

An emerging consensus on
bundled discounts under
section 2 of the Sherman Act?

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I. INTRODUCTION

Shave and a haircut, two bits. Burger, fries, and a soda. Buy the blades and we'll give you the razor. Internet, telephone, and television for one monthly price. Multiproduct, or "bundled," discounts are ubiquitous. Consumers want them. Sellers of all sizes offer them. Without question, the overwhelming majority of bundled discount or rebate arrangements—which allow a lower total price for buying two or more products from the same seller than is available for buying those products separately—are desired by consumers and procompetitive. Yet, in a handful of instances, competing sellers have challenged bundled discount arrangements as acts of monopolization or attempts to monopolize in violation of section 2 of the Sherman Act.¹ The small

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¹ 15 U.S.C. § 2.

number of antitrust challenges to pure bundled discount arrangements, compared to the ubiquity of such arrangements, is itself a strong testament to the rarity of anticompetitive issues raised by such arrangements. The challenge for courts and commentators has been to devise an effective, pragmatic test to identify and isolate the few bundled discount arrangements that may pose threats to competition from the many that do not. Too strict a standard can discourage legitimate price competition; too lenient a standard can insulate potentially anticompetitive behavior.

Discussion of bundled discounts in antitrust circles has intensified since the Third Circuit's en banc decision in *LePage's Inc. v. 3M Co.*² in 2003. Although widely criticized for providing little guidance for businesses considering bundled discounts or for courts evaluating those arrangements, *LePage's* has fostered vibrant and insightful discussion of the issue.

Now, an emerging consensus can be discerned. The Antitrust Modernization Commission (AMC),³ some commentators,⁴ at least one federal appellate court,⁵ and (briefly) the Antitrust Division,⁶ have

² 324 F.3d 141 (3d Cir. 2003) (en banc).

³ ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS (2007) [hereinafter AMC REPORT].

⁴ See, e.g., IIIA PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749d1 at 323 (3d ed. 2008); Jonathan M. Jacobson, *Exploring the Antitrust Modernization Commission's Proposed Test for Bundled Pricing*, 2007 A.B.A. SEC. PUB. ANTITRUST 23, 25 & n.21 (citing commentators in agreement).

⁵ *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 906 (9th Cir. 2008).

⁶ DEP'T OF JUSTICE, COMPETITION & MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008) [hereinafter DEP'T OF JUSTICE SECTION 2 REPORT]. In speeches on May 11, 2009, to the Center for American Progress and on May 12, 2009, to the Chamber of Commerce of the United States, Christine Varney, Assistant Attorney General for the Antitrust Division, announced that "I have withdrawn the Section 2 Report by the Department of Justice. Effective May 11, 2009, the Section 2 Report no longer represents the policy of the Department of Justice with regard to antitrust enforcement under Section 2 of the Sherman Act. The Report and its conclusions should not be used as guidance by courts, antitrust practitioners, and the business community." Asst. Att'y Gen. Christine A. Varney, Vigorous

embraced the “discount attribution rule” as at least an initial step in evaluating bundled discounts under section 2. As discussed below, the discount attribution rule allocates all discounts and rebates attributable to the bundle to the competitive product in the bundle, and then determines whether, after that reallocation of discounts and rebates, the competitive product is being sold above its incremental cost. Although most, but not all, acknowledge that the discount attribution rule is insufficient by itself to distinguish anticompetitive bundling arrangements from procompetitive ones, there is not yet a strong consensus about what the additional elements should be. It is the premise of this article that the three-part test set forth by the AMC, which adds the elements of likelihood of recoupment and an adverse effect on competition to the discount attribution rule, is an effective and practical test for evaluating bundled discounts under section 2.

II. BACKGROUND OF THE BUNDLING CONTROVERSY

Bundled discounting is the practice of offering discounts or rebates contingent upon a buyer’s purchase of specified quantities of two or more products from the same seller within a specified time period.⁷ Methods of bundling are legion, but the essential trait is that a purchaser of multiple products from the bundling seller is able to achieve a lower net price on the group of products than it would have

Antitrust Enforcement in This Challenging Era, Remarks as Prepared for the Center for American Progress (May 11, 2009), *available at* <http://www.usdoj.gov/atr/public/speeches/245777.htm>; Asst. Att’y Gen. Christine A. Varney, Vigorous Antitrust Enforcement in This Challenging Era, Remarks as Prepared for the United States Chamber of Commerce (May 12, 2009), *available at* <http://www.usdoj.gov/atr/public/speeches/245777.htm>. Although Assistant Attorney General Varney’s announcement is undoubtedly significant as a statement of current Antitrust Division policy, her stated reasons for withdrawing the Section 2 Report do not precisely address the Report’s analysis of bundled discounts. This article refers to the Report’s analysis of bundled discounts, undertaken in good faith by the prior administration, for the purpose of comparing and contrasting that analysis to other approaches to bundled discounts. This article does not invoke the Report as an authoritative statement of the Antitrust Division policy.

⁷ AMC REPORT, *supra* note 3, at 94; *see also* DEP’T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 91.

achieved by purchasing the products individually from the same seller. The lower net price may be achieved through off-invoice discounts or by back-end rebates based upon purchases of the products over a specified time. Typically, bundled pricing provides a consumer benefit, or “surplus,” equal to the difference between the net aggregate prices of the products purchased individually and the net price of the same products purchased together as a bundle.⁸

There are at least three conceptually distinct types of product mixes in bundled discount arrangements. The first, and perhaps most common, type of bundled discount arrangement occurs when a seller gives bundled discounts or rebates on a group of products in competition with other sellers, some of whom also sell the complete mix of products in the bundle. Examples include a shave and a hair cut, or burger, fries, and soda. These arrangements pose little, if any, threat to competition. Each competing seller can make its own decision whether to offer a competing bundle.

The second type of bundling arrangement occurs when the seller with the most diverse offering of products, each of which faces competitive products in its marketplace, offers bundled discounts on its package of diverse products. Although no individual competitor can exactly replicate the bundle, competing sellers of the individual products can collaborate either explicitly or implicitly to compete with the

⁸ As has been noted, however, not every bundled discount arrangement provides a true consumer benefit. When the seller increases the stand-alone price of one or more individual products, but then concurrently creates a bundle with discounts or rebates that reduce the net bundled price back to the prebundled level, but no lower, the consumer benefit of the bundle may be illusory. See Patrick Greenlee, David Reitman & David S. Sibley, *An Antitrust Analysis of Bundled Loyalty Discounts*, 26 INT'L J. INDUS. ORG. 1132, 1138 (2008) (stating that consumer welfare is diminished if the outside-the-bundle price of a monopoly product is more than the price of the monopoly product before the bundle). Such arrangements appear particularly susceptible to the discount attribution rule, since all discounts attributable to the bundle must be allocated to the competitive product. When the seller raises the stand-alone price of one or more products in the bundle, and makes higher discounts contingent on purchasing the bundle, the discount attribution rule attributes the higher bundled discounts to the competitive product, producing a greater likelihood that the competitive product will be below cost on an attributed discount basis.

bundle, or buyers can pick and choose to create their own bundles. If the multiproduct seller is able to achieve unique cost savings by virtue of the bundle based on efficiencies in packaging, distribution, or otherwise, the bundling seller may be able to offer a price on the bundle that is lower than the total price a purchaser could obtain by selecting the lowest unbundled prices on each individual product. Lower prices due to such efficiencies benefit consumers and are pro-competitive. Normal predation principles are applicable in both the first and second situations, in which competing bundles are possible.⁹

It is the third type of bundling that poses the greatest analytical difficulty. This third situation occurs when a seller provides bundled discounts on a group of products, at least one of which is a dominant product facing little if any competition, and at least one of which is a product facing competition. An antitrust allegation may arise when the bundling seller is accused of using its dominant position in one product to monopolize or attempt to monopolize the market in the competitive product.

This third situation has led to the most significant controversy and commentary. As recently as 2004, when the Antitrust Division opposed the petition for writ of certiorari in *LePage's*, it told the U. S. Supreme Court that "although the business community and consumers would benefit from clear, objective guidance on the application of Section 2 to bundled rebates . . . it would be preferable to allow the case law and economic analysis to develop further."¹⁰ Sufficient percolation has now occurred for the Supreme Court to address and resolve this issue.

III. VARIOUS ANALYTICAL FRAMEWORKS

The perceived threat of bundled discounts was well illustrated by Judge Kaplan in *Ortho Diagnostic Systems v. Abbott Laboratories, Inc.*¹¹

⁹ See, e.g., DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 101.

¹⁰ Brief for the United States as Amicus Curiae at 19, *3M Co. v. LePage's, Inc.*, 542 U.S. 953 (2004) (No. 02-1865), available at <http://www.usdoj.gov/atr/cases/f203900/203900.htm>.

¹¹ 920 F. Supp. 455 (S.D.N.Y. 1996).

Judge Kaplan's example of one seller of shampoo and conditioner competing against another seller of just shampoo has become a standard illustration in the commentary on bundling:

Assume for the sake of simplicity that the case involved the sale of two hair products, shampoo and conditioner, the latter made only by A and the former by both A and B. Assume as well that both must be used to wash one's hair. Assume further that A's average variable cost for conditioner is \$2.50, that its average variable cost for shampoo is \$1.50, and that B's average variable cost for shampoo is \$1.25. B therefore is the more efficient producer of shampoo. Finally, assume that A prices conditioner and shampoo at \$5.00 and \$3.00, respectively, if bought separately but at \$3.00 and \$2.25 if bought as part of a package. Absent the package pricing, A's price for both products is \$8.00. B therefore must price its shampoo at or below \$3.00 in order to compete effectively with A, given that the customer will pay A \$5.00 for conditioner irrespective of which shampoo supplier it chooses. With the package pricing, the customer can purchase both products from A for \$5.25, a price above the sum of A's average variable cost for both products. In order for B to compete, however, it must persuade the customer to buy B's shampoo while purchasing its conditioner from A for \$5.00. In order to do that, B cannot charge more than \$0.25 for shampoo, as the customer otherwise will find A's package cheaper than buying conditioner from A and shampoo from B. On these assumptions, A would force B out of the shampoo market, notwithstanding that B is the more efficient producer of shampoo, without pricing either of A's products below average variable cost.¹²

¹² *Id.* at 467. The Section 2 Report contended that "the impact of the conduct described in the hypothetical resembles that of tying more than that of predatory pricing." DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 96. To the contrary, if A is making both products available separately at prices that are no higher than their prebundle levels set by market forces, the tying analysis appears strained. Although an analysis of tying is beyond the scope of this article, suffice to say that such an analysis would typically require a fact-intensive analysis of coercion, including whether an overwhelming majority of buyers, ninety percent or more, purchased the two products as a bundle from A. See X PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1758a at 324 (2d ed. 2004) ("[T]he courts should not find a tying condition or agreement when the defendant's customers buy elsewhere 10 percent or more of the allegedly tied B while also buying the defendant's product A."). Moreover, it would be odd policy for the arrangement to be deemed anticompetitive as a tying arrangement but *not* anticompetitive when analyzed under section 2, since the effect on consumers is the same regardless of how the practice is characterized for purposes of the antitrust laws.

In this illustration, *A*'s bundled pricing is above its total average variable cost for both products in the bundle, shampoo and conditioner. Yet as Judge Kaplan has suggested, a competitive concern can arise when one of the products in the bundle faces no competition. This is the situation in which antitrust concerns have arisen. As discussed below, however, Judge Kaplan's hypothetical illustration is incomplete; standing alone, it still does not demonstrate an anticompetitive effect.

Building on this hypothetical, if, rather than being the only seller of conditioner, Company *A* faced competition in the sale of conditioner from Company *C*, the situation changes. To begin with, in contrast to Judge Kaplan's hypothetical in which *A* included a dominant product (conditioner) in the bundle, when *A* faces competition on both products, it is even more difficult to tell objectively whether *A* has created the bundled pricing to promote the sale of shampoo, conditioner, or perhaps both. Moreover, *A*'s competitors will likely react differently to the bundle if *A* faces competition on both products rather than on just one. Assuming *C*'s average variable cost for conditioner is at or below \$4.00, with *B*'s average variable cost of shampoo at the assumed \$1.25, *B* and *C* will have a strong motivation to discount their respective products to achieve a competitive alternative to *A*'s bundle. *B* and *C* could act jointly to price their products to compete against *A*'s bundle, perhaps with a competing bundle. Alternatively, *B* and *C* may decide independently to lower their respective prices of conditioner and shampoo to compete effectively against the bundle. So long as the combined price of *B*'s shampoo and *C*'s conditioner is no higher than \$5.25, their individual products can profitably compete against the bundle. The motivation of *B* and *C* to act in one of these ways is their recognition that *A*'s bundled pricing places them both at a disadvantage.

Courts and commentators have approached the issue of bundled pricing involving both dominant and competitive products in a variety of ways. In an early case from 1978, *SmithKline Corp. v. Eli Lilly & Co.*,¹³ the court found that Lilly had violated section 2 by using a volume rebate plan to sell its cephalosporin products. Lilly held legal patent

¹³ 427 F. Supp. 1089 (E.D. Pa. 1976), *aff'd*, 575 F.2d 1056 (3d Cir. 1978).

monopolies on four cephalosporins. Lilly and SmithKline had each obtained a nonexclusive license to sell a fifth cephalosporin in competition with each other. Lilly included this fifth cephalosporin in a volume rebate plan with two other patented, strong-selling cephalosporins. Judge Aldisert's analysis for the Third Circuit affirming judgment for plaintiff SmithKline may seem somewhat unsophisticated to reviewers three decades later, but the court's ruling focused on many of the important facts. It noted that SmithKline would have had to offer a rebate of between sixteen percent and thirty-six percent on its product to compete against the bundled pricing, and at that level of discount "SmithKline's prospects for continuing in the cephalosporin market under these conditions [were] poor."¹⁴ Yet, the court's focus on SmithKline's costs and ability to compete raised two questions: First, how could Lilly avoid the violation without detailed knowledge of SmithKline's costs? And second, was the court's decision more focused on protecting a *competitor* (SmithKline) than protecting *competition*?

Twenty-five years later, in *LePage's Inc. v. 3M Co.*,¹⁵ the Third Circuit sitting en banc affirmed a jury verdict finding that 3M had violated section 2 by bundling its unbranded transparent tape with its dominant Scotch brand transparent tape and a range of other products in competition with the unbranded transparent tape of LePage's. The court considered and rejected 3M's argument that *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,¹⁶ deemed all pricing actions, including bundled discounts and rebates, per se legal if above the seller's cost.¹⁷ The court affirmed based upon a lower

¹⁴ *SmithKline*, 575 F.2d at 1065. Although the court did not explicitly review Lilly's cost of selling its competitive cephalosporin, both Lilly and SmithKline licensed that product from the same patent holder; presumably Lilly's cost for the competitive cephalosporin was comparable to SmithKline's cost. Implicitly, the court's reasoning suggests that, under the discount attribution rule, Lilly's competitive product was being sold below its cost.

¹⁵ 324 F.3d 141 (3d Cir. 2003) (en banc).

¹⁶ 509 U.S. 209 (1993).

¹⁷ *LePage's*, 324 F.3d at 147, 151. The Third Circuit's suggestion that *Brooke Group's* holding might be limited to primary line price discrimination claims under the Robinson-Patman Act, *id.* at 151 (stating that *Brooke Group*

court's jury instruction that conduct is illegal under section 2 when it "has made it very difficult or impossible for competitors to engage in fair competition."¹⁸

The *LePage's* decision has been heavily criticized as providing little guidance to the jury, and no more to businesses attempting to comply with the law. For example, the AMC was highly critical of the *LePage's* decision in its April 2007 Report and Recommendations.¹⁹ The AMC explained that "[t]he fundamental criticism of the Third Circuit's decision is that it did not assess whether 3M's bundled rebates constituted competition on the merits. . . . [L]ower prices may harm a rival but benefit consumers."²⁰ The AMC further noted that the court did not require *LePage's* to demonstrate that it was an equally efficient rival to 3M, and "it is unclear what would have been sufficient to convince the court that 3M was competing on the merits, rather than on some basis other than efficiency, with the bundled rebates."²¹ Finally, the AMC noted that the decision "is too vague and is therefore likely to chill welfare-enhancing bundled discounts or rebates."²² Other courts and many commentators have disagreed with the *LePage's* application of section 2 to bundled discounts for similar reasons.²³

"was primarily concerned with the Robinson-Patman Act, not § 2 of the Sherman Act"), was rejected by the unanimous Supreme Court in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 318 n.1 (2007) (applying *Brooke Group* test to predatory buying claim under section 2).

¹⁸ *LePage's*, 324 F.3d at 168 (quoting district court).

¹⁹ See AMC REPORT, *supra* note 3, at 94.

²⁰ *Id.* at 97.

²¹ *Id.*

²² *Id.* (footnotes omitted).

²³ See, e.g., *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 899 (9th Cir. 2008); Daniel A. Crane, *Multiproduct Discounting: A Myth of Nonprice Predation*, 72 U. CHI. L. REV. 27, 29 (2005); Richard A. Epstein, *Monopoly Dominance or Level Playing Field? The New Antitrust Paradox*, 72 U. CHI. L. REV. 49, 71-72 (2005); Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1722-23 (2005); Daniel L. Rubinfeld, *3M's Bundled Rebates: An Economic Perspective*, 72 U. CHI. L. REV. 243, 243 n.4, 264 (2005). See also DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 93-95 (discussing decisions).

Another approach to bundled discounts under section 2 is the so-called “aggregate discount rule,” which would deem bundled pricing per se legal if the aggregate price of the bundle is above the aggregate average variable cost of the products in the bundle.²⁴ In Judge Kaplan’s example, the \$5.25 bundled price for shampoo and conditioner is above the \$4.00 aggregate average variable cost of the products in the bundle; the aggregate discount rule would indicate per se legality. To date, no court has adopted the aggregate discount rule, and it has been criticized for insulating from further antitrust scrutiny even bundled discount programs that employ a dominant product to gain an anti-competitive advantage over a competitive product,²⁵ as Judge Kaplan illustrated in his example of shampoo and conditioner above.²⁶

Another approach is the one taken by Judge Kaplan in *Ortho Diagnostic Systems* in 1996. The court held that a plaintiff “must allege and prove either that (a) the monopolist has priced below its average variable costs or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant’s pricing makes it unprofitable for the plaintiff to continue to produce”²⁷ the product. Because Ortho failed to come forward with such evidence, the court entered summary judgment against it. This test focuses upon the plaintiff’s ability to compete against the bundle. It is unclear whether the “average variable cost” test in Judge Kaplan’s alternative (a) requires analysis of the aggregate bundled price versus the aggregate bundled cost or a more nuanced calculation. Regardless, alternative (a) of this test is not, standing alone, sufficient to prove injury to competition.²⁸ Alternative (b) of the test might be criticized for providing no practical guidance to potential defendants, who can merely speculate about the cost structures of their competitors, and for focusing on the impact on a competitor rather than on competition.

²⁴ See *Cascade Health Solutions*, 515 F.3d at 904.

²⁵ *Id.*

²⁶ See *supra* note 12 and accompanying text.

²⁷ *Ortho Diagnostic Sys. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 469 (S.D.N.Y. 1996).

²⁸ See discussion of the discount attribution rule *infra* section IIIA.

The AMC entered the debate in its April 2007 Report and Recommendations. Rather than merely criticizing *LePage's*, the AMC proposed a three-part test for examining bundled discount programs under section 2 of the Sherman Act. The AMC recommended that a plaintiff should be required to show each one of the following elements (as well as the other elements of a section 2 claim), in order to prove a violation of section 2:

- (1) 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;
- (2) the defendant is likely to recoup these short-term losses; and
- (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.²⁹

The AMC's recommendation concerning bundled discounts is discussed more fully below.³⁰

So far only one appellate court has explicitly addressed the AMC bundling test.³¹ In *Cascade Health Solutions v. PeaceHealth*, the Ninth Circuit addressed the AMC test, embracing the discount attribution rule but not the second and third elements of that test.³² In *Cascade*, the plaintiff McKenzie (subsequently acquired by Cascade) filed a multi-

²⁹ AMC REPORT, *supra* note 3, at 99. The well-settled elements of monopolization are "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of the power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966). The elements of attempted monopolization are "(1) that the defendant has engaged in predatory or anticompetitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993). The challenge of applying these broad concepts to particular fact patterns has led to the controversy about bundled discounts, as well as recent efforts by the AMC and the Antitrust Division to provide guidance on the application of Section 2.

³⁰ See *infra* text accompanying notes 42, 52.

³¹ In *Meijer, Inc. v. Abbott Labs.*, a federal district court attempting to apply the Ninth Circuit's decision in *Cascade* appears to have misunderstood both *Cascade* and the AMC test. 544 F. Supp. 2d 995, 999-1005 (N.D. Cal. 2008).

³² *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 903 (9th Cir. 2008).

count complaint against PeaceHealth, alleging insofar as relevant here that PeaceHealth had illegally bundled primary and secondary hospital services with tertiary hospital services in Lane County, Oregon. In Lane County, PeaceHealth competed against McKenzie in the market for primary and secondary services, but it held a virtual monopoly on tertiary services, which McKenzie did not provide. McKenzie obtained a jury verdict against PeaceHealth based on evidence that PeaceHealth had contracted with insurers to provide bundled discounts on primary, secondary, and tertiary services. "The evidence showed that insurers who . . . purchase[d] from PeaceHealth a full complement of primary, secondary, and tertiary services, paid lower reimbursement rates than insurers who purchased tertiary services from PeaceHealth, but at least some primary and secondary services from McKenzie."³³

Reversing the jury verdict in favor of McKenzie, the Ninth Circuit rejected the lower court's jury instructions, which were based on *LePage's*. The Court reasoned that the Third Circuit's approach threatened to interfere with legitimate price competition.³⁴ It rejected the "aggregate discount rule," which deems legal per se any bundled discount for which the aggregate *price* of the entire bundle equals or exceeds the aggregate *cost* of the entire bundle, on the ground that a multiproduct firm can place a single product competitor at a huge disadvantage by offering bundled discounts across a broad range of products, while still pricing the bundle at an aggregate price above the aggregate cost of all products in the bundle.³⁵

The Ninth Circuit also rejected the standard applied by Judge Kaplan in *Ortho*. It reasoned that the *Ortho* standard "does not provide adequate guidance to sellers who wish to offer pro-competitive bundled discounts because the standard looks to the costs of the actual plaintiff."³⁶ It also pointed out that the *Ortho* test, like any test that focused on the production costs of the plaintiff, could lead to a different result if a different competitor brought suit.³⁷

³³ *Id.* at 893.

³⁴ *Id.* at 903, 910.

³⁵ *Id.* at 904.

³⁶ *Id.* at 905.

³⁷ *Id.* at 905–06.

Instead, the Ninth Circuit adopted the first element of the AMC test, the discount attribution rule. The court correctly observed that the “discount attribution standard provides clear guidance for sellers that engage in bundled discounting practices,”³⁸ because a seller is aware of its own costs and need not speculate about the ability of competitors to compete. On this basis, the court remanded the case to the district court for further proceedings.

The Ninth Circuit misunderstood the AMC test, however, as demonstrated by dicta in which it stated that the second and third elements of the AMC test are superfluous. In dismissing the recoupment element, the court observed that “a conclusion of below-cost sales under the discount attribution standard may occur in some cases even where there is not an actual loss because the bundle is sold at a price exceeding incremental cost. In such a case, we do not think it is analytically helpful to think in terms of recoupment of a loss that did not occur.”³⁹ As explained more fully below, however, the “loss” referred to in the AMC test, is the “loss” on the sale of the competitive product after application of the discount attribution rule.⁴⁰ Further, the court suggested that the third element, requiring proof of an adverse effect on competition, duplicated the requirement for proof of antitrust injury.⁴¹

More recently, the Antitrust Division of the Department of Justice addressed bundled discounting in its September 2008 Report on Single-Firm Conduct under section 2.⁴² Although the Report has been withdrawn by the current administration, its careful and extensive analysis of the bundling issue should not be neglected.⁴³ The Antitrust Division recommended that a predatory pricing test be used when

³⁸ *Id.* at 907.

³⁹ *Id.* at 910 n.21.

⁴⁰ See *infra* notes 42–52 and accompanying text.

⁴¹ 515 F.3d at 910, n.21.

⁴² DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 91–106.

⁴³ The report sets forth thoughtful analysis based on extensive testimony and input from the antitrust bar. Its endorsement after careful consideration of the discount attribution rule, referred to in the report as the “discount allocation rule,” is especially significant.

bundle-to-bundle competition is reasonably possible, such as when a competing seller sells all products in the bundle or presumably when all the products in the bundle are otherwise available, even if no single seller sells all the bundled products. When bundle-to-bundle competition is reasonably possible, the Division recommended that “a showing that recoupment is likely should be required.”⁴⁴

When bundle-to-bundle competition is not reasonably possible, the Division recommended the discount attribution rule as a safe harbor, but made clear that failing to come within the safe harbor should not create a presumption of anticompetitive conduct.⁴⁵ More precisely, “when actual or probable harm to competition is shown, bundled discounting by a monopolist that falls outside the discount-allocation safe harbor should be illegal only when (1) it has no pro-competitive benefits, or (2) if there are pro-competitive benefits, the discount produces harms substantially disproportionate to those benefits.”⁴⁶

The Report’s approach to bundled discounts differs from the AMC test, but perhaps more in wording than in practical effect. The ability of the bundling firm to recoup its imputed losses on the competitive product would, presumably, be a critical component for determining whether the bundle has procompetitive benefits that outweigh its competitive harms. In any event, by confirming that the discount attribution rule is an important screen, but by itself is not an indication of illegality, the Section 2 Report’s reasoning has lent weight to the search for an objective, easily applied safe harbor. For reasons explained below, however, the AMC test remains a superior approach.

IV. THE ANTITRUST MODERNIZATION COMMISSION’S TEST

In its April 2007 Report and Recommendations, the AMC examined the issue of bundled discounts and rebates. The AMC set forth a three-part test for evaluating bundled discount arrangements under

⁴⁴ DEP’T OF JUSTICE SECTION 2, *supra* 6, at 101.

⁴⁵ *Id.* at 101–02.

⁴⁶ *Id.* at 105.

section 2 of the Sherman Act.⁴⁷ The first element is the discount attribution rule, the second element is likelihood that the imputed loss sustained on the competitive product will be recouped, and the final element is an adverse effect on competition.

Implicit in this recommendation is that the seller offering a potentially anticompetitive bundled discount program must include in the program at least one dominant or monopoly product that is not sold by competitors who are attempting to compete with the bundler in selling other products covered by the bundle. Without a dominant product in the bundle, the seller would be unable to achieve much if any competitive advantage over rivals, either because an individual rival could offer a competitive bundle or because single product rivals could collaborate either explicitly or implicitly to compete against the bundle. As the Antitrust Division recognized, when bundle-to-bundle competition is possible, settled rules of predation should apply.⁴⁸

A. *The discount attribution rule*

It is worth pausing to look carefully at each element of the AMC's test. The first element states: "after allocating [1] all discounts and rebates [2] attributable to the entire bundle of products [3] to the competitive product, [4] the defendant sold the competitive product below its incremental cost for the competitive product."⁴⁹ This element seems to have garnered support among the commentators⁵⁰ and in the section 2 Report,⁵¹ as well as from the Ninth Circuit in *Cascade*.⁵²

⁴⁷ AMC REPORT, *supra* note 3, at 99.

⁴⁸ DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 101.

⁴⁹ AMC REPORT, *supra* note 3, at 12.

⁵⁰ See, e.g., Jacobson, *supra* note 4, at 23, 25 & n.21 (citing commentators); Erik Hovenkamp & Herbert Hovenkamp, *Exclusionary Bundled Discounts and the Antitrust Modernization Commission*, 53 ANTITRUST BULL. 517, 523 (2008) ("The attribution test does appear to provide a manageable and rational minimum criterion for illegality and thus creates a safe harbor for bundled pricing that passes the test.").

⁵¹ DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 101.

⁵² See *supra* note 35 and accompanying text.

The allocation begins by isolating all discounts and rebates. This presupposes, of course, that each product in the bundle is separately available at a stated unbundled price. In other words, the court must determine the net price of the dominant product (deducting all discounts and rebates given when it is purchased separately) and the net price of the competitive product (deducting all discounts and rebates given when it is purchased separately).

Next, the court must determine what portion of the discounts or rebates is "attributable to the entire bundle of products." If the discounts are available outside the bundle, they should not be considered in this analysis. Rather, the effort is to quantify the incremental benefit obtained by the buyer if it buys the bundle rather than purchasing the products separately. The question is: How much less does the purchaser pay for the dominant product and the competitive product together than it pays, with all available discounts and rebates, to purchase the dominant product and the competitive product separately from the bundling seller? Only if the seller is providing incremental discounts to those who purchase from it both the dominant product and the competitive product is the seller offering a true bundled discount, and it is that incremental discount with which the antitrust court must be concerned.

Third, this incremental discount attributable to the bundle must be allocated to the competitive product. To do so, the court must deduct that incremental discount from the best stand-alone price of the competitive product to determine the implicit price at which the seller is selling the competitive product in the bundle. The assumption here is that the seller does not need to offer further discounts on the dominant product,⁵³ and that the incremental bundled discounts are intended to drive sales of the competitive product. Indeed, most bundled discount litigation under section 2 has arisen when competing sellers of the competitive product have sued the bundling seller.⁵⁴

⁵³ David A. Argue, *The PeaceHealth Standard for Bundled Predation and Recoupment*, *ECONOMISTS INK*, Fall 2007, at 3 ("An argument for using the discount attribution approach is that a multi-product firm with market power in a product would not normally discount its price [on that monopoly product] below the monopoly profit-maximizing levels.").

⁵⁴ Among cases brought by competitors of the bundling seller are *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008) (bundling of

Finally with regard to the first element, the court must determine whether, after allocating the incremental bundled discount to the competitive product, the seller is selling the competitive product below incremental cost. As in other contexts, courts will likely gravitate toward average variable cost as a proxy for incremental or marginal cost.⁵⁵ If, after allocating the incremental bundled discount to the

hospital services); *LePage's, Inc. v. 3M Co.*, 324 F.3d 141 (3d Cir. 2003) (en banc) (bundling of transparent tape with other office products); *Virgin Atlantic Airways Ltd. v. British Airways PLC*, 257 F.3d 256 (2d Cir. 2001) (bundling of airline flights along monopoly routes with flights along competitive routes); *Multistate Legal Studies v. Harcourt Brace Jovanovich*, 63 F.3d 1540 (10th Cir. 1995) (bundling of preparation course for state-specific bar examination with preparation course for multistate bar examination); *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978) (bundling of antibiotics); *Meijer, Inc. v. Abbott Labs.*, 544 F. Supp. 995 (N.D. Cal. 2008) (bundling of antiviral medications); *Invacare Corp. v. Respironics, Inc.*, 2006 U.S. Dist. LEXIS 77312, 1:04-CV-1580 (N.D. Ohio Oct. 23, 2006) (bundling of masks for use by persons with sleep apnea with devices that supply air to the masks); *Masimo Corp. v. Tyco Health Care Group, L.P.*, 2006 U.S. Dist. LEXIS 29977, CV-02-4770 (C.D. Cal. Mar. 22, 2006) (bundling of oxygen-sensing medical devices with unrelated medical devices); *Ramallo Bros. Printing, Inc. v. El Dia, Inc.*, 392 F. Supp. 2d 118 (D.P.R. 2005) (bundling of printing services); *J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, 2005 U.S. Dist. LEXIS 11676, 1:01-CV-704 (S.D. Ohio June 13, 2005) (bundling of six different pharmaceutical products), *aff'd*, 485 F.3d 880 (6th Cir. 2007); *Info. Res., Inc. v. Dun & Bradstreet Corp.*, 359 F. Supp. 2d 307 (S.D.N.Y. 2004) (order stating Second Circuit law relating to bundled pricing); *Ortho Diagnostic Systems, Inc. v. Abbott Labs.*, 920 F. Supp. 455 (S.D.N.Y. 1996) (bundling of five different types of blood tests). Although none appear to have led to reported decisions, purchasers have brought a few cases against bundling sellers, typically after a competitor of the bundling seller brings a successful antitrust case. See Shannon P. Duffy, *Judge Approves \$40M Settlement in 3M Antitrust Suit*, LEGAL INTELLIGENCER, May 21, 2007, <http://www.law.com/jsp/article.jsp?id=1179479105233>.

⁵⁵ The Supreme Court has repeatedly declined to rule on the appropriate measure of cost. See, e.g., *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 n.1 (1993); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 585 n.8 (1986). Courts of appeals have tended to use average variable cost because of the difficulty of measuring marginal cost. See, e.g., *Tri-State Rubbish v. Waste Mgmt.*, 998 F.2d 1073, 1080 (1st Cir. 1993) (stating that pricing below variable cost is the "normal test of predation"); *Kelco Disposal, Inc. v. Browning-Ferris Indus. of Vt., Inc.*, 845 F.2d 404, 407 (2d Cir. 1988) ("Prices that are below reasonably anticipated marginal cost and its

competitive product the price of the competitive product is above cost, the AMC test indicates that there is no section 2 violation and the inquiry ends there. If that calculation indicates that the competitive product is being sold below cost after the allocation, the court would proceed to the second element of the AMC's test. The AMC, joined by commentators,⁵⁶ recognized that failing the discount attribution test,

surrogate, reasonably anticipated average variable cost, . . . are presumed predatory." (citations omitted)); *Advo, Inc. v. Phila. Newspapers*, 51 F.3d 1191, 1198 (3d Cir. 1995) (citing with approval the Areeda-Turner test using average variable cost); *Taylor Publ'g Co. v. Jostens Inc.*, 216 F.3d 465, 478 n.6 (5th Cir. 2000) ("We have endorsed average variable cost as an appropriate measure of below-cost pricing for purposes of determining predatory pricing." (citations omitted)); *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 937-38 (6th Cir. 2005) (indicating that average variable cost is the appropriate measure of cost in predation analysis); *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427, 432 (7th Cir. 1980) (explaining that average variable cost is relevant and extremely useful in predation analysis); *Int'l Travel Arrangers v. NWA, Inc.*, 991 F.2d 1389, 1395 (8th Cir. 1992) (quoting *Henry v. Chloride, Inc.*, 808 F.2d 1355, 1360 (8th Cir. 1987) (explaining that "[a]t prices above average variable cost the plaintiff must overcome a strong presumption of legality by showing other factors indicating that the price charged is anticompetitive")); *Cascade Health Solutions*, 515 F.3d at 909 ("we have approved the use of marginal or average variable cost statistics in proving predation"); *Multistate Legal Studies*, 63 F.3d at 1549 n.5 (finding both marginal and average variable costs are "relevant" to predatory pricing analysis); *McGahee v. N. Propane Gas Co.*, 858 F.2d 1487, 1503-04 (11th Cir. 1988) ("If a defendant's prices were below average total cost and above short run marginal cost, then there is circumstantial evidence of predatory intent."); *U.S. Philips Corp. v. Windmere Corp.*, 861 F.2d 695, 703 (Fed. Cir. 1988) (accepting the use of average variable cost as a measure of cost, but requiring analysis of subjective factors of predation).

⁵⁶ See, e.g., AMC REPORT, *supra* note 3, at 398-99 (separate Statement of Commissioner Carlton); Hovenkamp & Hovenkamp, *supra* note 50, at 523; Dennis W. Carlton & Michael Waldman, *Safe Harbors for Quantity Discounts and Bundling* 8 (Economic Analysis Group Discussion Paper EAG 08-01, Jan. 2008), available at http://papers.ssrn.com/abstract_id=1089202 ("The first prong of the AMC safe harbor test can falsely flunk non-exclusionary profit maximizing pricing behavior."); Benjamin Klein & Andres V. Lerner, *The Law and Economics of Bundled Pricing: LePage's, PeaceHealth, and the Evolving Antitrust Standard*, 53 ANTITRUST BULL. 555 (2008) ("The first AMC safe harbor of attributed price less than cost cannot, by itself, be a sufficient screen."). See also DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 102.

standing alone, neither demonstrates nor creates a presumption of anticompetitive behavior.

Using Judge Kaplan's illustration involving shampoo and conditioner, seller *A* charges \$5.00 for its dominant product conditioner and \$3.00 for its competitive product shampoo when those products are purchased separately, for a total price of \$8.00, but a total price of \$5.25 when those products are purchased together. The discount attribution rule would assign all the discounts attributable to the bundle—that is the unbundled price of \$8.00 minus the bundled price of \$5.25 for total discounts attributable to the bundle of \$2.75—to the competitive product shampoo. Since *A*'s stand-alone price for shampoo is \$3.00, the implicit price of shampoo in the bundle is only \$.25. When that price of \$.25 is compared to *A*'s cost of producing shampoo of \$1.50, it is clear that *A* does not pass the discount attribution test.

Although the AMC test deems above-cost sales after application of the discount attribution rule *per se* legal, below-cost sales after application of that test do not, standing alone, indicate a violation of section 2 or even a presumption of such a violation. A plaintiff must then satisfy the second and third elements of the test, and Judge Kaplan's hypothetical provides insufficient facts for that analysis.

Many examples illustrate why the discount attribution rule is a necessary but not sufficient test for a section 2 claim. One example concerns bundles with multiple competitive products bundled with a dominant product, where the rule may be overinclusive. Allocating the total discounts available from a ten-product bundle to a single product might very often result in imputed losses on the single product. An adverse effect on competition would not necessarily follow. A multiproduct discount arrangement encompassing ten products could provide an incentive for any competing seller of one of those ten products in the bundle to reduce price. Price reductions on some or all of the ten individual products might be sufficient to allow a buyer to assemble a competitively priced package of the ten products; moreover, buyers of fewer than all ten products would receive a collateral benefit from price reductions on the individual products. Nevertheless, when a bundle includes multiple competitive products and one dominant product, sellers of each of the competitive products might claim violations of section 2. If all discounts attributable to the

bundle were attributed to each competitive product in each of the separate cases, the bundling seller might fail the discount attribution test in every case. Finding an antitrust violation in this situation seems perverse, since the very same discounts would first be attributed to one product in case number 1, the second product in case number 2, and so on, with the bundling seller flunking the discount attribution test in each case. Yet, it is quite possible that consumer welfare would be enhanced, competition would not be harmed, and competitive plaintiffs could compete successfully by individually giving slight discounts on their respective products. Thus, responsible antitrust analysis of bundled discounts cannot be confined to the discount attribution rule standing alone.

B. Recoupment

The second element of the AMC test for bundled discounts states: "the defendant is likely to recoup *these short-term losses*."⁵⁷ As will be discussed below, this element has proved to be the most misunderstood of the three elements. The proper application of this element, however, continues to focus, as does the first element, on the competitive product. By using the phrase "*these short-term losses*," the AMC was plainly referring to the imputed losses on the competitive product resulting from application of the discount attribution rule. This is the only sensible reading.⁵⁸ If all discounts available pursuant to the bundled discount program are attributed to the competitive product, and if the competitive product is being sold at a loss, then it is *that imputed loss on the competitive product* that must be recouped. And the loss must be recouped when the price of that competitive product is raised sufficiently to recoup it.

Returning again to Judge Kaplan's example, if seller A sets a stand-alone price of its dominant product conditioner at \$5.00, then it is fair to assume that \$5.00 is the profit maximizing price of conditioner. All things being equal, that is the price seller A will charge for conditioner outside the bundle or in the absence of the

⁵⁷ AMC REPORT, *supra* note 3, at 12.

⁵⁸ As a member of the AMC, I attest that this is and was my understanding.

bundle.⁵⁹ If, after gaining an improved position on its competitive product shampoo through bundling, seller A abandons the bundle, it will set a profit-maximizing price on its dominant product conditioner. If it raises the price of the dominant product outside the bundle, presumably it would have done so regardless of the price of its (formerly) competitive product. In short, pricing of the dominant product conditioner outside the bundle is an independent decision by seller A that will stand on its own profitability and merit; seller A's ability to increase its profits on the dominant product conditioner should have no bearing on whether it can recoup its imputed losses on the competitive product shampoo.

Thus, the recoupment exercise again focuses on the competitive product shampoo. In Judge Kaplan's example, the "loss" on shampoo of \$1.25 would need to be recouped, regardless of the stand-alone price seller A decides to charge for conditioner. The recoupment could occur if seller A eliminates the bundle altogether and then sets the individual price of the competitive product sufficiently above its prior stand-alone price, or alternatively, if seller A retains the bundle but reduces discounts attributable to the bundle sufficiently to achieve the same result.

In his recent article, *Exploring the Antitrust Modernization Commission Proposed Test for Bundled Pricing*,⁶⁰ former AMC member Jonathan Jacobson persuasively argues that the AMC's proposed three-part test for evaluating multiproduct discounts, or bundling, under section 2 of the Sherman Act is a vast improvement over other approaches. Like the Ninth Circuit in *Cascade*, however, Mr. Jacobson deems the recoupment element essentially superfluous, stating that recoupment

⁵⁹ In some cases, it is possible that a factual dispute would arise about whether the stand-alone price is a bona fide price. A bundling seller might, for example, raise the unbundled price of its dominant product to make the bundle more attractive. If it did so, efforts to recoup the imputed losses on the competitive product would be unlikely to lead to a further price increase on the dominant product. Conversely, if the bundling seller *lowered* the unbundled price of the dominant product, the bundle would be less attractive, and the discounts attributable to the bundle would be lower. Moreover, efforts to recoup the imputed loss on the competitive product would remain analytically separate from efforts to restore the price of the dominant product to its monopoly profit-maximizing price.

⁶⁰ Jacobson, *supra* note 5, at 23.

is “simultaneous” because “the total price of the bundle exceeds the total incremental cost of all the products in the bundle.”⁶¹

In both instances, the view that the AMC’s recoupment element is “superfluous” stems from a misunderstanding of how to apply the test. In Mr. Jacobson’s case, the error is evidenced by his own characterization of the AMC’s intent:

The recoupment part of the test might be conducted in two ways. One would be to determine whether the defendant would be likely to recoup by comparing future revenues to costs for the competitive product only, and do so under the same attributed revenue basis as applied under part one of the test. The other would be to determine whether the bundled pricing strategy as a whole would result in recoupment of the attributed losses. The AMC test is based on the latter approach.⁶²

With all due respect, Mr. Jacobson’s assertion that the AMC test is based on the “latter approach” is incorrect. To the contrary, as previously shown, the grammatical antecedent of “these short-term losses” is the imputed loss derived by application of the discount attribution rule in the first element of the AMC test—that is, recoupment of the imputed loss on the *competitive* product. Moreover, as also shown above, the AMC’s recoupment element—if properly interpreted—is consistent with the developed case law on single-product predatory pricing and with the practical economics.⁶³ Only if the recoupment element is misinterpreted so as to be applied to the entire bundle of products does it become largely if not wholly “superfluous”—yet another reason why that was not the AMC’s intent.

A likelihood or “dangerous probability” of recoupment⁶⁴ of the per-
tinent losses is necessary for two separate and equally important rea-

⁶¹ *Id.* at 25.

⁶² *Id.*

⁶³ In single-product predation cases, courts have been reluctant to assume that recoupment could occur in geographic or product markets other than the relevant market for the competitive product. *See, e.g.*, *United States v. AMR Corp.*, 335 F.3d 1109, 1114–15 (10th Cir. 2003); *Advo, Inc. v. Phila. Newspapers*, 51 F.3d 1191, 1201 (3d Cir. 1995).

⁶⁴ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993). The Court also used the phrase “reasonable expectation of recovering, in the form of later monopoly profits, more than the losses

sons. First, unless the seller reasonably expects to recover the short term losses on its competitive product, with compound interest,⁶⁵ it is not rational to infer that the seller has been acting with predatory intent. There are a plethora of reasons why a bundled discount arrangement may have been adopted, and it makes even less sense to infer an illicit purpose in that context than in a single-product predatory pricing case.

The second reason recoupment of the imputed losses is important is that, unless and until a full recoupment has been made, consumer welfare has been enhanced by the bundle. Returning to Judge Kaplan's example, if a consumer purchases the bundle from seller *A*, he achieves a benefit of \$2.75 (\$8 minus \$5.25). The consumer retains that benefit if seller *A* ceases the bundle and returns to the prebundle pricing of \$5.00 for conditioner and \$3.00 for shampoo. Only if, over a discrete period of time, seller *A* is able to raise the price of shampoo *above* \$3.00, and sell enough units of shampoo to recoup its imputed losses with compound interest, will Seller *A* have made itself whole *and* extracted the full benefit from its consumer. And, seller *A*'s ability to raise the price of shampoo above the competitive level depends on numerous market factors: whether Seller *B* reenters the market after initial exit, or a new competitor enters in response to the higher price; the availability of other reasonable substitutes for shampoo; the price elasticity of shampoo (will consumers simply wash their hair less often if the price of shampoo reaches \$4.00?). In short, without proof of recoupment, seller *A* has not advanced its predatory goals and the consumer has not, on balance, been harmed by the bundle, even if the bundle fails the discount attribution test. Without recoupment, the bundled discount is a mere short-term price cut, which is procompetitive, even if it could hurt a nonbundling competitor in the short run.

Suggesting that the price of the dominant product will be returned to its prebundle level does not demonstrate recoupment; indeed, the whole point of the discount attribution exercise is implicitly to return

suffered." *Id.* (quoting *Matsushita Electric Industries Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588–89 (1986)). The AMC used the phrase "likely to recoup these short-term losses." AMC REPORT, *supra* note 3, at 99. No difference among these formulations is perceived.

⁶⁵ See *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 318 (2007) (noting that interest must be recouped along with losses).

the price of the dominant product to its unbundled level and highlight the implicit discount being given on the competitive product. Only when the price of the dominant product rises at least to the prebundle level and the price of the competitive product rises *above* the prebundle level will the defendant begin to recoup its losses and eliminate the benefit that the bundled arrangement has bestowed on consumers. If both the price of the dominant product and the price of the competitive product stay at or below the prebundle level, the consumers retain the benefit from the bundle, and that is procompetitive.

Thus, to meet the second element of the AMC's test for proving that a bundled discount program violates section 2, the plaintiff must show that the defendant is likely to be able to recoup the *full* imputed loss on the competitive product, with interest. As in other contexts, this proof of recoupment would entail proof that (1) competing sellers of that product will likely exit, and—even more important—(2) an increased price of the competitive product sufficient to recoup the implied losses will be insufficient because of entry barriers to draw either the old or new competitors back into the market to lower the price of product *B* to the prebundle level.

C. Harm to competition

Even if the defendant is able to recoup the imputed losses on the competitive product, however, there may be situations in which competition is not harmed. Accordingly, the third element of the AMC test is that "the bundled discount or rebate program has had or is likely to have an adverse effect on competition."⁶⁶

Some have criticized the third element as too vague to be useful, as sufficient by itself to show an antitrust violation without the other two elements, or as redundant of the antitrust injury requirement for all private antitrust actions. On the first of these criticisms, it is submitted that the third element calls for a rule of reason analysis to determine if, even in light of a challenged arrangement's failure of the discount attribution test, and even in the event that recoupment is likely, the procompetitive benefits outweigh the adverse effects on the

⁶⁶ AMC REPORT, *supra* note 3, at 12.

competitive process.⁶⁷ Because of the prevalence of bundled discount arrangements, courts should not lose sight of the importance of this ultimate test. By its nature, the rule of reason would allow both plaintiff and defendant to come forward with evidence relevant to the particular bundled discount arrangement under review. A one-size-fits-all description of how this analysis would work seems no more appropriate here than in other contexts.

The assertion that the third element, by itself, is a sufficient standard is also unpersuasive. While courts are experienced in weighing the facts and circumstances in individual cases, the rule of reason provides little guidance for juries or for the business community. This is essentially the same guidance provided to the jury and accepted by the Third Circuit in *LePage's*. And without more definitive guidance to the business community, which the first two elements of the AMC test provide, an open-ended application of the rule of reason to bundled discounts seems likely to deter procompetitive discounting, while providing little guidance to juries and courts reviewing those arrangements.

The redundancy point, made by the Ninth Circuit in *Cascade*,⁶⁸ also misses the mark for two reasons. Challenges to bundled discount arrangements are not limited to private plaintiffs. The Department of Justice or the FTC may also bring such challenges, and the rule of antitrust injury would not apply.⁶⁹ Moreover, it seems hypothetically possible for a competitor to demonstrate antitrust injury to itself, but for the challenged conduct to be, on balance, procompetitive. In balancing the procompetitive and anticompetitive effects of a particular action, the existence of some anticompetitive effects (and some resulting effect on a particular competitor) should not carry the day if on balance the procompetitive effects outweigh the anticompetitive effects.

⁶⁷ DEP'T OF JUSTICE SECTION 2 REPORT, *supra* note 6, at 105.

⁶⁸ *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 911 n.21 (9th Cir. 2008).

⁶⁹ *See Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 489 (1977).

V. CONCLUSION

The pervasiveness of bundled discounts suggests that consumers like them, that they are accepted devices of competition, and that courts should rarely condemn particular ones under section 2. The AMC test is grounded in both sound economics and legal analysis. It provides pragmatic guidance for the business community. It achieves the best balance between protecting procompetitive discounting and condemning anticompetitive bundles. As argued above, the discount attribution rule, standing alone, does not achieve this balance. Only in the clearest instances, when a plaintiff establishes all three elements of the AMC's test, should a bundled discount arrangement be deemed a violation of section 2.