JUNE 2008, RELEASE ONE

GCP
THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY

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"Bundling" is the practice of offering a product at a discount only when one or more other products are also purchased for the bundled price. Examples of this kind of pricing include the "menu meal" at fast-food restaurants or the "triple-play" package of phone service, broadband, and video offered by telecom providers. Businesspeople guard jealously the option to bundle, typically on the grounds that it is ubiquitous and that "consumers prefer it."

Bundling in competitive markets ordinarily raises no concern for antitrust. Under certain conditions, however, bundling may be employed by a firm with market power to protect or maintain its monopoly. In a typical scenario, a monopolist strategically sets the monopoly price jointly with one or more competitive products in a manner designed to stave-off or exclude a rival from the monopoly market, or to foreclose an adjacent market to the rival, or to impair the ability of a rival to achieve economies of scale or scope. This kind of bundling, particularly when observed with other varieties of exclusionary anticompetitive conduct in a "broth" of anticompetitive conduct, has been held to violate

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U.S. anti-monopolization law, specifically Section 2 of the Sherman Act.

A controversy in antitrust policy is raging over two principal and competing approaches to liability rules for bundling. Under the rule adopted by the U.S. Court of Appeals for the Third Circuit, the appropriate legal standard for liability for bundling is based on well-settled, general principles of monopolization law. Under the *LePage's* decision,[1] bundling may be deemed unlawful exclusionary conduct under the general rule in *Aspen Skiing*,[2] where the U.S. Supreme Court defined anticompetitive conduct as behavior that impairs the opportunities of rivals through conduct that either does not constitute competition on the merits or achieves a competitive benefit in an unnecessarily restrictive way.

The other approach to liability rules applies before the U.S. Court of Appeals for the Ninth Circuit[3] and was recommended by the Antitrust Modernization Commission (AMC).[4] This approach requires as an essential element of liability some form of below-cost pricing. Under the AMC's "cost-based" test, for example, a firm violates Section 2 if the fully discounted price of the product facing competition—attributing any discounts given on other products to the price of the product facing competition—falls below the cost of its production by a hypothetical equally efficient rival. The presumption is that a cost-based rule provides a sensible proxy for determining when an equally efficient rival should have grounds to complain. The maintained assumption is that as long as the

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

[2] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 602 (1985).

[3] Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).

[4] ANTITRUST MODERNIZATION COMMITTEE, REPORT AND RECOMMENDATIONS 99 (2007) [hereinafter AMC Report].

dominant firm sets prices above its cost, equally efficient rivals should be able to compete and antitrust intervention should not be necessary.

Various grounds have been put forward in support of a cost-based rule. Because it would presumably not intervene to protect firms less efficient than the dominant incumbent, it seems to operationalize the famous dictum that the antitrust laws are enacted for "the protection of competition not competitors."[5] On a more practical level, it also seems to satisfy the need for predictable rules to help the business community determine ex ante when rebate and discount strategies might constitute anticompetitive unilateral misconduct. Last, and perhaps not least, is that a cost-based rule would extend the decision-theoretic regime established for predatory pricing by the Supreme Court in *Brooke Group*[6] and for predatory bidding in *Weyerhaeuser*,[7] lending an appearance of continuity and consistency to the development of Supreme Court antitrust doctrine.

The Supreme Court should not extend the decision-theoretic approach to liability rules taken in predatory pricing (and bidding) cases to bundling or to other types of exclusionary conduct, even if the exclusionary strategy involves pricing, discounts, or rebates. The Third Circuit's approach to bundling under standard antitrust principles conceives of bundling not as predatory pricing, but as exclusionary conduct, or "exclusionary pricing." As a matter of antitrust policy, dealing with exclusionary pricing on its own terms is superior to trying to apply rules adopted for the rare and atypical case of predatory pricing. Certain "plus factors," which, when present with exclusionary

[5] Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962).

[6] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

[7] Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. ___ (2007).

effects, can be identified that focus attention on those cases in which competitive harm is most likely to occur.

I. A COST-BASED RULE?

A cost-based rule is neither necessary nor sufficient for an administrable bundling regime in antitrust. Bundling to maintain monopoly is not comparable to single-product pricing (or predatory pricing) for several reasons.

Bundling *involves* pricing, but that does not mean that it deserves the same type of cost-based liability rule applicable to predatory pricing, which *is* pricing. Predatory pricing poses unique challenges to a finder of fact, in part because on its face it is indistinguishable from vigorous price competition and in part because it leads unambiguously to the short-run increase in consumer welfare associated with low prices. Because it is so difficult to differentiate between vigorous price competition and unlawful predatory pricing, there is some reason to choose a legal rule that minimizes the risks of false positives and attempts to err on the side of avoiding chilling legitimate competitive conduct.

Significantly, bundling lacks the short-term consumer benefit of lower prices or higher bids and does not impart an *unambiguous* short-run benefit. Whether a particular instance of bundling does or does not create consumer surplus in a particular case would depend on the circumstances. Not so with predatory pricing, in which *every penny* of lower prices during the “pre recoupment” phase inures to the benefit of consumers. As a result, a decision-theoretic, cost-based rule may be justified for predatory pricing, where the risk of a false positive arguably overwhelms the costs of making a correct decision. Decision-theoretic liability rules, however, are not appropriate for bundling, or other exclusionary strategies.

Consider the difference in the mechanism of anticompetitive effect between bundling and predatory pricing, and its significance for the tendency of an antitrust tribunal to err. To monopolize through predatory pricing, the predator's low price must cause exit from the market and the predator must have an opportunity to recoup its investment (and earn monopoly profits). This is a long-term strategy that differs markedly from a mechanism in which bundling is used to foreclose a rival's opportunities or prevent it from access to markets or the achievement of minimum efficient scale. Evidence bearing directly on the latter is likely to be in the form of witnesses and documents that a tribunal can readily understand, so evaluating the evidence of exclusionary practices is not nearly as challenging as adjudging predatory pricing, the evidence which is likely to consist of a demonstration of low prices and a great deal of economic speculation as to why the low prices ought to be unlawful.

The functional difference between the two practices also recommends against a cost-based rule. The discount offered in connection with predatory pricing case is unconditional while the discount offered as part of an exclusionary pricing strategy is only available to customers that agree to the competition-limiting conditions. It is these conditions, wholly absent in the predatory pricing context, which are the instruments of competitive harm in the exclusionary case. Moreover, the conditions are unrelated to the level at which prices are set, so there is no good reason to believe that a cost-based test can help determine the anticompetitive effect of non-price conditions.

Beyond the limited context of predatory pricing or bidding, a cost-based test is also inappropriate because it almost never lives up to its reputation for predictability and certainty. Neither does it reliably implement a screen for conditions under which an "equally efficient" competitor can compete.

The cost-based test is extremely sensitive to several economic parameters, many of which may be unknown or unknowable. The test is affected, for example, by whether the products are consumed in fixed or variable proportions, whether cross-demand is for complements or substitutes, whether the products are valued independently or negatively or positively correlated, whether the products are undifferentiated or branded.

Even with adequate demand data, one still must account for whether the rival firm experiences constant or decreasing marginal costs, or whether it is capacity-constrained. These conditions can empower a monopolist to cripple or impair a rival through above-cost bundled pricing so that the rival is never able to achieve "equal efficiency."

And, of course, it also matters how costs are measured or allocated. Is R&D included? Other fixed costs? Variable costs? Opportunity costs? Some of these costs are associated with productive efficiency and others to dynamic efficiency (i.e., product and market innovation). In which sense should the "competitor" be "equally efficient?"

Finally, the strategic alternatives facing a monopolist will often depend on the relationship of the various markets, whether adjacent or non-adjacent, and customer sets, whether common or artificially linked through the bundling strategy. As a result of the sensitivity of a cost-based test to these and other parameters, the test is not as easily administrable as often is assumed, and the certainty often attributed to a cost-based test may be something of an illusion.

II. BUNDLING AS EXCLUSIONARY PRICING

Rather than look to predatory pricing, bundling should be analyzed within a broader class of conduct that can be characterized as "exclusionary pricing." Defined broadly, exclusionary pricing includes bundled discounts, loyalty rebates, and exclusive dealing, all strategic forms of *conditional* pricing. The offense lies in the conditions to which the price is attached and the anticompetitive effect does not require the exit of a rival firm. It is enough for a monopolist to freeze the status quo or stave off the "gale of creative destruction." This type of conduct should be assessed with liability rules more in keeping with the traditional evidentiary demands relevant to a Section 2 claim based on exclusionary conduct.

Indeed, well-settled principles of Section 2 monopolization law already provide for a decision regime that does not lead to systematic errors and remains administrable. For example, the *LePage's* decision was not "standardless," as the AMC and others have portrayed it.[8] *LePage's* demonstrated that the *Aspen* rule could provide reasonably good guidance to juries and judges charged with evaluating the lawfulness of bundling and other exclusionary pricing strategies. Certainly, the *LePage's* instruction to follow the *Aspen* rule was far more informative than the alternative proposed in *Weyerhaeuser*, in

[8] AMC Report, *supra* note 4, at 97.

which the jury was instructed that a bid price that was more than "fair," or quantities purchased that were "more than necessary," are unlawful. Justice Souter in oral argument said those instructions put the jury on a "free float." The same cannot fairly be said about the carefully crafted instructions in *LePage's*.

Exclusionary pricing often involves the strategic exploitation of some relationship between the monopolized and a related market. The traditional Section 2 doctrine of "monopoly leveraging," which the Supreme Court collapsed into attempted monopolization in *Trinko*,[9] is not what implicates two markets. Rather, the strategic relationship between the markets provides the opportunity to execute an exclusionary pricing strategy. Nonetheless, exclusionary pricing as cognizable under Section 2 is consistent with the traditions of monopolization law. The particular offense of maintaining monopoly through exclusionary pricing captures the same concern as § 3 of the Clayton Act, which outlaws discounts conditioned on agreements not to deal with rivals that cause harm to competition.

Consistent with traditional Section 2 principles, a typical exclusionary pricing case would require monopoly power and demonstrable harm to competition in the form of evidence of monopoly maintenance and exclusion of a rival from some market, customer, or opportunity by means not constituting competition on the merits. Commissioner J. Thomas Rosch at the U.S. Federal Trace Commission (FTC) has proposed looking to "plus factors" indicative of anticompetitive exclusion.[10]

[9] Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

[10] FTC Commissioner J. Thomas Rosch, Vertical Restraints & Sherman Act § 2, Speech Presented at the Conference on Current Topics in Antitrust Economics and Competition Policy, CRA International, Washington, DC (Jun. 13, 2007).

III. EXCLUSION "PLUS"

Section 2 cases are susceptible to an immediate triage depending on the immediate, short-run effect of the conduct:

- Unambiguous short-term benefit (predatory pricing or predatory bidding)
  → Use cost-based test
- Unambiguous short-term harm ("cheap exclusion"[11])
  → Liability under abbreviated rule of reason
- Ambiguous short-term effect
  → close calls, look to "plus factors"

For "close call" cases in which conduct does not fall into either the very difficult category of predatory pricing or the very easy category of cheap exclusion, identifying "plus factors" can serve to raise the likelihood that the observed exclusion is primarily the result of an anticompetitive scheme.

Potential plus factors are suggested by recent Section 2 cases. For example, a complementary or collaborative relationship can be exploited to establish or maintain monopoly, as in *Kodak*.[12] Another plus factor would be a large effect on the ability of the rival to achieve minimum efficient scale, as in *Dentsply*[13] or *LePage's*. Finally, an installed base advantage and strong network effects can contribute to the success of an anticompetitive strategy, as in *U.S. v. Microsoft*.[14]

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[11] *See* Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975, 977 (2005).

[12] Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451 (1992).

[13] United States v. Dentsply Int'l., Inc., 399 F.3d 181 (3rd Cir. 2005), cert denied 546 U.S. 1089 (2006).

[14] United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (en banc), cert. denied 534 U.S. 952 (2001).

IV. CONCLUSION

The decision-theoretic liability rules established for predatory pricing and bidding should not be extended to bundling or to other types of exclusionary conduct, even where pricing, discounting, or rebates are directly involved. As a matter of antitrust policy, developing a jurisprudence of exclusionary pricing is superior to trying to apply rules adopted for the rare and atypical case of predatory pricing. Certain “plus factors” can suggest when observed exclusionary effects are most likely to result in competitive harm of the type the antitrust laws were meant to protect.