean that one actually exists. Applying the “discount attribution” standard to a perfect economy might effectively test whether consumers are harmed, but the test does not take certain things into consideration, such as switching costs, ease of entry into the market, and oligopoly situations.

Bundled discounts help consumers by lowering prices; they only harm consumers if they are coercive.¹⁶¹ It is important for courts to determine whether consumers are truly harmed by a bundled discount before deeming it anticompetitive. The “discount attribution” standard does not actually measure consumer harm, but instead measures how consumers could potentially be harmed if an equally efficient firm exists.¹⁶² If the standard is applied in situations where no equally efficient firm could exist or will exist, then the court could be over-condemning bundles that are harmless. Regardless of the standard or test adopted, courts should force plaintiffs to demonstrate that con-

160. See generally *id.*

161. Averitt & Lande, *supra* note 42, at 233.

162. *Cascade*, 515 F.3d at 906.

sumers are actually or will actually be harmed by the defendant's conduct.

The "discount attribution" standard does not take into account other market factors such as entry barriers and oligopoly situations.¹⁶³ If the market in question is extremely easy to enter, then the bundled discount will never harm consumers because another firm will quickly enter the market as soon as the defendant firm attempts to raise prices above the competitive level.¹⁶⁴ Thus, in such a market, even if the defendant is pricing below cost, there is absolutely no harm to consumers because prices will never be able to escalate above the competitive level for the product in question.¹⁶⁵ Another factor courts should consider is how many firms are actually in the market for the product in question. If the competitive product is part of an oligopoly¹⁶⁶ situation, then comparing to a hypothetical firm makes no sense because there are only a few firms in the market. If the hypothetical firm turns out to be more efficient than the only other firm in the relevant market, the "discount attribution" standard will over-condemn the bundled discount.

2. What about Business Justification?

A second assumption the *Cascade* court makes is that there could be no business justification for a firm to give up any profit that it could make on a product.¹⁶⁷ The court makes this assumption by applying the "discount attribution" standard without allowing the defendant any chance to show a business justification for its pricing strategy.¹⁶⁸ The court also fails to require the plaintiff to prove that there is a dangerous probability of recoupment, as would be necessary in a single product predatory pricing claim.¹⁶⁹ An example will be given to show how using a pure "discount attribution" standard without also looking at other factors can lead to over-condemning bundles that are not predatory. After the example there will be an analysis on how a

163. *See id.*

164. The ease of entry only has to do with the market of the competitive product. The illegality of bundled discounts is based on the assumption that the defendant firm has a monopoly in the second product and is using that monopoly to give itself a competitive advantage in the competitive product market.

165. The defendant firm can never raise the price of the monopoly product because that product will already be priced at the monopoly price and a firm will lose profits if it prices above the monopoly price.

166. An oligopoly market is one in which there are only two to four firms in the relevant market.

167. *See generally Cascade*, 515 F.3d 883.

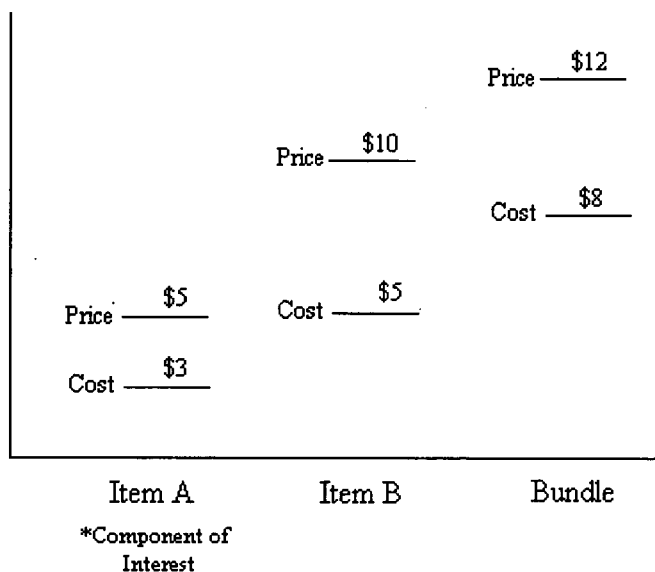
168. *Id.* at 906.

169. *Id.* at 910.

business justification and the inability to recoup lost profits can change the effect on consumer welfare.

Figure 1 illustrates a situation in which a firm offers a bundled discount when items A and B are purchased together. The price of items A, B, and the bundle of both A and B is \$5, \$10, and \$12, respectively, while the corresponding cost of making items A, B, and the bundle is \$3, \$5, and \$8.¹⁷⁰ If a court given a situation like this followed the *Cascade* court in its application of the "discount attribution" standard, the court would first decide what the component of interest is ("item A").¹⁷¹ The component of interest is the item the firm is trying to "force" consumers to buy by purchasing the bundle as opposed to just purchasing item B from the firm and item A from another firm.¹⁷²

FIGURE 1



Next, a court would apply the whole discount to item A, and use that to determine if item A is being sold predatorily.¹⁷³ The discount is found by determining how much a consumer would pay for both items if there was no discount and then comparing that number to the price

170. This is a hypothetical situation used to demonstrate how a bundled discount could be analyzed by the court. The prices and costs were made up; however, the cost of the bundled discount was found by adding the costs of making both items A and B. This simulation ignores many factors such as marginal and fixed costs, which items are sold by competitors, and how many items total are produced by this firm.

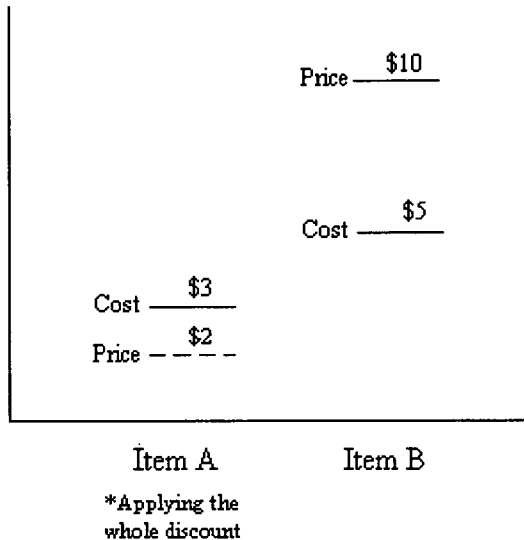
171. *Cascade*, 515 F.3d at 906.

172. *Id.*

173. *Id.*

of the bundle. This shows how much the consumer is saving by purchasing the bundle as opposed to purchasing both items separately. In Figure 1, the difference between the \$15 cost of both items separately and the \$12 for the bundle makes the discount \$3. Figure 2 shows that if the whole discount is applied to the component of interest (item A), the “new” price of item A is \$2. Because the cost of making item A is \$3, the price is below cost, so this bundle would be predatory under the “discount attribution” standard.¹⁷⁴

FIGURE 2



According to the test established in *Cascade*, a court would most likely find this is potentially harmful to an equally efficient competitor and, therefore, is a violation of antitrust law.¹⁷⁵ One of the reasons that “discount attribution” works is because if the component of interest is priced below cost, even if the company is not losing money on the bundle, then the company would still be losing profits. Going back to Figure 1, the firm is making \$4 in profit for every bundle sold, and the bundle as a whole is not predatory. However, bundled discounts are created so that the firm can increase sales on the component of interest because the firm already has a monopoly on the other product. If the firm in the example did not sell the bundle, it could make \$5

174. This is assuming that the \$2 is also a price that is below the competitors costs because in order for a predatory pricing claim, the firm must price below the competitors more efficient costs and there must be a probability of recoupment. GAVIL ET AL., *supra* note 18, at 619 (referencing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)).

175. See *Cascade*, 515 F.3d at 906.

in profit for every item B sold and would actually be making more money even if it did not sell any of item A. The "discount attribution" standard assumes the only reason a firm would choose a \$4 profit over a \$5 profit would be if it was trying to harm competitors.

Under the antitrust laws, it is illegal for a firm to act against its own interest simply to harm its rivals because it is assumed consumers will lose in the long run by the creation of an unnatural monopoly. However, it is legal under the antitrust laws for a firm to act in its own interest and indirectly cause another firm to go out of business; this is considered nothing more than fierce competition. The assumption that a firm would never take \$4 over \$5 is not always correct. There could be many valid business justifications for a firm to not try to realize every possible profit dollar. One justification could be trying to create brand loyalty. Companies will often give away products for free or at a discount because they believe that once consumers become loyal to their product, consumers will choose their product over others regardless of the price. This is also possible if the firm currently has a monopoly in item B, but is anticipating losing that monopoly soon and will count on brand loyalty in the future.

Brand loyalty is very common and can be easily seen in many drug stores. For example, in most drug stores, Advil® will be on the shelf right next to a much cheaper drug store version of Ibuprofen.¹⁷⁶ Even though both products have exactly the same formula, exactly the same dosage, and exactly the same amount per package, many people will still choose the more expensive Advil® because they feel a type of loyalty to the brand name. Earning less of a profit in the short run could entice more people to try a certain brand and could create brand loyalty for the firm.

A question that arises when looking at profits and losses is whether choosing to receive less in profits can be considered predatory pricing. One of the major elements of predatory pricing is that the firm is losing money and is doing so for the sole purpose of driving competitors out of business. If the firm is still actually making a profit on the bundle and the profit is just less than it could be, is the firm still engaged in predatory pricing?

One way to fix this assumption would be for the courts to require either no business justification for the pricing strategy or the plaintiff to demonstrate consumers will likely be harmed in the future. To do this, the plaintiff would need to show that the defendant firm will be

176. Advil is a product of Wyeth Pharmaceutical, formerly known as American Home Products (AHP).

able to recoup the lost profits in the future by raising prices. The *Cascade* court explained that plaintiffs need not prove recoupment because “the recoupment requirement from single product cases translates to multi-product discounting cases. Single-product predatory pricing, unlike bundling, necessarily involves a loss for the defendant.”¹⁷⁷ The court pointed out that it would hold a firm liable for a bundled discount that does not lose the defendant money. If a court does not require the plaintiff to show that the defendant will later recoup the lost profits and does not inquire into possible business justifications, the court’s limited test could condemn bundled discounts which do not harm consumers.

B. *Comparing to a Hypothetical Firm: Analyzing Legal Issues*

Even if the *Cascade* court correctly defined the economics of the antitrust laws and how they should be applied, the court may still have created legal problems involving standing and awarding damages. The test the court adopted is unusual because it completely ignores the plaintiff. Not only is such a test potentially unfair to the defendant, but it might also be improper under United States law. Because antitrust laws are concerned with competition and not competitors,¹⁷⁸ using a hypothetical firm does not necessarily harm antitrust principles, but it may harm other legal principles. Even if a court’s solution fits with the antitrust laws, the court still must make sure the plaintiff has standing to bring the case and is not awarded damages that the plaintiff does not deserve.¹⁷⁹

1. Standing

The test adopted in *Cascade* focuses on the defendant. In most antitrust litigation, the result focuses on the injury to consumers through the plaintiff, not the injury to a hypothetical firm. Comparing to a hypothetical firm causes standing issues with the firm bringing the lawsuit. The United States Constitution limits the federal courts to litigating situations that involve a case or controversy.¹⁸⁰

177. *Cascade*, 515 F.3d at 910 n.21.

178. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

179. Standing and damages are only an issue when a suit is brought by a private firm or private individual and not when the suit is brought by the Department of Justice or the Federal Trade Commission. See Department of Justice Antitrust Division, <http://www.usdoj.gov/atr> (last visited Oct. 18, 2008); Federal Trade Commission, <http://www.ftc.gov> (last visited Oct. 18, 2008). Criminal charges are also exempt from the standing and damages issues as they are presented here. *Id.*

180. See U.S. CONST. art. III, § 2.

In *Cascade*, the Ninth Circuit ultimately decided whether there was an antitrust violation by comparing the defendant firm to a hypothetical firm and determining if the defendant could drive out an equally efficient, yet non-existent, competitor.¹⁸¹ This form of analysis should be a standing violation under the Constitution because the court is analyzing a case or controversy that is not present.¹⁸² If the firm bringing the suit has not actually been harmed, then the firm does not have standing. While an antitrust violation may be tangibly affecting everyone, there is no way of knowing whether the competitor is actually being harmed by the antitrust violation or is just not as good of a competitor. This lack of standing could be very dangerous in future antitrust litigation because it allows a less efficient firm to bring an antitrust suit against a competitor just because there is a chance that a hypothetical and more efficient firm would have been harmed.

Not only is the lack of standing a constitutional issue, but it also upsets many of the economic standards upon which the antitrust laws are based.¹⁸³ When consumers are offered a bundled discount, they receive products at a lower price than if the items were purchased separately.¹⁸⁴ Having lower prices is beneficial to consumer welfare and is only a problem if the firm offering the bundled discount later raises prices after a more efficient competitor is forced out of business.¹⁸⁵ If there are no competitors that are more efficient, and there is only a hypothetical firm that is more efficient, then the long term affects on consumer welfare are inapplicable. This leaves consumers with only the short-term benefits. Holding bundled discounts illegal because of the comparison with the hypothetical firms does not benefit consumers, which is the purpose of the antitrust laws. The same reasons that standing is important in the legal system are the same reasons it needs to be important in the antitrust laws. There must be a legal harm before courts can consider whether a bundled discount harms consumers.

The Department of Justice and the Federal Trade Commission can bring suit against a firm believed to have violated an antitrust law.¹⁸⁶ While the government need not have been personally harmed, the government may bring a violation suit representing all consumers to

181. *Cascade*, 515 F.3d at 906.

182. See U.S. CONST. art. III. § 2.

183. Charles N. Charnas, *Segregation of Antitrust Damages: An Excessive Burden on Private Parties*, 72 CAL. L. REV. 403, 408 (1984).

184. Averitt & Lande, *supra* note 42, at 233.

185. See *id.*

186. See Department of Justice Antitrust Division, <http://www.usdoj.gov/atr> (last visited Oct. 18, 2008); Federal Trade Commission, <http://www.ftc.gov> (last visited Oct. 18, 2008).

be a vessel to promote consumer welfare.¹⁸⁷ Just because the Department of Justice and the Federal Trade Commission are allowed to bring these suits does not mean that a private citizen or firm can bring a suit without the proper standing.

2. Damages

Damages are regulated by both the federal government and, more specifically, by the antitrust laws themselves.¹⁸⁸ By comparing to a hypothetical firm, as done in *Cascade*, it is difficult to determine the damages for the plaintiff firm because it was not the firm that was used to determine the antitrust violation. A private party may sue for damages for a violation of section 2 of the Sherman Act and recover threefold the damages and counsel fees.¹⁸⁹ “Federal law does not provide for automatic monetary damages as an antitrust remedy and damages cannot be recovered unless proved.”¹⁹⁰ The United States Supreme Court has also stated that “Congress did not intend to allow every person tangentially affected by an antitrust violation to maintain an action” for treble damages.¹⁹¹ The statutory language of the antitrust laws require a plaintiff to show an injury to either its “business or property” and a “proximate causal connection” between the violation and the injury to recover damages.¹⁹²

With the *Cascade* court’s test, it is almost impossible to determine what would have happened to the plaintiff firm even if the defendant firm did not price below cost. It could not be determined if there would have been the same injury because of legal competition. If this were the case, then the violation did not cause an injury to this firm and cannot be remedied with monetary damages. If a court finds a defendant firm participated in predatory pricing (based on the Ninth Circuit’s hypothetical firm analysis), it is possible the plaintiff firm would have been forced out of business even if the defendant firm had not participated in predatory pricing because it was less efficient. This means the plaintiff firm could get lucky and receive damages for something that would have happened to them regardless of whether the defendant firm priced below cost.

187. *Id.*

188. Charnas, *supra* note 183, at 404.

189. 15 U.S.C. § 2 (2002) (describing antitrust damages); 15 U.S.C. § 15 (2002) (allowing treble damages and attorney’s fees).

190. 54 AM.JUR. 2D *Monopolies and Restraints of Trade* § 696 (2007).

191. *Blue Shield v. McCready*, 457 U.S. 465, 477 (1982).

192. Charnas, *supra* note 183, at 407.

“An antitrust plaintiff seeking treble damages may not recover for losses due to factors other than defendant’s anticompetitive violations.”¹⁹³ This begs the question whether a plaintiff could be awarded treble damages even though the defendant firm is being punished for harm it did not cause the plaintiff. It seems unfair to award the firm bringing the antitrust suit damages that were sustained by a hypothetical firm.

VI. IS THERE A PERFECT SOLUTION?

Although bundled discounts are common in daily life, illegal bundled discounts are rare.¹⁹⁴ It is important to properly adjudicate bundled discount cases to protect consumer welfare and free enterprise and to avoid condemning legal bundled discounts.¹⁹⁵ The bundled discount cases that do come up in the court system have involved large hospital practices, as in *Cascade*,¹⁹⁶ and even giving big warehouse discounts to huge suppliers, as in *LePage’s*.¹⁹⁷ The way in which a court decides to measure a bundle’s below-cost pricing can mean the difference between a plaintiff company going out of business and a defendant company having to change their pricing practices.

Although the *Cascade* court’s analysis was not wrong, it failed to resolve a number of bundle discount issues and created two new questions: (1) is it okay to compare the efficiency of a company to that of a hypothetical company; and (2) is there a better way to determine if a bundle is being priced predatorily or anticompetitively?¹⁹⁸ What could the *Cascade* court have done differently?

The standing and damages issues are important and can only be resolved if there are no comparisons to a hypothetical firm in personal civil suits. One main solution to these problems is have either the Department of Justice or the Federal Trade Commission bring section 2 bundled discount cases when individual plaintiffs lack standing to do so themselves.¹⁹⁹ Because the Department of Justice and the Federal Trade Commission are government-run, they have standing to bring charges against a firm as representatives of the government and consumer welfare as a whole. This would also solve the remedies problem. Treble damages could be awarded because the Department of

193. 54 AM.JUR. 2D, *supra* note 190, at § 696.

194. Crane, *supra* note 1, at 425.

195. *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 901 (9th Cir. 2008).

196. *See Id.*

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

198. *See generally Cascade*, 515 F.3d at 903-09.

199. *See* Department of Justice Antitrust Division, <http://www.usdoj.gov/atr> (last visited Oct. 18, 2008); Federal Trade Commission, <http://www.ftc.gov> (last visited Oct. 18, 2008).

Justice and the Federal Trade Commission need only show there was an injury to consumer welfare (such as by showing predatory pricing), and they need not show any injury to one particular firm.²⁰⁰ The only disadvantage of this solution is that it is important in antitrust law that individuals, as well as the government, are able to bring a suit when they have sustained an antitrust injury. In order to allow an individual who has standing and a legitimate injury to bring a suit, the court must rely on either additional factors or a completely different test when examining a bundled discount in a civil antitrust action.

The *Cascade* court decided it was important to make sure a defendant is actually pricing below cost.²⁰¹ Although this court used the “discount attribution” standard, there are many different ways to determine whether a firm is pricing below cost. Because of the potential problems with courts creating hypothetical firms,²⁰² it is important to determine whether the *Cascade* court’s standard is the best to use or if there are other ways to analyze the bundles without having to compare the results to a hypothetical firm.

There are different ways the *Cascade* court could have analyzed whether the bundled discount was priced below its cost.²⁰³ It is possible that applying the whole discount to only the component of interest could label some behavior as predatory that is not, in fact, predatory. If the component of interest is significantly less expensive than the other items in the bundle, the *Cascade* court’s way of analyzing the discount will almost always lead the component of interest to seem as if it is priced under cost. The test shows whether a firm is *not* participating in predatory pricing, but it could be argued that the test does not properly predict whether the firm *is* participating in predatory pricing.

A solution to the dilemma of how to determine predatory pricing could be to look for a way of distributing the discount so the end result is something between the “aggregate discount” rule and the “discount attribution” standard. One way to do this, which was not mentioned in *Cascade*, is to apply the percentage of the discount to each item accordingly. This test can be illustrated by looking back at the example in section V.A.2.²⁰⁴ Returning to figure one, if a consumer bought item A and item B separately, item A would constitute 1/3 of the money spent and item B would make up the other 2/3. Be-

200. *Id.*

201. *Cascade*, 515 F.3d at 901.

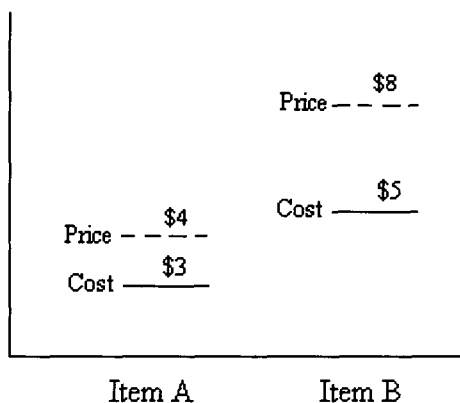
202. *See supra* Part V.B.

203. *Cascade*, 515 F.3d at 903-09.

204. *See supra* Part V.A.2.

cause the discount is equal to \$3, the bundle could be analyzed by splitting the \$3 into 1/3 (for item A) and 2/3 (for item B). The "new" prices that are assigned to each item can be seen in figure 3. Here, \$2 of the discount is applied to item B, and \$1 of the discount is applied to item A. As can be seen in figure 3, neither item A nor item B is priced below the cost of making the item.

FIGURE 3



Both this simulation and the *Cascade* court's test are acceptable ways of analyzing a bundled discount and allocating the discount to determine whether the firm is participating in predatory pricing. However, there are situations, even if rare, where the *Cascade* court's bundle analysis can create a predatory result that would not be considered predatory under the percentage analysis.²⁰⁵ If courts started using the percentage method, it may be possible to eliminate the need for a hypothetical firm comparison.

No matter which test future courts use to determine whether a bundle is predatory, courts can eliminate many problems by considering additional factors, instead of just using a numbers test. When courts look to business justifications, entry barriers, probability of recoupment, and the actual makeup of the market, the economic tests that are over-condemning can be balanced out. Analyzing bundled discounts using more of a full on rule of reason test will require more effort from the courts but will also ensure the only kinds of bundled discounts that are deemed illegal will be ones that are truly predatory and anticompetitive.

205. *Id.*

VII. CONCLUSION

Bundled discounts are a relatively new claim under the antitrust laws. Bundled discounts are common in everyday life; however, they harm competition when the discount coerces consumers. The two main categories that courts look to when analyzing bundled discounts are efficiency and predatory pricing.

Although the Third Circuit determined that most bundled discounts are anticompetitive in *LePage's Inc. v. 3M*, the Ninth Circuit created a completely different standard in *Cascade Health Solutions v. PeaceHealth* using the "discount attribution" standard. The "discount attribution" standard is a way to correctly identify pricing, yet it is not the only way that the courts can consider whether a firm is pricing predatorily. One of the main problems with the "discount attribution" standard is that it compares the defendant firm to a hypothetical firm. A comparison such as this can lead to economically over-condemning bundles as well as standing and damages issues.

Courts can eliminate some of the problems caused by analyzing bundled discounts by either using a percentage test to measure predatory pricing or by analyzing additional factors when using the "discount attribution" standard. Examining factors such as the ease of entry into the market and the market dynamic will help eliminate many of the problems with the "discount attribution" standard. Whether a bundled discount consists of fries and a drink or levels of hospital care, it is important for courts to realize its impact on consumer welfare and condemn only those bundles that will harm consumers.

