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Antitrust Liability From Bundled Rebate Plans

Law360, New York (October 31, 2008) -- Five years ago, in *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc), cert. denied, 542 U.S. 953 (2004) the Third Circuit affirmed a jury award finding that 3M had committed acts of monopolization in the transparent tape market through use of a bundled rebate plan.

The lack of defined parameters of what facts could create antitrust liability made antitrust counseling on bundled rebate plans a nightmare. Five years later, several developments have provided antitrust counselors with additional, although imperfect, guidance.

LePage's

3M admitted it was a monopolist with over a 90 percent share of the transparent tape market. Plaintiff *LePage's*, however, had made some inroads on 3M's market share with its private label tape.

Arguably in response to *LePage's* success, 3M instituted a bundled rebate program in which it offered rebates conditioned on customers purchasing all of their requirements in six diverse product lines.

Customer specific target growth rates were set in each product grouping, and the number of product groupings in which the target was met led to increasingly higher rebates across all product lines.

The Third Circuit held that: The principal anti-competitive effect of bundled rebates as offered by 3M 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.

The court held that the bundled rebate plan presented a huge obstacle to *LePage's* because a customer might lose rebates amounting to "as much as half of *LePage's* entire prior tape sales to that customer" as a result of purchasing *LePage's* tape and therefore not qualify for the rebate.

Practical Counseling Problems Created By LePage's

This decision, which the Supreme Court declined to review, sent shock waves throughout both the antitrust bar and in-house counsel. It was believed that use of bundled rebate plans was widespread.

The fundamental practical problem with the LePage's opinion is that it provides little or no limit on the circumstances in which a bundled rebate plan utilized by a manufacturer with arguable market power in at least one relevant product market can constitute predatory or exclusionary conduct.

As the DOJ wrote in an amicus brief filed in connection with 3M's petition for writ of certiorari, "the court of appeals' failure to identify the specific factors that made 3M's bundled discount anticompetitive may lead to challenges to procompetitive programs and prospectively chill the adoption of such programs."

As a result, antitrust attorneys who were called on to counsel clients regarding the permissible boundaries of bundled rebate plans had very little guidance on how to provide practical, understandable, and concrete advice to their clients.

The hope following issuance of the LePage's decision, and the Supreme Court's denial of the cert petition, was that subsequent case law quickly would fill the void and provide antitrust attorneys and businesses with more specific parameters concerning when a bundled rebate plan might raise real antitrust exposure.

The DOJ suggested in connection with 3M's cert petition that "it would be preferable to allow the case law and economic analysis to develop further ..."

Development of case law, however, has been slow in coming.

In the first several years following LePage's, there was virtually no new case law, and today—five years later—only a handful of cases fully addressing bundled rebates exist.

What did not occur, however, was an explosion of cases challenging the legality of bundled rebates. Antitrust counselors' fear of rampant litigation over bundled rebate plans were not, for the most part, fulfilled. A large gray area existed concerning the antitrust risk of a bundled rebate plan offered by any seller with arguable market power.

Development Since LePage's

Over the past 18 months three major developments have provided at least some guidance on how antitrust counselors should evaluate antitrust exposure resulting from use of bundled rebate plans:

(1) in April 2007, issuance of the Antitrust Modernization Commission's ("AMC") recommended standard for bundled rebate plans;

(2) the Ninth Circuit’s decision in *Cascade Health Solutions v. Peacehealth*, 515 F.3d 883 (9th Cir. 2008); and

(3) the recently issued September 2008 DOJ report on “Single-Firm Conduct Under Section 2 of the Sherman Act.”

Each report or opinion provides a more concrete test for evaluating the legality of bundled rebate plans than provided by the Third Circuit’s opinion in *LePage’s*.

Although none of these three tests entirely are consistent with the others, and only the *Cascade* decision has precedential value, all three stress the necessity for identifying the actual market foreclosure the bundled rebate will cause before labeling it “predatory” or “exclusionary.”

Taken together, they provide antitrust attorneys with increased ability to provide more concrete guidance, at least in jurisdictions outside of the Third Circuit.

AMC Report

The first major development addressing bundled rebate plans was the April 2007 issuance of the AMC report.

The AMC report repeated the criticism of *LePage’s* that the decision “did not assess whether 3M’s bundled rebates constituted competition on the merits” but also accepted the view that “bundled discounts could be unreasonably exclusionary.”

The AMC proposed that bundled rebates could not be considered predatory or exclusionary conduct unless:

(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 (a “discount attribution” test);

(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.

This approach provides a safe harbor for instances in which the full amount of the rebate, attributed solely to the price of the product at issue, does not result in below cost sales.

This is similar to the *Brown & Williamson* predatory pricing rule that no claim exists without sales below cost, but it evaluates the price of the product at issue rather than the bundle as a whole.

If the conduct does not fall within the safe harbor, a plaintiff must still prove likelihood of recoupment, again as in predatory pricing cases, as well as prove a likely adverse effect on competition.

Actual application of this safe harbor, however, can be problematic in a counseling environment.

It appears that this test is performed on a bundled sale at a specific account, much like in a predatory pricing analysis. If so, the result of this test is very dependent upon the quantity of the product at issue sold by the defendant at that specific account.

As the quantity of purchases of the product at issue in the bundle decreases, the bundled rebate plan is more likely to flunk the safe harbor test because of the disproportionate impact of attributing the entire value of the discount to that product.

For an antitrust counselor to assess whether a proposed bundled rebate plan will pass this test, assumptions need to be made concerning the mix of products sold to a given account. These could be difficult numbers to predict.

Cascade V. PeaceHealth

Shortly after issuance of the AMC standard, the Ninth Circuit, in *Cascade*, rejected the Third Circuit's broad holding of illegality of bundled rebate plans but allowed for illegality of bundled rebate plans in certain circumstances.

Prior to *Cascade*, two district court decisions within the Ninth Circuit split on whether bundled rebate plans could constitute predatory or exclusionary conduct.

In *Masimo Corp. v. Tyco Healthcare Group*, 2006 U.S. Dist. LEXIS 29977 (C.D. Cal. Mar. 22, 2006), the trial court rejected the reasoning of *LePage's* and held "the practice of offering a discount on two or more bundled products is not anticompetitive."

Another district court, in *Applied Medical Resources Corp. v. Ethicon, Inc.*, 2006 U.S. Dist. LEXIS 12845 (C.D. Cal. Feb. 2, 2006) held, however, that under certain facts such a theory could be viable.

The Ninth Circuit resolved this dispute when it adopted the AMC's "discount attribution" standard.

In addition, the *Cascade* opinion makes clear that absent a dangerous probability of monopolization, the bundled rebate plan cannot be a Section 2 violation, even if the plan flunks the discount attribution test.

The *Cascade* opinion, however, is not clear on what flunking the discount attribution test means. It is unclear whether a bundled rebate plan that flunks this test may or must be found to constitute predatory or exclusionary conduct.

This uncertainty results from the Ninth Circuit explicitly adopting only one prong (the “discount attribution” test) of the AMC’s three-prong test for bundled rebate plans.

The AMC wrote: “The first screen is not perfect ... Thus, it is crucial to apply the second and third parts of the test.”

In fact, the Ninth Circuit explicitly rejected the recoupment prong of the test, and declines to adopt the third prong as being superfluous in light of the “pre-existing requirement of antitrust injury.”

Thus, Cascade can be read to stand for the proposition that if the attributed discount puts the defendant below its average variable cost, the conduct is predatory or exclusionary.

DOJ September 2008 Report

The DOJ’s September 2008 report on “Single-Firm Conduct Under Section 2 of the Sherman Act,” which announces the Antitrust Division’s enforcement policy, constitutes the most recent post-LePage’s development on bundled rebate plans.

The DOJ’s approach also utilizes safe harbors based upon price and cost, but additionally involves an initial determination of whether other competitors in the market are able to offer their own bundles to compete with a defendant’s bundled rebate plan.

One practical problem faced by LePage’s, Inc. was that it manufactured only one product (transparent tape) and thus had no ability to respond with a bundled plan of its own.

The DOJ determined that “where bundle-to-bundle competition is reasonably possible, the potential competitive harm of bundled discounting mirrors that of predatory pricing.”

In instances in which competitors have the ability to bundle, the DOJ would only challenge bundled plans in which the price of the bundle as a whole is below an appropriate measure of cost of the bundle.

When, however, there is “the inability of any substantial competitor or group of competitors to provide a similar range of items,” the DOJ would apply the discount attribution test.

Implicitly addressing the concern expressed above regarding Cascade, the DOJ’s report specifically states that conduct falling outside of these safe harbors should not give rise to a negative presumption about legality and that the conduct must still be analyzed for anticompetitive effects.

A Framework For Counseling On Bundled Rebate Plans Today

Unless and until the U.S. Supreme Court squarely decides a Section 2 bundled rebate case, inherent uncertainty will remain in antitrust counseling in this area.

Taken together, however, the AMC standard, Cascade and the recent DOJ report suggest that any proposed bundled plan should be subjected to a three-step analysis.

First, if a defendant does not have market power in at least one of the relevant product markets at issue, there is no real antitrust exposure resulting from bundling.

Second, a price/cost assessment should be made. If the proposed plan passes the discount attribution test, the likelihood of antitrust exposure is greatly reduced. If it does not pass the discount attribution test, a third step, analysis of anticipated actual market foreclosure, is required.

Based upon the DOJ report, this market foreclosure analysis should begin with evaluating whether competitors have the ability to bundle a similar range of products.

The more competitive bundling is possible, the lower the antitrust risk. Other factors, such as:

- (1) how widely offered the bundled rebate plan is and how long it will remain in effect;
- (2) whether purchasers' compliance with the plan prevents them from also purchasing competitors' products;
- (3) the strength of defendant's market position; and
- (4) whether the bundled rebate plan is in response to other bundled plans, i.e. whether it is offensive or defensive, should be addressed and considered.

The goal from a counseling perspective is to determine how significant of a market foreclosure effect might result from the bundled rebate plan, and if necessary, to adjust the terms of the plan to reduce the market foreclosure effect.

At a minimum, five years after LePage's, more objective factors exist that allow antitrust counselors to evaluate effectively the legality of bundled rebate plans.

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