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Ninth Circuit Antitrust Ruling Rejects Approach to Bundling Claims Adopted By Third Circuit in *LePage's*

The antitrust significance of "bundling" has been a subject of enormous interest in both the business and academic communities over the last several years. The United Sates Court of Appeals for the Ninth Circuit this week weighed in[1] with a decision explicitly rejecting the approach previously adopted by the Third Circuit sitting *en banc* in the *LePage's* decision.[2]

Bundling involves an offer of reduced pricing on several different products if purchased together. The potential anti-competitive impact arises where rivals of the firm offering bundled discounts make products that compete with some, but not all of the products in the bundle. Discounts that are available only to those who purchase all (or a large number) of the bundled products may make it difficult for such rivals to compete. On the other hand, the bundled discounts result in lower consumer prices.

As the Ninth Circuit recognized, bundled discounts are "pervasive" in our economy: "[s]eason tickets, fast food value meals, all-in-one home theater systems" are all examples of such bundling.[3] The court noted that "[t]he frequency" with which such bundled discounts are encountered does not insulate the practices from review, but it "heightens the need to ensure that

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1 *Cascade Health Solutions v. PeaceHealth*, No. 05-35627, 2007 WL 2473229, (Sept. 4, 2007) ("Cascade").

2 *LePage's Inc. v. 3M Co*., 324 F.3d 141 (3d Cir. 2003) (*en banc*), *cert. denied*, 542 U.S. 953 (2004).

3 *Cascade*, slip op. at 11206.

the rule adopted does not expose inventive and legitimate forms of price competition to an over-broad liability standard."[4]

The Ninth Circuit was called upon to review a jury verdict finding that a hospital system (PeaceHealth) had engaged in attempted monopolization in violation of § 2 of the Sherman Act by offering a discount system to insurers (purchasing medical services for their clients) that provided greater discounts to insurers who used PeaceHealth exclusively for primary and secondary hospital services ("common medical services") as well as for tertiary services ("more complex" services). PeaceHealth faced competition on primary and secondary services from the plaintiff, a competing hospital system, but little or no competition on tertiary services. The defendant hospital system was willing to make tertiary services available even to those that did not agree to use it exclusively for the products on which it faced competition, but only at higher prices.

The district court, choosing to follow the Third Circuit's *LePage's* decision, instructed the jury that a seller engages in anticompetitive conduct in the bundling of products if it is a monopolist and its conduct "substantially foreclose(s) portions of the market to a competitor who does not provide an equally diverse group of services and who therefore cannot make a comparable offer."[5] So instructed, the jury found that the defendant had engaged in attempted monopolization. It awarded damages of $5.4 million, trebled to $16.2 million.

The Ninth Circuit vacated the judgment. It observed that price cutting is a practice that the law should aim to promote and that, with this in mind, courts "should not be too quick to condemn price-reducing bundled discounts as anti-competitive, lest we end up with a rule that discourages legitimate price competition."[6] The court concluded that the Third Circuit's *LePage's* standard, applied by the district court in the decision on review, was insufficiently protective of that interest because it did not include a cost-based standard. It held that the exclusionary conduct element required of § 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."[7]

It considered various approaches to such "measure." It rejected a rule that would have found liability only if the *aggregate price* of all bundled products fell below incremental costs for such products as insufficiently sensitive to the competitive harm that could be caused where some manufacturers did not produce all bundled products. It rejected as well a rule that was dependent on proof that the plaintiff was at least as efficient as the defendant and that the competitive product was priced below plaintiff's cost. This rule was too dependent on informa-

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4 Id. at 11207, n. 5

5 Id. at 11213.

6 Id. at 11208.

7 Id. at 11221.

tion not available to a manufacturer when it was deciding on pricing of its products and would be cumbersome to enforce, the court concluded.

It ultimately adopted a measure that had been among those discussed by scholars and had been proposed as the first part of a three part test recommended by the Antitrust Modernization Commission ("AMC"). The test (referred to as the "discount attribution" standard) requires that the full amount of any discounts given by the defendant seller on all the products in the bundle be allocated to the product or products as to which there was competition.[8]

Under its holding, assuming the other requisites for liability under § 2 are established, liability can be established under § 2 only if the price arrived at by attributing all discounts in the bundle to the competitive product is below the seller's average variable cost[9] for the competitive product. In other words if three products are bundled, but plaintiff competes on only one, the discounts on the other two are subtracted from the price charged for the competitive third product by the seller. If the resulting price is above the seller's average variable cost for that product, there is no § 2 liability.

The Ninth Circuit declined to adopt two additional elements of the AMC test, namely (1) a requirement that even if sales were made below the cost of the competitive product in such calculation, liability would result only if any losses suffered by the seller-defendant likely could be recouped and (2) that even if this were true, the bundling program must also have an adverse effect on competition. It rejected the first element because it noted that in some cases an equally efficient rival could be eliminated even without the defendant-seller suffering a loss on the overall bundle and, in the Court's view, liability could be appropriate in such cases. It rejected the "adverse effect" standard because it concluded that this requirement was already imposed by the general obligation for a plaintiff to show antitrust injury.[10]

The net effect of the court's analysis is to provide sellers with far greater guidance as to permissible pricing than did the Third Circuit (a consideration explicitly focused on by the Ninth Circuit), but to leave open the potential for liability even where the seller of bundled products would not have incurred any loss with respect to the sale of the overall bundle.

The Ninth Circuit also set aside the lower court's grant of summary judgment to the defendant-seller on a tying claim based on the same facts but advanced under § 1 of the Sherman Act. It left open the possibility that, on the facts of the case (including the bundling claim), purchasers had been coerced and that such purchasers viewed the various services as tied

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8 Id. at 11231.

9 The Ninth Circuit considered the appropriate "cost" to be used in this calculus and concluded, as had many circuits in other § 2 contexts, that average variable cost was the best, routinely accessible measure. Id. at 11233.

10 Id. at 11234, n. 21.

for practical purposes. Interestingly, the Court left open the question of whether the AMC tripartite standard should apply to such claims.[11]

The Ninth Circuit's thoughtful discussion of bundling contemplates that courts following its holding will create factual records that will allow the Supreme Court to assess the economic facts surrounding bundling[12] and eventually to resolve the split in the circuits that the opinion creates. In the meantime, the opinion's cost-based analysis provides greater guidance for sellers who wish to adopt bundling programs, although its tying ruling may create a new potential ambiguity. Sellers subject to the jurisdictional reach of the Third Circuit must still make their plans with the *LePage's* holding in mind.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Dean Ringel at (212) 701-3521 or dringel@cahill.com; or Elai Katz at (212) 701-3039 or ekatz@cahill.com.

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[11] Id. at 11247-48 and n. 30.

[12] Id. at 11230-31.