22. Tying Arrangements and Mixed Bundling

Antitrust Law

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Tying Arrangements and Mixed Bundling

- Concepts
  - Tying arrangements
    - "[A] tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[1]
    - The usual form of a tying arrangement is "I will sell you Product X, but only if you also buy Product Y from me."
      - Product X, which is called the *tying product*, is the product that the customer wants to buy from the seller
      - Product Y, which is call the *tied product*, is the product that the customer does not want to buy, or at least does not want to buy from the seller.
    - Possible anticompetitive effects
      - Foreclosure of competitors in the market for the tied product (current theory)
      - Coercion of consumers to purchase something—the tied product—from the seller that they do not want (rejected today as a theory of anticompetitive harm)
  - Mixed bundling (sometimes called discounted bundling)
    - Each of the products in the bundle is available separately, but when purchased together in the bundle at available at a substantial discount compared to the sum of the individual prices
    - Possible anticompetitive effects
      - Foreclosure of competitors in the market for one of the component products in the bundle

[1] Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958).

Tying Arrangements

Harm in Tying Arrangements

- Early views
  - *Northern Pacific*

> [T]ying agreements serve hardly any purpose beyond the suppression of competition. They deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market. At the same time buyers are forced to forego their free choice between competing products. [1]

    - "Leverage" of monopoly power from tying market to tied market
    - Forcing buyers to forego their free choice
  - *Fortner*

> "[T]ying arrangements may be used to evade price control in the tying product through clandestine transfer of the profit to the tied product; they may be used as a counting device to effect price discrimination; and they may be used to force a full line of products on the customer so as to extract more easily from him a monopoly return on one unique product in the line."[2]

    - Evasion of price controls on the tying product
    - Fuller exploitation of the seller's market power in the tying product through metering

[1] Northern Pacific Ry. v. United States, 356 U.S. 1 (1958) (internal quotation marks and citation omitted).
[2] Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 513-14 (1969) (Fortner I) (White, J., dissenting)

Harm in Tying Arrangements

- Modern view

> "Our cases have concluded that the essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms. When such "forcing" is present, competition on the merits in the market for the tied item is restrained and the Sherman Act is violated.“[2]

  - Restraining competition on the merits in the tied product market

[1] Northern Pacific Ry. v. United States, 356 U.S. 1 (1958) (internal quotation marks and citation omitted).
[2] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12 (1984); *accord* Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28, 34-35 (2006).

Harm in Tying Arrangements

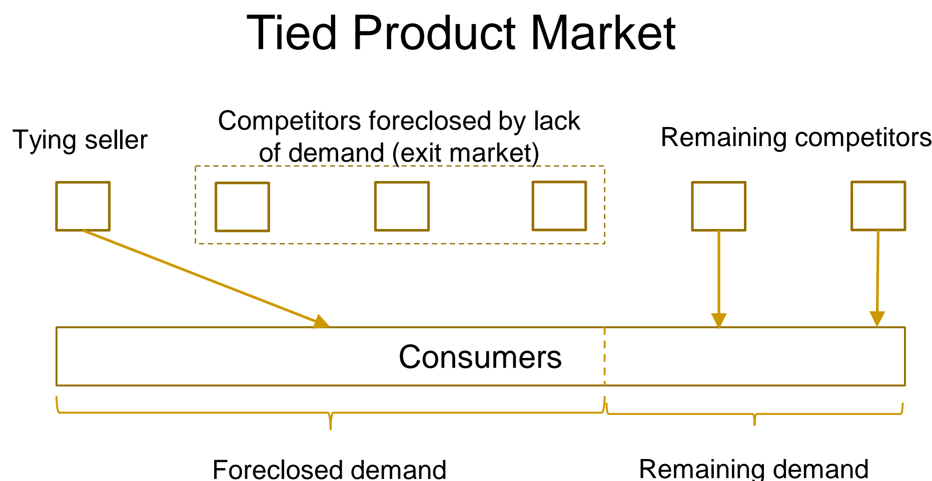
- More on the modern view

> [T]he law draws a distinction between the exploitation of market power by merely enhancing the price of the tying product, on the one hand, and by attempting to impose restraints on competition in the market for a tied product, on the other. When the seller's power is just used to maximize its return in the tying product market, where presumably its product enjoys some justifiable advantage over its competitors, the competitive ideal of the Sherman Act is not necessarily compromised. But if that power is used to impair competition on the merits in another market, a potentially inferior product may be insulated from competitive pressures. This impairment could either harm existing competitors or create barriers to entry of new competitors in the market for the tied product, and can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie. And from the standpoint of the consumer—whose interests the statute was especially intended to serve—the freedom to select the best bargain in the second market is impaired by his need to purchase the tying product, and perhaps by an inability to evaluate the true cost of either product when they are available only as a package.[1]

[1] *Jefferson Parish*, 466 U.S. at 14 (footnotes and internal citations omitted).

Harm in Tying Arrangements

- Modern foreclosure theory (from an economic perspective)
  - Tying arrangement reduces demand in tied product for competitive products, reducing the number of sellers of these competitive products
    - Reduced number of competitors gives tying seller a greater share of the tied product market and may enable tying seller to reduce output and raise prices in the tied product market
      - Requires competitors to be limited in their ability to expand output to offset the tying seller's production contraction
    - Increased concentration of third-party sellers may facilitate coordination and raise prices in tied product market



Harm in Tying Arrangements

- Fuller exploitation of market power in the tying product through price discrimination
  - While foreclosure of the tied product market is the modern focus of competitive concern, some older cases viewed certain tying arrangements as anticompetitive because they provide a means of more fully exploiting the seller's market power in the tying product
  - These types of tying arrangements are called *metering tying arrangements* because they enable the tying seller to ascertain the intensity of demand of its customers based on their usage
    - These arrangements are also known as *requirements tying arrangements*
  - The usual metering tying arrangement is the sale of a single unit of a durable tying product and the sale of multiple units of the consumable tied product depending on the customer's usage of the tying product

Tying product	Metering tied product
Printer	Printer cartridges
Razor	Razor blades
Camera	Film

Harm in Tying Arrangements

- Fuller exploitation of market power in the tying product through price discrimination
  - Example
    - Consider a manufacturer with market power in printers. The demand for printers is derived from the demand for printing. All other things being equal, customers that require a high volume of printing will have a higher reservation price for printers than customers require only a low volume of printing. Assume that the same printer can handle high and low volume printing.
    - In the absence of tying, the printer manufacturer will set price for its marginal revenue equals its marginal cost of manufacturing printers, since it has no means of distinguishing high volume customers from low volume customers.
    - Although customers need only one printer, high volume customers will require more printer cartridges than low volume printers. If the printer manufacturer can tie the sale of printer cartridges to the sale of printers, the manufacturer can effectively price discriminate between high volume and low volume customers
    - The usual profit-maximizing solution is to lower the price of printers below the stand-alone price and raise the price of printer cartridges above their stand-alone price
      - Now you understand why printers are so inexpensive and printer cartridges are so expensive

Harm in Tying Arrangements

- Fuller exploitation of market power in the tying product through price discrimination
  - Historical treatment
    - Most early United States Supreme Court decisions that have condemned tying arrangements have involved a requirements tie[1]
    - Congress focused on a metering tying arrangement when it enacted Section 3 of the Clayton Act in 1914
      - Section 3 was a response to *Henry v. A.B. Dick Co.,*[2] which upheld a contributory infringement claim where Henry sold ink for use in a patented mimeograph machine manufactured by A.B. Dick knowing that that the ink purchaser was bound by her license agreement to purchase ink and other supplies for use in the machine only from A.B. Dick.
  - Modern treatment
    - Metering as a theory of anticompetitive harm in tying arrangements has fallen out of favor
      - Very common, even when the seller lacks significant market power in the tying product
      - The consumer welfare effect is ambiguous, since low intensity customers pay lower prices while high intensity customers pay higher prices than would have been the case in the "but for" world without the tying arrangement
      - Consistent with the view that a lawful monopolist can charge a monopoly price, a common device such as metering that allows a lawful monopolist to extract more of the surplus from its customers is not considered anticompetitive on its own even if the overall consumer welfare effect is negative

[1] *See, e.g.*, International Salt Co. v. United States, 332 U.S. 392 (1947); IBM Corp. v. United States, 298 U.S. 131 (1936); United Shoe Mach. Corp. v. United States, 258 U.S. 451 (1922); Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502 (1917).
[2] 224 U.S. 1 (1912).

Tying Arrangements

- Statutory coverage
  - Sherman Act § 1
    - Almost always invoked as the statutory violation
  - Sherman Act § 2
    - Tying arrangements are exclusionary whenever they foreclose demand for competitor's products in the market for the tied product
      - There is a separate question of whether it is *anticompetitively* exclusionary
    - Section 2 is rarely invoked in practice
      - Easier to prove a Section 1 violation
  - Clayton Act § 3
    - Same elements as for Sherman Act § 1, except for more restricted "in commerce" requirements
      - Sometimes see pleaded but superfluous in light of Section 1

Section 1 Analysis

- The per se rule against tying arrangements
  - History
    - Congressional concern reflected in Clayton Act § 3
    - Per se rule first enunciated by Supreme Court in 1947 in *International Salt Co.*[1]
      - Use of the per se rule against tying arrangements has been endorsed repeatedly by the Supreme Court since 1947
    - *Jefferson Parish*
      - Justice Stevens, for five members of the Court:

        > It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable "*per se*."[2]

      - Justice O'Connor, concurring in judgment, for four members of the Court (urging rule of reason treatment):

        > The "*per se*" doctrine in tying cases has thus always required an elaborate inquiry into the economic effects of the tying arrangement. As a result, tying doctrine incurs the costs of a rule of reason approach without achieving its benefits: the doctrine calls for the extensive and time-consuming economic analysis characteristic of the rule of reason, but then may be interpreted to prohibit arrangements that economic analysis would show to be beneficial. Moreover, the *per se* label in the tying context has generated more confusion than coherent law because it appears to invite lower courts to omit the analysis of economic circumstances of the tie that has always been an necessary element of tying analysis.[3]

[1] International Salt Co. v. United States, 332 U.S. 392, 396 (1947).
[2] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 9 (1984).
[3] *Id.* at 34-35 (O'Connor, J., concurring in judgment) (footnote omitted).

Section 1 Analysis

- "Elements" of a per se unlawful tying arrangement
  - Modern requirements[2]
    - *Separate products*: The tying and tied products must be two separate products in two distinct relevant markets
    - *Market power*: The defendant must have market power in the market for the tying product
      - Kodak returns to the use of the "appreciable economic power articulation"[3]
    - *Coercion*: The defendant must use its market power in the tying product to coerce the purchaser into purchasing the tied product from it
    - *Foreclosure in the tied market*: The tying arrangement must foreclose a substantial volume of commerce (sometimes worded as a "not insignificant" volume of commerce)
  - Tying arrangement
    - The requirement of a tying arrangement is implicit in the coercion requirement

[1] 332 U.S. 392, 396 (1947).
[2] *See* Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 461-62 (1992); Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12-18 (1984); United States v. Microsoft Corp., 253 F.3d 54, 85 (D.C. Cir. 2001).
[3] *Kodak*, 504 U.S. at 462.

Section 1 Analysis

- Practice
  - Almost every case uses these elements to completely define a per se violation
  - The rule of reason applies if one of the above elements is missing
    - But the rule of reason has almost no bite as a practical matter
    - If a plaintiff cannot satisfy the four requirement of per se illegality, it almost never can prove the likely anticompetitive effect required for a rule of reason violation
  - Technological tying cases (see below)
    - Some courts do not apply the per se rule even if the four requirements appear to be satisfied in technological tying cases
- Possible plaintiffs with antitrust injury
  - Competitors that were foreclosed from the tied product market (most common)
  - Direct purchasers that are injured because they were coerced into buying the tied product from the seller that they otherwise would not have purchased

Section 1 Analysis

- A doctrinal problem
  - The above test is more accurately a test for the *anticompetitive effect* (unreasonableness) of a tying arrangement
  - Under *Trinko*, the other elements of a Section 1 prima facie case also need to be proved
    - *Plurality*: Satisfied if buyer and seller are independent of one another
    - *Agreement*
      - This is the dicey one
        - Sometimes tying arrangements are embodied in a contract between the seller and the buyer
        - Other times they are simply part of a course of dealing
      - In the course of dealing cases, the case law appears to (implicitly) assume that the purchase of the tied and tying product in an tying arrangement constitutes an agreement for Section 1 purposes between the seller and the buyer
        - *Query*: Did you enter into an agreement for Section 1 purposes the last time you purchased a pair of shoes?
      - The agreement element of a Section 1 prima facie case is almost never addressed in tying cases
        - And there has been no change since *Trinko*
    - *Restraint*
      - Flows from the requirement that the buyer must coerced into buying the tied product from the seller and hence foreclosing that demand to third-party competitors in the tied product market

Unlike the cases, we have spotted a potentially serious doctrinal problem; like the cases, we will ignore it

Separate Products

- Requirement
  - The tying and tied products must be two separate products in two distinct relevant markets
    - The nature of the products involved in early tying cases—intuitively distinct items such as a movie projector and a film—led courts either to disregard the separate-products question or to discuss it only in passing
- *Jefferson Parish*
  - The first case to give content to the separate-products test was *Jefferson Parish*
    - The facts were a challenge for casual separate-products analysis because the tied service—anesthesia—was neither intuitively distinct from nor intuitively contained within the tying service—surgical care.
    - A further complication was that new economic research began to show that in some circumstances tying arrangements could be procompetitive

Separate Products

- *Jefferson Parish* test: Separable demand

> The answer to the question whether petitioners have utilized a tying arrangement must be based on whether there is a possibility that the economic effect of the arrangement is that condemned by the rule against tying that petitioners have foreclosed competition on the merits in a product market distinct from the market for the tying item. Thus, in this case no tying arrangement can exist unless there is a sufficient demand for the purchase of anesthesiological services separate from hospital services to identify a distinct product market in which it is efficient to offer anesthesiological services separately from hospital services.[1]

- Separable demand means that consumers have a demand to purchase the tied product from a supplier other than the seller of the tying product
  - This makes sense if the competitive harm to be prevented is the foreclosure of competition in the market for the tied product
    - If there is no consumer demand to purchase the tied product from a supplier other than the seller of the tying product, then there is no foreclosure
    - Significant efficiencies in the joint sale of the tying and tied products can eliminate separable demand, since the efficiencies enable a reduction in price that the consumer would otherwise have to pay+

[1] *Jefferson Parish*, 466 U.S. at 21-22 (footnote omitted).

Separate Products

- Functional integration
  - Simply because the components in a package are functional integrated with one another does not make them separate products
  - Under the *Jefferson Parish* test, a functionally integrated package contains separate products if the demands for the components are separable[1]
    - *Jefferson Parish* held that surgical services and anesthesiological services
  - Even before *Jefferson Parish*, the Supreme Court had found functionally integrated packages to contain separate products
    - Computer and computer punch cards[2]
    - Salt machine and salt[3]

[1] *Jefferson Parish*, 466 U.S. at 19 (holding that "whether one or two products are involved turns not on the functional relation between them, but rather on the character of the demand for the two items").
[2] IBM Corp. v. United States, 298 U.S. 131 (1936).
[3] International Salt Co. v. United States, 332 U.S. 392 (1947).

Separate Products

- Pleading and proof
  - As a technical matter, the tying and tied products, and the relevant markets in which they respectively reside, should be pleaded and proved as part of the plaintiff's prima facie case
    - The plaintiff bears the burden of proof
    - Pleading subject to the *Twombly* rule
  - Need to show that—
    - there is a sufficient demand for the purchase of one component (the putative tied product) separate from the other component (the putative tying product) such that it is efficient to offer the first product separately from the second product
    - at the prices that would exist in the "but for" world without the tying arrangement
      - This second requirement is not mentioned in the cases, but demand needs to be evaluated at some price and the prices in the "but for" world are the correct prices for this evaluation
      - The "but for" world prices also will reveal whether the efficiency gains from the tying arrangement (if any) are sufficient to eliminate any separable demand
  - The existence of a profitable supplier supplying the tying product standing alone is evidence—and perhaps conclusive evidence—of separable consumer demand

Separate Products

- *Jefferson Parish* test: Examples of evidence
  - *Jefferson Parish*: Anesthesiological service separate from surgical service
    - There is no impediment to providing the anesthesiological component separately from the other services offered in the hospital package, and anesthesiological services are provided separately by numerous other hospitals
    - Anesthesiological services are billed separately from hospital services
    - Patients or surgeons often request specific anesthesiologists to come to a hospital and provide anesthesia
    - The hospital required purchases from Roux even though other anesthesiologists were available and Roux had no objection to their receiving staff privileges at East Jefferson
    - In addition, there was no testimony that patients or their surgeons do not differentiate between anesthesiological services and hospital services when making purchasing decisions
  - *Microsoft*: Browser separate from the operating system
    - *Direct consumer demand test*: Many consumers, if given the option, would choose their browser separately from the OS (or, equivalently, would chose a browser other than IE)
    - *Indirect industry custom test*: Although all major OS vendors offered bundled browsers with their OSs, vendors other than Microsoft either sold versions without a browser, or allowed OEMs or end- users either not to install the bundled browser or in any event to "uninstall" it

Existence of a Tying Arrangement

- Requirement
  - There must be a “tying arrangement”
- Types of tying arrangements
  - Contractual tying
    - This might be better called explicit tying, since it occurs when the tying arrangement is explicit: “I will sell you Product X but only if you also buy Product Y from me.”
    - It sometimes occurs in the form of a contract, but it more often occurs just as a course of dealing (think right shoes and left shoes or a car that comes with a car radio)
  - Economic tying
    - Courts have found tying arrangements where the products are technically available separately but the buyer's only economically reasonable option is to purchase both the tying and the tied product from the same seller even if the seller would prefer purchasing the tied product from another seller
    - This is now increasingly being treated as *mixed bundling* rather than tying (see below)
  - Technological tying
    - Courts have found tying arrangements where one product can operate only with another product and the seller of the first product is the exclusive provider of the second product
    - There is even if the seller imposes no contractual requirement that purchasers of the first product also purchase the second product
    - *Example*: A printer that only uses toner cartridges that are sold by the printer manufacturer

Existence of a Tying Arrangement

- Direct economic interest rule
  - Where the defendant does not have a direct economic interest in the sale of the tied product, there is no actionable tying arrangement
  - *Example*: A high-speed printer manufacturer requires that its printer only be serviced by the ABC Service Company, but the manufacturer has no interest whatsoever in the ABC company
    - The idea is that if the seller has no interest in the tied product sale, then its requirement must result from some efficiency consideration
- Pleading and proof
  - Burden is on the plaintiff
  - In the absence of a formal agreement, a plaintiff can establish the existence of an illegal tie-in by coming forward with proof that they were coerced into buying the tied product
  - "[W]here the buyer is free to take either product by itself there is no tying problem even though the seller may also offer the two items as a unit at a single price."[1]
    - This rule turns on the definition of "free"
    - If you buy a printer that only uses the seller's printer cartridge, courts do not regard you as "free" not to buy the printer cartridge from the seller, since in the absence of the printer cartridge the printer is useless

[1] Northern Pacific R. Co. v. United States, 356 U.S. 1, 7 n.4 (1958).

Market Power in the Tying Product

- Requirement
  - The defendant must have market power in the market for the tying product
    - The idea is that customers so desire the tying products—and have no good alternatives for obtaining it other than from the tying seller—that customers are willing to by the tied product from the tying seller even through they do not want to do so.
- History
  - Originally, the requirement was "appreciable economic power," which court took to be something less than market power
    - *Example*: Where land was the tying product there would be the requisite market power, where the land conferred some advantage on the seller[1]
    - *Example*: A patent conferred the requisite economic power on the tying product [2]
  - Today, a showing of true market power is required
    - In particular, a patent by itself is no longer sufficient to prove the requisite power[3]

[1] *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1958) (holding that a railroad's control over vast tracts of western real estate gave the railroad a unique kind of bargaining power that enabled it to tie the sales of that land to exclusive, long term commitments that fenced out competition in the transportation market over a protracted period).
[2] *See, e.g.*, United States v. Paramount Pictures, 334 U.S. 131, 156-59 (1948); International Salt Co. v. United States, 332 U.S. 392, 395-96 (1947); IBM Corp. v. United States, 298 U.S. 131 (1936).
[3] Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28, 42 (2006).

Market Power in the Tying Product

- Pleading and proof
  - The usual means
    - Circumstantial evidence from market share (the usual method)
      - 50% or above: Presumptively sufficient
      - 30-50%: Need more than share to make out prima facie case
      - Below 30%: Insufficient
    - Direct evidence of anticompetitive effects showing market power
- Rule of reason
  - *Jefferson Parish*: "When, however, the seller does not have either the degree or the kind of market power that enables him to force customers to purchase a second, unwanted product in order to obtain the tying product, an antitrust violation can be established only by evidence of an unreasonable restraint on competition in the relevant market."[2]
    - *Query*: Does this make any sense? In the absence of market power in the tying product that can be used to force customers to purchase the tied product, how could the tying arrangement cause an significant foreclosure (much less an anticompetitive effect) in the tied product market?

[1] Illinois Tool Works Inc. v. Independent Ink, Inc., 547 U.S. 28, 42 (2006)
[2] *Jefferson Parish*, 466 U.S. at 17-18.

Coercion

- Requirement
  - "Tying arrangements can only be condemned if they restrain competition on the merits by forcing purchases that would not otherwise be made."[1]
  - This is separate from the requirement that the tying seller has market power
    - If customers are willing purchasers of the tied product from the tying seller, then the tying seller has not used its market power to "coerce" customers into purchasing the tied product
- Willing purchasers
  - Where the evidence shows that customers find it convenient to purchase the allegedly "tied" good along with the "tying" good at the same time from the same vendor, courts have found that there is a lack of the requisite coercion
  - Conversely, proof that a high percentage of customers had purchased the tied product from the defendant along with the tying product is insufficient, by itself, to prove coercion

[1] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 27 (1984).

Coercion

- Economic coercion
  - Where the seller offers so large a discount on a bundled package that the purchaser's only economic reasonable option is to purchase the package even if the components are available separately, the trier of fact may conclude that the buyer has been "coerced" to purchase the package
    - When only a small fraction of similarly situated buyers elect to purchase the components separately, the trier of fact may conclude that the buyers were "coerced" into purchasing the package[1]
    - *Query*: Given the per se rule against tying arrangements, should economic coercion ever be recognized or should all bundled discounts be treated as mixed bundling (see below)?
- Pleading and proof
  - Plaintiff bears the burden of proof
  - Plaintiff must plead and prove that customers were coerced to purchased the tied good in the sense that in the "but for" world without the tying arrangement a sufficiently large number of the tying seller's customers would not have purchased the tied good from the tying seller
    - Cases unclear what a sufficiently large number would be

[1] *See* Cascade Health Solutions v. PeaceHealth, 515 F.3d 883, 915 (9th Cir. 2008) (noting that where only four of 28 insurers purchased components separately there is a question for the jury whether other buyers were economically coerced into purchasing the package).

Foreclosure in the Tied Product Market

- Requirement
  - The tying arrangement must foreclose a "substantial volume of commerce"
    - In the older cases, this is worded as a "not insignificant" volume of commerce
- *Fortner* test

> "[N]ormally the controlling consideration is simply whether a total amount of business, substantial enough in terms of dollar-volume so as not to be merely de minimis, is foreclosed to competitors by the tie"[1]

  - Almost any foreclosure will suffice
  - The Supreme Court held that as little as $60,000 was not insubstantial[2]
  - Has not been revisited by modern cases
- But still an element: Where there is no foreclosure, the tying arrangement is not unlawful
  - *Example*: Customers do not want to buy the tied product from anyone
  - *Example*: There are no other suppliers in the market for the tied product for reasons unrelated to the tying arrangment (e.g., regulatory requirements)

[1] Fortner Enters., Inc. v. U.S. Steel Corp., 394 U.S. 495, 501 (1969).
[2] United States v. Loew's Inc., 371 U.S. 38, 49 (1962).

Foreclosure in the Tied Product Market

- Criticism
  - The foreclosure of a “not insubstantial amount” of commerce in the market for the tied product is not a test of anticompetitive effect
  - As the DOJ amicus brief argued and the four members of the *Jefferson Parish* concurrence dissent recognized, if the antitrust harm of a tying arrangement resides solely in the market for the tied product, then to violate the antitrust laws the tying arrangement should be the proximate cause of a likely lessening of competition in the tied product market
    - Acceptance of this view would have removed tying arrangements from treatment under the per se rule and made them subject to rule of reason scrutiny
  - But in 1984, when *Jefferson Parish* was decided, the consistent historical treatment of tying arrangements as per se unlawful apparently too strong to swing one more member of the Court to the concurrence

Business Justifications and Defenses

- Availability
  - Even if all four elements of per se illegal tying are present, courts (including the Supreme Court) have been wiling to entertained a business justification defense
  - The defense must be compelling and the defendant bears a heavy burden of proof
- Examples
  - Where a small market entrant requires limited duration ties to facilitate its market entry[1]
  - Where the tie was the least expensive and most effective means of policing quality[2]
  - Where the tie was reasonably necessary to ensure the functioning of the products in the tying arrangement

[1] United States v. Jerrold Elecs. Corp., 187 F. Supp. 545, 557-58 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961) (concluding that a tie was justified for a limited time in a new industry to assure effective functioning of complex equipment).
[2] Mozart Co. v. Mercedes-Benz of N. Am., Inc., 833 F.2d 1342, 1348-51 (9th Cir. 1987).
[3] Dehydrating Process Co. v. A. O. Smith Corp., 292 F.2d 653, 655-57 (1st Cir. 1961) (affirming a judgment of a district court that directed a verdict in favor of the defendant because a tie was necessary to assure utility of two products when separate sales led to malfunctions and widespread customer dissatisfaction).

Jefferson Parish[1]

- Background
  - In 1971, shortly before East Jefferson Hospital (EJH) opened, it entered into an exclusive contract with Roux & Associates to provide EJH anesthesiology services
    - Fees for anesthesiology services billed separately, designed to cover hospital cost and professional services, and divided equally between Roux and EJH
  - Edwin G. Hyde, a board-certified anesthesiologist, applied for admission to the medical staff of EJH
    - Approved by the credentials committee and medical staff executive committee
    - Denied by board of directors because of Roux contract
- Hyde's complaint
  - Contract constituted an exclusive dealing arrangement and a tying arrangement, both of which violated Sherman Act § 1
  - Prayer
    - Declaratory relief that contract is unlawful
    - Injunction ordering EJH to appoint Hyde to the medical staff
- District court: After trial, no antitrust violation
  - EJH no market power in the New Orleans hospital market, so that the anticompetitive consequences of the challenged conduct could be minimal at most
  - If there were any small anticompetitive effects, they were outweighed by improved patient care enabled by the Roux arrangement

[1] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

Jefferson Parish

- Fifth Circuit: Reversed
  - The relevant surgical services market was the East Bank of Jefferson Parish
    - Patients chose by location
    - Prevalence of health insurance eliminates a patient's incentive to compare costs
    - Patients not sufficiently informed to compare quality
    - Family convenience tends to magnify the importance of location
  - Per se illegal tying arrangement
    - Two products
    - Patients faced a tying arrangement because of the exclusive dealing contract
    - EJH had market power in the relevant surgical services market
    - A not insubstantial amount of commerce was affected in the anesthesiology services market
      - 875 operations per month requiring anesthesiology services were performed at the hospital
- Supreme Court: Reversed and remanded (9-0, but split 5-4 on reasons)
  - Stevens (for 5-member majority)
    - *Anticompetitive harm*: The restraint of competition in the tied product market that results from the forcing of an unwanted purchase of the tied product from the tying seller
    - Preconditions for per se illegality
      - Two products with separable demands
      - “Market power" (ability to force) in tying product
      - Coercion (use of the seller’s market power to force the buyer to purchase the tied good from the seller)
      - Forcing must affect “competition”
        - Captured roughly in the requirement the tying arrangement affect a not insubstantial amount of commerce in the material for the tied product

Jefferson Parish

- Supreme Court: Reversed and remanded (9-0, but split 5-4 on reasons)
  - Stevens (for 5-member majority)
    - Two products
      - Existed here: surgical facilities (tying product) and anesthesiology services (tied product)
      - *Test*: Existence of two products turns not on functional relationship, but on character of demand
      - Here, demand was separable
        - Services billed separately
        - Patients or surgeons at times request specific anesthesiologists
    - Market power
      - Insufficient evidence on market power and therefore on forcing (coercion)
        - Cited evidence
          - 70% of patients in Jefferson Parish go to other hospitals
          - Every patient undergoing surgery "needs" anesthesiology services
          - No evidence patients were "forced" to take unwanted services
        - Other evidence (cited in other sections of the opinion)
          - "The evidence indicates that some surgeons and patients preferred respondent's services to those of Roux, there is no evidence that any patient who was sophisticated enough to know the difference between two anesthesiologists was not also able to go to a hospital that would provide him with the anesthesiologist of his choice." (466 U.S. at 20).
          - "If, as is likely, it is the patient's doctor and not the patient who selects an anesthesiologist, the doctor can simply take the patient elsewhere if he is dissatisfied with Roux. The District Court found that most doctors in the area have staff privileges at more than one hospital." (466 U.S. at 20 n.50)

Jefferson Parish

- Supreme Court: Reversed and remanded (9-0, but split 5-4 on reasons)
  - Stevens (for 5-member majority)
    - Disposition
      - Reversed Fifth Circuit's finding of a per se illegal tying arrangement
      - Remanded for consideration under the rule of reason
  - Brennan (concurring, with Marshall)
    - Majority reaffirms per se rule, even if not applicable here
    - If the longevity of the per se rule, if it is to be changed, it should be changed by Congress
      - The idea that a long-standing judicial rule has been implicitly confirmed by Congress is known as *congressional ratification*
  - O'Connor (concurring in judgment, with Burger, Powell, and Rehnquist)
    - Would hold tying arrangement subject only to the rule of reason
      - Per se rule in tying arrangements always involves elaborate inquiry into economic effects; time to abandon per se label
      - O'Connor rule of reason requirements
        - "First, the seller must have power in the tying product market."
        - "Second, there must be a substantial threat that the tying seller will acquire market power in the tied-product market."
        - "Third, there must be a coherent economic basis for treating the tying and tied products as distinct."

Kodak[1]

- Background
  - Kodak manufactures and sells high-volume photocopiers and micrographic equipment as well as service and replacement parts for its equipment
    - Equipment, although expensive when new, have little resale value
    - Parts are unique—not compatible with replacement parts for copiers of other manufacturers
    - After the initial warranty period, Kodak provides service either through annual service contracts, which include all necessary parts, or on a per-call basis.
    - Kodak provides 80% to 95% of the service for Kodak machines.
  - Respondents are 18 independent service organizations (ISOs) that in the early 1980's began servicing Kodak copying and micrographic equipment
    - ISOs keep an inventory of parts, purchased from Kodak or other sources, primarily the OEMs that manufacture for Kodak
  - In 1985-86, Kodak adopted policies limiting sales of parts only to buyers of Kodak equipment
    - who use Kodak service, or
    - repair their own machines
  - In addition, Kodak:
    - Obtained agreement from OEMs that they would only sell Kodak parts to Kodak, and
    - Pressured Kodak equipment owners not to sell spare parts to ISOs
    - Took steps to restrict the availability of used equipment
  - These changes in policy
    - deprived ISOs of a source of parts, causing many ISOs to lose money or be forced out of business, and
    - forced customers that would rather use ISOs to use Kodak service

[1] Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451 (1992).

Kodak

- Complaint: Kodak's changed policies violated
  - Section 1 by unlawfully tying the sale of Kodak equipment service (tied product) to the sale of parts (tying product), and
  - Section 2 by monopolizing and attempting to monopolize the sale of service for Kodak machines
- District court: Summary judgment for Kodak
  - No tying arrangement between equipment and service (but this is not the tying arrangement in issue)
  - Kodak had a natural monopoly over the market for parts it sells under its name, but a unilateral refusal to sell those parts to ISO's did not violate Section 2

Kodak

- Ninth Circuit: Reversed and remanded for trial
  - Section 1 claim
    - Found sufficient evidence to raise a genuine issue concerning
      - whether parts and service are separate markets,
      - whether a tying arrangement existed between them
      - whether Kodak had market power in the market for Kodak parts
    - Rejected Kodak's contention that lack of market power in parts must necessarily be assumed when such power is absent in the equipment market: "[M]arket imperfections can keep economic theories about how consumers will act from mirroring reality."
    - On Kodak's justifications:
      - to guard against inadequate service-genuine issue
      - to lower inventory costs-genuine issue, and
      - to prevent ISO's from free-riding on Kodak's investment in the copier and micrographic industry-legally insufficient
  - Section 2 claim
    - Sufficient evidence existed to support a finding that Kodak's implementation of its parts policy was "anticompetitive" and "exclusionary" and "involved a specific intent to monopolize."

Kodak

- Supreme Court: Affirmed (6-3)
  - Blackmun (for six members of the Court)
    - Section 1 claim
      - A tying arrangement "violates § 1 of the Sherman Act if the seller has 'appreciable economic power' in the tying product market and if the arrangement affects a substantial volume of commerce in the tied market." (504 U.S. at 462)
      - Genuine issue of whether service and parts are separate products
        - "Evidence in the record indicates that service and parts have been sold separately in the past and still are sold separately to self-service equipment owners. Indeed, the development of the entire high-technology service industry is evidence of the efficiency of a separate market for service." (504 U.S. at 462)
        - Functionally integrated components are separate products if an appreciate number of customers wish to purchase them from different sellers
      - Genuine issue of whether Kodak tied parts to service
        - Record indicates that Kodak would sell parts to third parties only if they agreed not to buy service from ISOs
      - Genuine issue of whether Kodak as appreciable economic power in market for tying product (parts)
        - Kodak has control over the availability of parts
        - Evidence that
          - consumers have switched to Kodak service even though they preferred ISO service,
          - Kodak service was of higher price and lower quality than the preferred ISO service, and
          - ISOs were driven out of business by Kodak's policies.
        - Sufficient under precedents to raise genuine issue on market power in market for Kodak parts

Kodak

- Supreme Court: Affirmed (6-3)
  - Blackmun (for six members of the Court) (con't)
    - Section 1 claim
      - Rejected Kodak's argument that courts should adopt a (conclusive) presumption that the lack of market power in the market for equipment necessarily implies a lack of market power in any derivative aftermarket
        - Kodak presents no empirical evidence that this rule holds in the instant case
        - Conceptually possible that, in the wake of the change in Kodak's policy, Kodak could raise prices in the aftermarket and lose sales in the equipment market, but still have the increased profits in the aftermarket more than offset the profit losses in the equipment market.
        - Evidence that service prices increased with no loss in Kodak equipment sales
        - Market imperfections could negative application of theory
          - Significant information costs prevent all customers from estimating total cost of ownership and hence purchasing equipment on the basis of lifecycle costs
          - Significant switching costs allows Kodak to charge higher aftermarket prices and so holdup "locked-in" customers that purchased under old policy
    - Section 2 claims
      - *Monopoly power*. Genuine issue as to Kodak's possession of monopoly power in the sale of service and parts for Kodak machines
        - Kodak controls nearly 100% of the Kodak parts market
        - Kodak controls 80-95% of the service market
        - Rejected Kodak's argument that a single brand can never be a relevant market: "Because service and parts for Kodak equipment are not interchangeable with other manufacturers' service and parts, the relevant market from the Kodak equipment owner's perspective is composed of only those companies that service Kodak machines." (504 U.S. at 480)

Kodak

- Supreme Court: Affirmed (6-3)
  - Blackmun (for six members of the Court) (con't)
    - Section 2 claims
      - Will acquisition or maintenance.
        - Kodak's change in policy excluded competitors and is actionable unless justified by "valid business reasons"
        - Genuine issues of fact are present for each of Kodak's three proferred justifications, precluding summary judgment
          - "(1) to promote interbrand equipment competition by allowing Kodak to stress the quality of its service;"
            - But evidence that ISOs provide quality service and that some Kodak customers preferred ISO service precludes summary judgment
          - "(2) to improve asset management by reducing Kodak's inventory costs; and"
            - But inventory costs are a function of equipment breakdown, not who services the machines
          - "(3) to prevent ISOs from free-riding on Kodak's capital investment in equipment, parts and service."
            - Rejected as a matter of law: "[O]ne of the evils proscribed by the antitrust laws is the creation of entry barriers to potential competitors by requiring them to enter two markets simultaneously." (504 U.S. at 485)
  - Scalia (dissenting, with O'Connor and Thomas)
    - Question: Is "a manufacturer's conceded lack of power in the interbrand market for its equipment is somehow consistent with its possession of 'market,' or even 'monopoly,' power in wholly derivative aftermarkets for that equipment"? Majority: Yes. Right answer: No

Kodak

- Supreme Court: Affirmed (6-3)
  - Scalia (dissenting, with O'Connor and Thomas)
    - Consider counterfactual
      - If Kodak had required all purchasers of its equipment at the time of purchase to agree to purchase all service and parts from Kodak, there would have been a tying arrangement but it would not have been per se unlawful, since Kodak lacked market power in the market for the tying product (equipment)
        - This would have the same economic effect as the policy Kodak ultimately adopted, and the legal result should be no different
        - "If Kodak set generally supracompetitive prices for either spare parts or repair services without making an offsetting reduction in the price of its machines, rational consumers would simply turn to Kodak's competitors for photocopying and micrographic systems." (504 U.S. at 496)
      - Rejects majority's information costs and lock-in theories as a basis for finding market power
        - "We have never suggested that the principal players in a market with such commonplace informational deficiencies (and, thus, bands of apparent consumer pricing indifference) exercise market power in any sense relevant to the antitrust laws." (504 U.S. at 496)
        - "If Kodak's general increase in aftermarket prices were to bring the total 'system' price above competitive levels in the interbrand market, Kodak would be wholly unable to make further foremarket sales-and would find itself exploiting an ever-dwindling aftermarket, as those Kodak micrographic and photocopying machines already in circulation passed into disuse." (504 U.S. at 497 (emphasis in original))
        - Power over "locked-in" customers is commonplace and never considered as basis for market or monopoly power within the meaning of the antitrust laws

Illinois Tool Works[1]

- Background
  - Illinois Tool
    - Manufactures and sells:
      - a patented piezoelectric impulse ink jet printhead;
      - a patented ink container, consisting of a bottle and valved cap, which attaches to the printhead; and
      - specially designed, but unpatented, ink.
    - Sells systems to OEMs that manufacture and sell printers
    - Requires OEMs to agree that they will purchase their ink exclusively from Illinois Tool and that neither they nor their customers will refill the patented containers with ink of any kind
  - Independent Ink
    - Developed ink suitable for use in Illinois Tool containers
- Complaint
  - Illegal tying in violation of Sherman Act § 1
  - Monopolization in violation of Sherman Act § 2
- District court: Summary judgment for defendant for lack of market power
- Federal Circuit: Reversed on Section 1 tying claim

[1] Illinois Tool Works Inc. v. Independent Ink, Inc.,547 U.S. 28 (2006).

Illinois Tool Works

- Supreme Court: Vacated and remanded (8-0)
  - Stevens (for eight members):

    > Congress, the antitrust enforcement agencies, and most economists have all reached the conclusion that a patent does not necessarily confer market power upon the patentee. Today, we reach the same conclusion, and therefore hold that, in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product.

    - Rejects historical presumption beginning with *International Salt Company v. United States* in 1947 that a patent confers requisite power on tying product to predicate an unlawful tying arrangement[2]
    - Rejects Independent Ink's suggestion that there should be at least a rebuttable presumption

[1] *Illinois Tool Works,* 547 U.S. at 45-46.
[2] International Salt Co. v. United States, 332 U.S. 392 (1947),

Mixed Bundling

Mixed Bundling

- Concept
  - Each of the products in the bundle is available separately, but when purchased together in the bundle at available at a substantial discount compared to the sum of the individual prices
    - Sometimes called *discounted bundling*
    - The practice is ubiquitous from the smallest to largest companies
- Distinction from tying arrangements
  - Basic distinction
    - A tying arrangement *forces* the buyer to accept both products, as well as any cost savings
    - A mixed bundling arrangement gives the buyer the *choice* of accepting the cost savings by purchasing the package, or foregoing the savings by purchasing the products separately
  - As a result, a mixed bundling arrangement does not constrain the buyer's choice as much as a tying arrangement

[1] LePage's Inc. v. 3M Co., 324 F.3d 141, 155 (3d Cir. 2003) (en banc).

Mixed Bundling

- Concept
  - Possible anticompetitive effects
    - Foreclosure of competitors in the market for one of the component products in the bundle

      > 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. [1]

    - The idea is that the defendant rewards the customer for buying its product B rather than the plaintiff's B, not because defendant's B is better or even cheaper. Rather, the customer buys the defendant's B in order to receive a greater discount on A, which the plaintiff does not produce. In that case the rival can compete in B only by giving the customer a price that compensates it for the foregone A discount
  - *Query*: Should mixed bundling arrangements be treated as
    - *Tying arrangements*, at least where the discount is so compelling the result is that customers always purchase the package, or
    - *Predatory pricing*, since the inducement to purchase the package is a lower price

[1] LePage's Inc. v. 3M Co., 324 F.3d 141, 155 (3d Cir. 2003) (en banc).

Mixed Bundling

- *Example*: Microsoft Office Suite

Office Home & Business 2013	$219.99
Purchased separately:	
Word	$79.99
Excel	$79.99
OneNote	$69.99
PowerPoint	$79.99
	$309.96

  - The bundle is priced about 30% lower than the aggregate price of the components purchased separately.
  - Possible competitive problem
    - Say everyone likes Word, Excel, and PowerPoint and wants these programs. Purchasers also like digital notebooks, but have mixed views about OneNote. Still, the bundle is $20 less than purchasing Word, Excel, and PowerPoint separately and, viewed that way, you get OneNote for free. So the purchasers buy the bundle, and rather than spend extra money for a OneNote substitute just stay with OneNote.
    - *Query*: Does the bundle foreclose OneNote's competitors in violation of the antitrust laws? If not here, are there other circumstances in which it would (or should)?

Mixed Bundling

- History
  - Originally developed as “economic” tying, where the discount so compelling that consumers acted as if there was a contractual tie
    - Applied the applicable test for unlawful tying arrangements
  - Mixed bundling generalized the concept to cases where some material number of consumers would buy only a component and not the whole package
    - With the components available and being purchased separately, the tying rubric no longer fits
    - But there could still be foreclosure of third-party competitors of some components if enough consumers were buying the bundle, so another rubric was needed
- Statutory coverage
  - Section 1 of the Sherman Act
    - But like tying arrangements, can often be problematic in finding concerted action unless the mere purchase of a bundle by a customer creates a Section 1 agreement between the seller and customer for Section 1 purposes
      - Especially problematic given that the customer was free to purchase the components separately
  - Section 2 of the Sherman Act
    - The doctrinally better statute to apply when the customers simply purchase the bundle in the absence of an contract

Mixed Bundling

- Two approaches to competitive harm
  - Tying
    - Since mixed bundling operates to a degree like a tying arrangement, a sufficient foreclosure of the market for one of the components should qualify as the requisite anticompetitive harm[1]
  - Predatory pricing
    - Mixed bundles are usually priced so that there is some demand for the individual components; the bundle is attractive only when the consumer demands multiple (but not necessarily all) components in the bundle
    - Unlike tying, where the operative notion of the harm is the "forcing" of the customer to buy the tied product from the seller in order to be able to purchase the tying product, mixed bundles induce the customer to purchase the bundle through a discounted price
    - The discounting suggests a consumer benefit, which should make the courts very cautious in prohibiting mixed bundling
    - To this end, some courts have adopted a predatory pricing approach to mixed bundling[2]
      - Allocate all of the discount to the "competitive product" (the product in which the foreclosure is alleged)
      - The mixed bundle is anticompetitively exclusionary only if the individual price of the competitive product net of the full discount is below the marginal cost (or whatever the appropriate measure is in the circuit) of the competitive product

[1] *See, e.g.,* LePage's Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003) (en banc).
[2] *See, e.g.,* Cascade Health Solutions v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008).

LePage's[1]

- Background
  - 3M, which manufactures Scotch tape for home and office use, dominated the United States transparent tape market with a market share above 90%
    - Sells both branded ("Scotch tape") and private label transparent tape
    - Almost 100% of the branded segment of the market
  - 3M's mixed bundling program (introduced beginning in 1993)
    - Offered discounts to certain customers conditioned on purchases spanning six of 3M's product lines
      - Not simple volume discounts
      - One of the six categories was "Stationary Products" (which included transparent tape)
    - 3M set customer-specific target growth rates in each product line
    - The number of targets met by the buyer determined the rebate it would receive on all of its purchases
    - If a customer failed to meet the target for any one product line, it would to lose the entire rebate for that line
    - Created a substantial incentive for each customer to meet the targets across all product lines
  - Lepage's
    - In 1992, sold 88% of all private label transparent tape (a very small fraction of the overall market)
    - Healthy operating income from 1990 to 1993, rapidly declining operating income from 1993 to 1995, and large operating losses from 1996 through 1999
      - Lost key large volume customers, such as Kmart, Staples, American Drugstores, Office Max, and Sam's Club, while other large customers, such as Wal-Mart, drastically cut back their purchases
      - Share of relevant market dropped from 14.44% in 1992 to 9.35% in 1997
      - As a result of reduced output, LePage's manufacturing process became less efficient and its profit margins declined

[1] LePage's Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003) (en banc).

LePage's

- District court
  - Jury (after a nine-week trial)
    - For LePage's on Section 2 monopolization and attempt to maintain monopoly counts
      - Awarded damages: $22,828,899 (Plaintiff's expert testified damages were $36 million)
    - For 3M on Section 1 and Section 3 exclusive dealing counts
  - Court
    - JMOL for 3M on "attempted" maintenance of monopoly power
      - There is no offense of an "attempt" to maintain monopoly.
      - The offense must be either attempted monopolization or monopolization
    - But sustained jury verdict on LePage's monopolization claim
    - Awarded trebled damages of $68,486,697
- Third Circuit: Affirmed (7-3 en banc)
  - Summary
    - Sustained verdict on Section 2 monopolization count
    - Rejected 3M's argument that in a mixed bundling case a plaintiff cannot succeed unless it shows that the defendant-monopolist sold its products below cost
    - Not in issue
      - Parties agree that sales of branded and private label transparent tape in the United States is the relevant market
      - 3M acknowledges that it has monopoly power in the relevant market
      - LePage's acknowledges that 3M sold its products "above cost," however calculated
    - *Only issue*: Whether 3M maintained its monopoly power through anticompetitive exclusionary conduct

LePage's

- Third Circuit: Affirmed (7-3 en banc)
  - Challenged conduct could be anticompetitively exclusionary even through sales were above cost
    - Point of departure for analysis*: Alcoa,*[1] which condemned conduct that aggressively anticipated where the market was going and thereby preempted the opportunities of other firms:

> Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel.[2]

      - Also cites *Grinnell*, which most believe cut back on *Alcoa*, since *Grinnell* allowed conduct that maintained monopoly product as the result of a "superior product" or "business acumen."[3]
    - Distinguishes *Brooke Group*[4]
      - Nothing in *Brooke Group* "suggests that its discussion of the issue [below-cost pricing] is applicable to a monopolist with its unconstrained market power"--Monopolists are subject to more restrictive rules
      - LePage's, unlike Liggett, did not make a predatory pricing claim

[1] United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).
[2] *Id.* at 431.
[3] United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).
[4] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

LePage's

- Third Circuit: Affirmed (7-3 en banc)
  - Challenged conduct had the effect of excluding LePage's from the market
    - *WDC comment:* Recall that LePage's maximum share of the relevant market (all transparent tape nationwide), was small, so that it was unlikely that LePage's could have seriously threatened 3M's overall position in transparent tape with its private label brands
  - 3M's mixed bundling program created a substantial incentive for customers to buy all (or almost all) of their transparent tape from 3M
    - One of the six categories was "Stationary Products" (which included transparent tape)
    - Although not discussed in the opinion, presumably 3M set its targets for Stationary Products in a way that would make it difficult for the customer to purchase a significant amount of LePage's private label tape and still meet the Stationary Products target
    - In any event, the rebate formula made it very costly for customers to miss targets, especially in comparison with LePage's sales
      - For example, LePage's sales to Sam's Club in 1993 totaled $1,078,484, while 3M's 1996 rebate to Sam's Club was $666,620
      - LePage's 1992 sales to Kmart were $2,482,756; 3M's 1997 rebate to Kmart was $926,287
  - Exclusive dealing as further exclusionary conduct
    - Evidence showed that 3M offered substantial rebates (separate from its mixed bundling program) for certain large customers that agreed to be exclusive with 3M
    - Jury finding for 3M on Sherman Act § 1 and Clayton Act § 3 exclusive dealing claims does not preclude using evidence of 3M's exclusive dealing to support LePage's Section 2 claim
    - Jury could have credited 3M's rebate program to obtain exclusives as additional exclusionary conduct to support the jury's verdict on LePage's Section 2 claim

LePage's

- Third Circuit: Affirmed (7-3 en banc)
  - Anticompetitive effect
    - "When a monopolist's actions are designed to prevent one or more new or potential competitors from gaining a foothold in the market by exclusionary, i.e. predatory, conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general."[1]
    - Here
      - Had 3M continued with its program it could have eventually forced LePage's out of the market
      - Jury could reasonably have inferred that
        - 3M's program, if continued, would have eliminated private label tape from the relevant market, and
        - Given the substantial barriers to entry, enable 3M to recoup any sacrificed profit by reducing or eliminating its own private label product and channeling customers into the higher-priced, higher-margin Scotch-branded tape

- Dissent (Greenberg, with Alito and Scirica)
  - LePage's argument is that 3M's bundling programs were designed to put it out of business
  - Although not framed as predatory pricing, the claim is directed toward aggressive pricing, which unless anticompetitively exclusionary, benefits consumers
  - Whether 3M's programs are anticompetitively exclusionary should be judged under the same standard as predatory
  - Since LePage's conceded that 3M's price was not below cost, however measured, would have reversed district court and remanded for entry of judgment in favor of 3M

[1] *LePage's*, 324 F.3d at 159.

LePage's

- Subsequent treatment
  - No other circuit has adopted the *LePage's* approach
  - Even the Third Circuit has narrowly interpreted it[1]

> The reasoning of *LePage's* is limited to cases in which a single-product producer is excluded through a bundled rebate program offered by a producer of multiple products, which conditions the rebates on purchases across multiple different product lines. Accordingly, we join our sister circuits in holding that the price-cost test applies to market-share or volume rebates offered by suppliers within a single-product market. *See NicSand, Inc. v. 3M Co.,* 507 F.3d 442, 452 (6th Cir. 2007); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1061 (8th Cir. 2000); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236 (1st Cir. 1983).[2]

[1] *See* ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254, 274 n.11 (3d Cir. 2012) (Noting that "[f]or several reasons, we interpret *LePage's* narrowly" and holding that *LePage's* does not apply to discounting programs related only to single product lines).
[2] *Id.*

Cascade Health[1]

- Background
  - McKenzie and PeaceHealth are the only two providers of hospital care in Lane County, Oregon
    - PeaceHealth operates three hospitals
      - Sacred Heart Hospital, a 432-bed hospital that offers primary, secondary, and tertiary care in Eugene, Oregon
      - Peace Harbor Hospital, a 21-bed hospital in Florence, Oregon
      - Cottage Grove Hospital, an 11-bed hospital in Cottage Grove, Oregon
      - Shares in relevant market
        - 90% of tertiary neonatal services
        - 93% market share of tertiary cardiovascular services
        - Roughly 75% of primary and secondary care services
    - McKenzie operates one hospital (later changed name to Cascade Heath Solutions)
      - Cannot provide tertiary care
- Gravamen of complaint
  - PeaceHealth engaged in anticompetitive conduct by offering insurers "bundled" or "package" discounts of 35% to 40% on tertiary services if the insurers made PeaceHealth their sole preferred provider for *all* services—primary, secondary, and tertiary
    - *Example*: PeaceHealth offered an 85% reimbursement rate for all services if it remained Regence BlueCross BlueShield's sole preferred provider of primary, secondary, and tertiary services, and a 90% reimbursement rate if McKenzie was added as a preferred provider of primary and secondary services.

[1] Cascade Health Solutions v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008).

Cascade Health

- District court
  - Court
    - Summary judgment for PeaceHealth on tying claim
      - Services were available separately
  - Jury:
    - Relevant market: Primary and secondary acute care hospital services in Lane County
    - Verdict for PeaceHealth on monopolization, conspiracy to monopolize and exclusive dealing
    - Verdict to McKenzie on attempted monopolization, price discrimination, and tortious inference
      - $5.4 million in actual damages
- Ninth Circuit
  - Summary
    - Vacate verdict for McKenzie on attempted monopolization, state price discrimination, and tortious inference
    - Vacate summary judgment for PeaceHealth on tying claim
    - Vacate award of attorneys' fees, costs and expenses
    - Certify question to Oregon Supreme Court on state price discrimination
  - Mixed bundling
    - Mixed bundling is a form of price cutting that usually benefits consumers, so care must be taken in condemning it
    - Still, may be anticompetitive
      - *Example*: A competitor who sells only a single product in the bundle (and who produces that single product at a lower cost than the defendant) might not be able to match profitably the price created by the multiproduct bundled discount (WDC: But is this always anticompetitive?)

Cascade Health

- Ninth Circuit
  - Rejects *LePage's* rule
    - The problem:

> [T]he fundamental problem with the *LePage's* standard 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 with respect to its competitors who do not manufacture an equally diverse product line. The *LePage's* standard . . . asks the jury to consider whether the plaintiff has been excluded from the market, but does not require the jury to consider whether the plaintiff was at least as efficient of a producer as the defendant. Thus, the *LePage's* standard could protect a less efficient competitor at the expense of consumer welfare.[1]

- The solution:

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

[1] *Cascade Health*, 515 F.3d at 899 (internal citations omitted).
[2] *Id.* at 903 (footnote omitted).

Cascade Health

- Ninth Circuit
  - Possible mixed bundling below-cost tests
    1. "Aggregate discount rule"—Rejected
       - Bundled discounts are exclusionary only if the bundle's discounted price is less than the aggregate incremental cost to produce the bundle
       - But will not protect a more efficient competitor in one of the components, where the competitor does not produce all of the components in the bundle and hence cannot match the discount necessary for customers to elect to purchase separately
    2. *Ortho* rule—Rejected
       - Bundled discounts are exclusionary only if the plaintiff can show (a) it was an equally or more efficient producer of the competitive product, and (b) the defendant's discounted bundle made it impossible for the plaintiff to produce the competitive product profitably
       - Advantages
         - Protects more efficient competitors
       - Disadvantages
         - *Information problem*: Firms considering bundled discounts are likely to know the incremental costs of their component competitors
         - *Administrative problem*: Test is likely to invoke complex and costly litigation over the relative efficiency of the parties (and may require multiple litigations if several competitors have been excluded or are threatened with exclusion)

Cascade Health

- Ninth Circuit
  - Possible mixed bundling below-cost tests
    3. "Discount attribution" rule—Adopted
       - Bundled discounts are exclusionary only if the competitive component's individual price minus the bundle's total discount (when compared to the individual component prices) is less than the competitive component's incremental cost
       - Advantages
         - Protects the equally or more efficient competitor
         - Provides clear guidance, since it depends entirely on the defendant's prices and costs and not on the costs of any competitive producer
         - Does not require any litigation over relative producer efficiency
    4. Antitrust Modernization Commission test—Rejected
       - A bundled discount is exclusionary only if:
         a. after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product;
         b. the defendant is likely to recoup these short-term losses; and
         c. the bundled discount or rebate program has had or is likely to have an adverse effect on competition
       - *Below-cost leg*: Discount attribution rule is the first leg of the AMC test
       - *Recoupment leg*: Inappropriate in mixed bundling, since, unlike single-product predatory pricing where the defendant must earn negative profits during the predation period, in mixed bundling the defendant can remain profitable while excluding equally efficient but less diverse producers
       - *Competition leg*: Redundant in light of the antitrust injury requirement

Cascade Health

- Ninth Circuit
  - Possible mixed bundling below-cost tests
    4. Antitrust Modernization Commission test—Rejected (con't)
       - WDC: Is the Ninth Circuit's critique of the AMC test correct?
         - *Recoupment*:
           - Does the Ninth Circuit misunderstand the recoupment requirement? The foundation of the recoupment requirement is not that the defendant earned negative profits, but rather that it earned less profits during the predation period than it could have absent its below-cost pricing and, for predation to be economically rational, the firm must recoup these foregone profits (with interest) in the post-predation period
           - Is the same true of mixed bundling?
             - If it is, doesn't a requirement of recoupment make sense? Just as in predatory pricing, if the firm cannot recoup, then consumers win overall even if prices eventually increase as competitors exit the market?
             - If the firm is not sacrificing short-run profits, then the bundled price must be the long-run equilibrium price. Since it benefits consumers, why should courts declare it exclusionary?
         - Effect on competition
           - By finding a redundancy with the antitrust injury requirement, does the Ninth Circuit confuse an element of private antitrust standing with an element of an antitrust violation? While it might be redundant in a private case, there is no antitrust injury requirement in government standing. Does the Ninth Circuit really mean to say that mixed bundling that is below cost under its discount attribution rule is anticompetitively exclusionary even if there is no adverse effect on competition?

Mixed Bundling

- Another look: The *Ortho* example
  - Two products, two firms:
    - Monopolist produces both conditioner and shampoo
    - Competitor produces only shampoo
  - Consumers consume in fixed proportions
    - 1 conditioner: 1 shampoo
  - *Ortho* conclusion
    - The monopolist can exclude the more efficient shampoo competitor by selling the bundle

		Conditioner	Shampoo
Cost	Monopolist	$2.50	$1.50
	Competitor		$1.25
Price (unbundled)	Monopolist	$5.00	$3.00
	Competitor	--	$3.00
Price (bundled)	Monopolist	$5.25	

Competitor must price at or below $0.25 to stay in the game against the monopolist's bundle

  - Looks straightforward—but there are some problems
    1. What demand structure yields these unbundled prices in equilibrium?
       - If the firms play Bertrand in shampoo, then the unbundled price should be $1.49 and the competitor should have a structural monopoly in shampoo—the monopolist could never charge an unbundled price of $3.00 for shampoo
       - If the firms play Cournot in shampoo, I cannot find a (linear) aggregate demand function consistent with the costs and fixed proportions demand that give the unbundled prices in equilibrium
       - Examples are not meaningful if they are untethered to realistic economic equilibria

[1] Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455, 467 (S.D.N.Y. 1996) (giving example).

Mixed Bundling

- Another look: The *Ortho* example
  - Looks straightforward—but there are some problems
    - Even if the bundle excludes the more efficient shampoo firm—the major concern in *Cascade Health*—why does it matter?
      - Antitrust law is about competition and consumer welfare, not competitors
      - Consumers are better off with the bundle at the $5.25 bundled price than without it
        - The lower cost of the competitor in shampoo is what caused the monopolist to lower the price of conditioner below its monopoly price in the first instance
          - In an unbundled world, the monopolist would charge $5.00 for conditioner and the market price for shampoo would be at least $1.49, for a total of at least $6.49
        - If the antitrust rule that enables the competitor to survive results in the monopolist returning to a monopoly price for conditioner, the total price paid by the consumer may be higher than the bundled price, making the antitrust rule is counterproductive from a consumer welfare perspective
          - The efficiency of the competitor cannot be considered in isolation
          - Rather, the fashioning of a proper rule needs to weigh the consumer welfare consequences of the market equilibrium with mixed bundling compared to the consumer welfare consequences of the market equilibrium with the antitrust rule in place
      - For the same reasons, should recoupment be required?
        - If the threat of competitor expansion or entry forces the bundler to maintain the low mixed bundle price of $5.25, doesn't this promote consumer welfare compared to a consumer expenditure of at least $6.49 in an unbundled world?