

BUNDLED DISCOUNTS: CONFLICT BREWING IN THE CIRCUITS

In its September 4, 2007 decision in *Cascade Health Solutions v. PeaceHealth* (“*PeaceHealth*”),¹ the United States Court of Appeals for the Ninth Circuit adopted a new standard for determining whether bundled discounts are illegal. The *PeaceHealth* standard differs sharply from the Third Circuit’s decision in *LePage’s Inc. v. 3M*.² That difference creates conflicting legal standards that firms must consider in setting pricing policies and also creates a potential opportunity for the Supreme Court to address the legality of bundled discounts.

Bundled Discounts

Bundled discounts occur when a firm sells a bundle of goods or services for a lower price than the firm charges for the goods or services if they are purchased individually.³ According to the Ninth Circuit, bundled discounts are “pervasive” and include season tickets, fast food value meals, and all-in-one home theater systems.⁴ Such discounts “generally benefit buyers because the discounts allow the buyer to get more for less.”⁵ They can also result in savings for the seller, “because it usually costs a firm less to sell multiple products to one customer at the same time than it does to sell the products individually.”⁶

Despite the possible benefits of bundled discounts, the *PeaceHealth* court noted that a firm could harm consumer welfare in the long run by using a bundled discount to exclude an equally or more efficient competitor that cannot offer the same bundle or profitably match the price created by the bundled discount.⁷ Such harm can occur even if the seller’s discount prices for the entire bundle are above the seller’s average variable cost for the bundle.⁸

The Ninth Circuit held that a bundled discount cannot satisfy the exclusionary conduct element of a claim arising under §2 of the Sherman Act unless the discount results in prices that are below an appropriate measure of the defendant’s costs.⁹ After evaluating several different cost-based standards, the court adopted the “discount attribution” standard, under which the full amount of the defendant’s discount on the bundle is allocated to the product or products in which the seller lacks market power, referred to as the “competitive products.”¹⁰ Thus, in the Ninth

¹ *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895 (9th Cir. 2007). On February 1, 2008, the Ninth Circuit decided not to review the bundled discount issue en banc, although the panel indicated that it will reconsider the state law price discrimination claim after it receives guidance from the Oregon Supreme Court on interpreting the state’s law. Whether *certiorari* is sought in *PeaceHealth* and, if so, whether the Supreme Court hears the case, remain uncertain at this time.

² *LePage’s Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc).

³ *PeaceHealth*, 502 F.3d at 905.

⁴ *Id.*

⁵ *Id.* at 906.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 906-07.

⁹ *Id.* at 913-14.

¹⁰ *Id.* at 916.

Circuit, to prove that a bundled discount is exclusionary or predatory for purposes of a monopolization or attempted monopolization claim, the plaintiff must prove that, after allocating the discount given by the defendant on the entire bundle of products to the competitive product or products, the defendant sold the competitive product or products below the defendant's average variable cost of producing them.¹¹

The Ninth Circuit rejected the standard adopted by the Third Circuit in *LePage's*, which held that bundled discounts are anticompetitive if they are offered by a monopolist and "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."¹²

Implications Of The Ninth Circuit's Decision

In the short run, the *PeaceHealth* decision adds yet another legal standard that a firm must consider in setting its pricing policies. Firms need to exercise caution when offering bundled discounts because, as *PeaceHealth* illustrates, no single standard governs the legality of such discounts. Indeed, until the Supreme Court clarifies the proper legal standard for assessing bundled discounts, firms will confront considerable uncertainty in anticipating how their bundled discounts will be assessed under the antitrust laws.

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¹¹ *Id.* at 920 (describing when a bundled discount can satisfy the exclusionary conduct element of a monopolization or attempted monopolization claim; the plaintiff must also prove the additional elements of the claim at issue).

¹² *Id.* at 908 (citing *LePage's*, 324 F.3d at 155).