

Bundled Pricing and Antitrust

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I. Bundled Pricing

- A. Bundling is the practice of offering, for a single price, two or more goods or services that could be sold separately. A bundled discount occurs when a firm sells a bundle of goods or services for a lower price than the seller charges for the goods or services purchased individually.
- B. Bundled discounts are pervasive in our economy. Razors and blades cost less as a package than if purchased separately. Software comes at a discount if pre-loaded on a PC. Parts and service cost less when purchased together. Season tickets, fast food value meals – all these are bundled discounts.
 - 1. It is clear that bundled discounts generally benefit buyers because the discounts allow the buyer to get more for less. Sellers also can benefit from bundled discounts, for example to increase demand in lieu of advertising, to encourage use of a new product, or to enter a new market.
- C. The varied and pervasive nature of bundled discounts is important, because the fact that you're just as likely to encounter it from the corner hot-dog vendor as anywhere else means that it's likely to be efficient, pro-competitive, and that we want to act with especial care so as to prevent chilling price discounting – the same concern that caused the Court to adopt a rigorous test for predatory pricing in the *Brooke Group* case.

II. Antitrust Objections to Bundling

- A. Despite these benefits, however, bundled discounting is not free of antitrust concerns. For 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 multi-product bundled discount.
- B. Consumers clearly can be harmed by this behavior. If the multi-product discount shrinks the available sales opportunities for the “competitive” product so that rivals face increased costs because of diminished economies of scale (or exit the market entirely), the multi-product firm may gain market power over the competitive product and raise prices to consumers. Exclusion of rivals in the competitive product also may raise barriers to entry in the monopoly product market, enhancing or protecting the multi-product firm’s power in that market as well.
 - 1. These conditions can occur in normal and realistic market scenarios. For example, a multi-product firm might “raise” its stand-alone price for the monopoly product, and then offer a “reduced” price as part of the package

discount. Under those circumstances the bundling clearly can reduce consumer welfare.

- C. So what to do? One of the first steps is to recognize that bundled discounts are similar to – but also different from – each of the types of behavior to which it is most frequently compared:
1. **Predatory pricing:** it is like predatory pricing because it involves a form of price cutting; but it is *unlike* predatory pricing in that the multi-product firm can exclude rivals without suffering short-term losses, by lowering the package to a level that is above its total incremental cost, but with discounts that an equally efficient single-product provider cannot meet.
 2. **Tying:** it is like tying in that power in one product might be used to attract added sales of the other; but it is *unlike* tying because no element of coercion may be involved.
 3. **Exclusive dealing;** it is similar to exclusive dealing in that customers might be induced to patronize the defendant exclusively; but it may be *unlike* exclusive dealing because there may be no agreement requiring the customer to take any portion of its purchases from the defendant.
- D. One distinguishing characteristic of bundled discounting is that the efficiencies associated with bundled discounting arrangements – as opposed to package selling – can be quite small. There are often transaction cost savings, shipping cost savings, and marketing cost savings attributable to package sales, but these efficiencies are associated with the combined selling and shipping of multiple products, not with the bundled *pricing* arrangement as such. In this respect, bundled discounting may be distinguishable from exclusive dealing, for example, which almost always has substantial efficiency benefits that result from the exclusivity.
- E. So where does that leave us? Bundled discounts are ubiquitous, and frequently benefit – indeed, are demanded by – consumers; and we want to be especially careful not to chill beneficial price discounting. At the same time, there are circumstances where bundled discounting can raise realistic antitrust concerns, and where recoupment can be immediate (or in any event far more plausible than in predatory pricing), and so likely to be more frequently tried. Bundled discounts also may involve fewer efficiencies than other types of conduct, and involve different trade-offs from the arrangements to which they are most frequently compared.
- F. In this uncertain state of the world, the Ninth Circuit recently addressed the issue of bundled discounting in *Cascade Health Solutions v. PeaceHealth*, 2007-2 Trade Cas. (CCH) ¶ 75,846 (9th Cir. Sept. 4, 2007).

III. *PeaceHealth* Case

- A. The facts of *PeaceHealth*:
1. The plaintiff (McKenzie), with one hospital, and the defendant (*PeaceHealth*), with three, were the only hospitals in Lane County Oregon
 2. *PeaceHealth* offered primary, secondary, and tertiary care; McKenzie just primary and secondary
 3. *PeaceHealth* offered additional discounts to insurers of up to 35%-40% if the insurer made *PeaceHealth* the only preferred provider for primary, secondary, and tertiary care
 4. The trial court charged the jury that it could find *PeaceHealth* liable if its discounts “substantially foreclose portions of the market to a competitor who does not provide an equally diverse set of services and who therefore cannot make a comparable offer.”
 5. Judgment of \$16.2 million after trebling
- B. The central issue confronting the Ninth Circuit was whether to follow the Third Circuit’s decision in *Le Pages v 3M*, 324 F.3d 141 (3d Cir. 2003). In *Lepage’s*, the court focused primarily on harm to rivals. It held that where a bundled pricing arrangement by a firm with monopoly power uses that bundled pricing to expand its share in the competitive market, it can be an unlawful use of monopoly power. But the court articulated no “test” for courts to apply.
- C. The Ninth Circuit took the unusual step of reaching out for amicus briefs, and in response received amicus briefs that together provided a comprehensive analysis of each of the major alternatives to *Lepage’s*:
1. A general “consumer welfare effects” or Rule of Reason analysis;
 2. an “aggregate price-cost” test based on *Brooke Group’s* predatory pricing analysis;
 3. an “attributed price-cost” test recommended recently by the Antitrust Modernization Commission. [full disclosure: one of the co-authors of this outline, Jon Jacobson, was on the AMC, and the authors’ firm submitted an amicus brief in *PeaceHealth* that advocated for that test.]
- D. The Ninth Circuit rejected the *Lepage’s* standard as too vague, and unduly chilling of legitimate package discounts. That part wasn’t hard: *Lepage’s* doesn’t have many defenders.

- E. Court also rejected the so-called “full *Brooke Group*” approach urged by the telecoms as amici. Under that test, one would look at the seller’s total revenues from the sale of all products in the bundle, and compare that value with the incremental (that is, marginal or average variable) cost of producing all these products. If the relevant sales are below cost on that basis, the plaintiff would have to demonstrate probable recoupment.
 - 1. Under this standard, the bundling aspects of the conduct basically become irrelevant: bundling as such becomes legal *per se*, and is only problematic if it falls afoul of the *Brooke Group* predatory pricing standard.
- F. Instead, the Court adopted a variant of the “discount attribution” test, largely in a manner consistent with the proposal of the Antitrust Modernization Commission and the writings of Professor Hovenkamp and Judge Posner. The discount attribution test falls in between the “consumer welfare” test and the *Brooke Group* test

IV. AMC’s Discount Attribution Test and its Ninth Circuit Variant

- A. The AMC’s discount attribution test begins by creating a safe harbor where, after allocating all discounts and rebates to the competitive product, the competitive product is sold above its incremental cost. The purpose of this safe harbor is to ensure that most discounted bundles do not suffer from undue chilling.
 - 1. Proponents of the consumer welfare test argue that this safe harbor can permit some “false negatives,” in that the exclusion even of less-efficient rivals can result in competitive harm. But the notion here is that the cost-benefit trade-off clearly favors erring on the side of allowing price discounting.
 - 2. The Ninth Circuit adopted this safe-harbor provision
- B. If the package discount does not meet this safe harbor, the AMC’s test allows a second safe-harbor if the plaintiff cannot show recoupment. Under the AMC’s test, however, this recoupment requirement only comes into play if the price bundle as a whole is below the incremental cost of all the products in the bundle.
 - 1. In effect, it applies *Brooke Group* to discount bundles that would potentially be actionable under the aggregate-price test.
 - 2. The *PeaceHealth* court did not understand the AMC’s cryptic description of the need to show “recoupment” and so rejected this requirement.
- C. In between – for bundled discounts that exceed the competitive product’s incremental cost, but are less than the incremental cost of the bundle as a whole – the AMC would apply a Rule of Reason analysis, requirement a showing of actual or probable harm to competition

1. The Ninth Circuit basically adopted this standard, referring to the plaintiff's need to show what the court called "antitrust injury," by which the court meant an actual or probable adverse effect on competition.

V. Discount Attribution Test

- A. The 9th Circuit's variant of the discount attribution test provides at least some guidance for firms in business operations and a basis for counseling
- B. Calculation of the attributed discount, at least in an approximate amount, should be straightforward in most instances, allowing businesses to price without undue fear of legal repercussions
- C. Even if a bundled discount fails to the discount attribution safe harbor, it will not be condemned absent what the court called "antitrust injury"
 1. Better phrasing would be "harm to competition"
 2. Alternative rules are either unacceptably vague and overbroad (*LePage's*) or unacceptably narrow (the "full *Brooke Group*" variety of per se legality)