

Checking in on *PeaceHealth*: Providing Some Clearer Guidance to Bundling Sellers

David Reichenberg and Lauren J. Stiroh

In 2007, the Antitrust Modernization Commission (AMC) published broad recommendations for changes and clarifications to antitrust enforcement in the United States. Since then, multiple courts have discussed the portion of the AMC Report relating to Section 2 of the Sherman Act recommending use of what has become known as the discount attribution test when evaluating the competitive effects of bundled discounts.¹ In 2008, the Ninth Circuit adopted most of the AMC's recommendation in *Cascade Health v. PeaceHealth*,² finding the discount attribution test superior to the standard previously applied by the Third Circuit in *LePage's v. 3M*.³ The Ninth Circuit did not follow the AMC's recommendation to require that the plaintiff additionally prove that a defendant would likely recoup losses sustained.

Whether *PeaceHealth* provides the best guidance for sellers offering bundled discounts remains to be seen. In the decade plus since *PeaceHealth*, only a handful of plaintiffs have attempted to satisfy the *PeaceHealth* test. While numerous cases and discussions generally touch on loyalty discounts and other allegedly exclusionary practices, very few judicial decisions bear upon and provide guidance to firms on the subject of bundled discounts. Beyond that, courts may want to take a closer look at *PeaceHealth*'s own pros and cons.

The *PeaceHealth* test removes some of the flaws of prior tests for price predation, which, for instance, asked the jury to consider whether the plaintiff has been excluded from the market but without requiring the jury to consider whether the plaintiff was at least as efficient of a producer as the defendant.⁴ The prior tests could lead to over-correcting, and eliminate some procompetitive discounts. However, *PeaceHealth*'s failure to address future competitive effects of pricing conduct leaves markets vulnerable to under-correcting and allowing pricing strategies that offer consumers short-term benefits but risk competitive foreclosure over the long run.

Courts should consider such long-run effects on competition and affirm that the discount attribution test applies regardless of the specific circumstances of an individual plaintiff. A core strength of the discount attribution test is the ability it affords sellers to assess their bundling practices under an ex ante standard, using the hypothetically equally efficient plaintiff, while leaving courts with the ability to identify bundles that fail discount attribution; it thereby prevents "more antitrust litigation than is reasonably necessary to ferret out anticompetitive practices."⁵ Courts

■ **David Reichenberg** is an Antitrust and Litigation Partner at Cozen O'Connor, and thanks Dean Harris Porter for his valuable assistance with this article. **Lauren Stiroh** is Managing Director and Chair of the Antitrust and Competition Practice at NERA Economic Consulting.

¹ The AMC report has also been referenced by courts with respect to price-fixing overcharges, the Robinson-Patman Act, and the Class Action Fairness Act.

² *Cascade Health Sol. v. PeaceHealth*, 515 F.3d 883, 899 (9th Cir. 2008).

³ *LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003).

⁴ We refer here to the tests for predation described in *LePage's, id.*, and *Ortho Diagnostic Systems Inc. v. Abbott Labs, Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996), discussed further below.

⁵ *PeaceHealth*, 515 F.3d at 905–06.

may also consider whether unique circumstances are driving the potential for false positives or false negatives under the test.

Criticisms of *LePage's* and the Substantial Adoption of the AMC Recommendation in *PeaceHealth*

Bundled discounts are pricing incentives that are offered only if the consumer buys a range of products (the bundle) from the same producer. For example, a seller of both shampoo and conditioner that offers a 10 percent discount on the price of both shampoo and conditioner if the consumer buys both products together is offering a bundled discount. An antitrust concern potentially arises if the pricing incentive forecloses a manufacturer of only a subset of the bundled products from competing successfully. A manufacturer of only shampoo, for example, may have to offer a discount of up to 20 percent on its product in order to entice customers to choose to buy the products separately and forgo the bundled discount offered by the seller of both products. If the discount necessary to entice consumers to buy the products separately (and forgo the bundled discount) is below the variable cost of the shampoo-only manufacturer, the shampoo-only manufacturer will not be able to sell its product profitably.

Whether PeaceHealth

provides the best

guidance for sellers

offering bundled

discounts remains

to be seen.

In *LePage's v. 3M*, the Third Circuit Court of Appeals adopted a standard for assessing the legality of bundled discounts under the Sherman Act that was based on the ability of a firm's bundled discount to exclude a rival from competition—also referred to as the foreclosure standard.⁶ This approach considered “whether the bundle is structurally capable of excluding some hypothetical rival who produces only a subset of the goods in the bundle.”⁷

LePage's alleged that 3M's conduct—offering discounts on bundles that included products not offered by LePage's (specifically brand-name tape) as well as a common product offered by both parties (private-label tape)—constituted monopolization under Section 2 of the Sherman Act.⁸ LePage's alleged that 3M attempted to monopolize the competitive market for private-label tape by leveraging its market power as the sole producer in the brand-name tape market. The Third Circuit, while acknowledging that 3M did not price below its own average variable cost, ruled that 3M's bundled rebates “impeded LePage's ability to compete” and “harmed competition itself.”⁹ Despite accepting that LePage's was a less efficient competitor, the court ruled that 3M was still liable for antitrust injury because its bundled discounts extended and maintained market power by foreclosing LePage's from the private label transparent tape market.¹⁰

The foreclosure standard applied by the court in *LePage's* did not use a cost-based test to determine whether 3M's bundled discounts were anticompetitive, but instead broadly considered the effects of the discounts on LePage's long-term sustainability.¹¹ This deviated from the two cri-

⁶ *LePage's*, 324 F.3d at 155 (“The principal anticompetitive 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.”). See also Nicholas Economides & Ioannis Lianos, *The Elusive Antitrust Standard on Bundling in Europe and in the United States in the Aftermath of the Microsoft Cases*, 76 ANTITRUST L.J. 483, 494 (2009).

⁷ Herbert Hovenkamp & Erik Hovenkamp, *Complex Bundled Discounts and Antitrust Policy*, 57 BUFFALO L. REV. 1227, 1233 (2009).

⁸ *LePage's*, 324 F.3d at 145.

⁹ *Id.* at 162.

¹⁰ *Id.* at 177 (Greenberg, J., dissenting) (“LePage's economist conceded that LePage's is not as efficient a tape producer as 3M. Thus, in this case section 2 of the Sherman Act is being used to protect an inefficient producer from a competitor not using predatory pricing but rather selling above cost.”); see also Economides & Lianos, *supra* note 6, at 491.

¹¹ *LePage's*, 324 F.3d at 163.

teria for single-product predatory pricing established in *Brooke Group v. Brown & Williamson*, that (1) “a plaintiff seeking to establish competitive injury resulting from a rival’s low prices must prove that the prices complained of are below an appropriate measure of its rival’s cost” and (2) “a demonstration that the competitor had a reasonable prospect, or under § 2 of the Sherman Act, a dangerous probability of recouping its investment in below-cost prices.”¹² The first criterion tested whether the discount-offering firm was losing money on sales of the good in question, while the second criterion, the recoupment policy, assessed whether the firm’s below-cost prices could ultimately be profitable if a rival could be excluded from the market.

In its 2007 report, the AMC asserted that the majority in *LePage’s* did not properly assess the competitive effects of 3M’s bundled discounts, stating, “[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.”¹³ In other words, the mere finding that 3M weakened its rival was insufficient for establishing liability under the Sherman Act.¹⁴ The AMC pointed out that the foreclosure standard embraced by *LePage’s* did not require proof that the plaintiff was at least as efficient as the defendant and could therefore protect a less efficient competitor at the expense of proconsumer discounts.¹⁵

Moreover, the AMC noted that the foreclosure standard lacked coherent guidelines needed for firms to gauge ex ante whether they would face anticompetitive liability for their discounts,¹⁶ noting that *LePage’s* “offers no clear standards by which firms can assess whether their bundled rebates are likely to pass antitrust muster.”¹⁷ In addition, firms that hold market power in at least one product of a bundle are vulnerable to treble damage penalties, even if their strategies reflect valid price competition.¹⁸ Firms’ inability to gauge the anticompetitive impact of a bundled discount under the foreclosure standard, in tandem with their exposure to trebled antitrust damages, could discourage sellers from even offering such discounts, thereby reducing potential gains for consumer welfare.

Ex ante assessment of anticompetitive liability under the foreclosure standard is further complicated by the difficulties of acquiring detailed information on competitors’ cost of sales. A diligent antitrust analysis under the foreclosure standard would entail individual analysis of potential competitors using sensitive, rival-specific cost information to determine the risk of foreclosure.¹⁹ Firms in competitive markets generally do not have access to their rivals’ cost and sales infor-

¹² *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222, 224 (1993). Although economic theory dictates that marginal cost is the appropriate definition of incremental cost, in practice marginal cost is difficult to observe. Average variable cost is often used as a proxy for marginal cost, but how to measure it—and whether traditional accounting methods properly quantify it—is an open debate. The limitations of data, and the lack of a definitive standard in assessing firms’ cost structures, demonstrate that economic analysis can be most effective when applied on a case-by-case basis. See Russell Pittman, U.S. Dep’t Of Justice, *Who Are You Calling Irrational? Marginal Costs, Variable Costs, and the Pricing Practices of Firms* (Discussion Paper EAG 09-3, July 2009), <https://www.justice.gov/sites/default/files/atr/legacy/2009/07/27/248394.pdf>.

¹³ ANTITRUST MODERNIZATION COMM’N, REPORT AND RECOMMENDATIONS 97 (2007) (Recommendation 16) [hereinafter AMC REPORT], https://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

¹⁴ *Id.*

¹⁵ *Id.* at 12, 94, 97; see also *PeaceHealth*, 515 F.3d at 899.

¹⁶ AMC REPORT, *supra* note 13, at 94.

¹⁷ *Id.*

¹⁸ Gary P. Zanfagna, *LePage’s v. 3M: A Reality Check*, ANTITRUST SOURCE, Nov. 2004, at 4, https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Nov04_FullSource1129.pdf.

¹⁹ *PeaceHealth*, 515 F.3d at 907.

mation. Absent such intelligence, firms are unable to conduct a thorough appraisal of anticompetitive liability and, as a result, those with substantial market share or which have achieved significant brand-name recognition risk exposure to antitrust litigation if they adopt bundled discounts.

In deciding *PeaceHealth*, the Ninth Circuit echoed many of the AMC's criticisms. It declined to endorse the Third Circuit's definition of exclusionary conduct and instead proposed an alternative standard known as the discount attribution test or *PeaceHealth* test, which the court noted had been endorsed by Areeda and Hovenkamp and adopted by other lower courts.²⁰ According to the test, a firm's bundled discount is anticompetitive if the price of a competitive product in the bundle, after applying its entire discount to that product, is below the firm's average variable cost of the product.²¹ This standard requires a bundler to use its own price and cost information to measure potential injury to a hypothetical equally efficient rival.²²

The discount

attribution test used

by PeaceHealth

recognizes that only

the exclusion of equally

efficient rivals risks

anticompetitive harm

to consumers.

The question of antitrust harm under the discount attribution standard rests on the defendant firm's conduct, and not on the bundle's effects on any particular rival. Bundlers are granted a definitive guideline: if a firm can profitably apply an entire discount to a single competitive product, given its own cost structure, then it can assume the discount is in a safe harbor. Such a test closely matches the standard set by the Supreme Court in *Brooke Group* for single-product predatory pricing, an approach the AMC sought to reflect.²³ However, where the *Brooke Group* test as applied to bundles would ask only whether the price of the bundle was above the cost of producing it, the *PeaceHealth* test asks whether such a discount could nonetheless drive a hypothetically competitive but less diversified firm from the market.

In adopting the discount attribution test, the Ninth Circuit limited the broad foundation set by the Third Circuit in *LePage's* for claims of injury by less efficient competitors, based on a concern that *LePage's* premise impedes procompetitive price competition. The discount attribution test used by *PeaceHealth* recognizes that only the exclusion of equally efficient rivals risks anticompetitive harm to consumers. A rival that makes a single product contained in the bundle may produce at an equal or lower cost than the bundler but cannot continue to compete because of its inability to amortize the discount over other products in the bundle.

PeaceHealth's standard differs from the cost assessment utilized when applying the *Brooke Group* predatory pricing standard. The *Brooke Group* standard would allow a bundler to avoid liability if the total discounted price of the bundle exceeds the cost of producing the entire bundle—despite the exclusion of an equally efficient rival. The Ninth Circuit's test, by directing bundlers to consider ex ante the potential of a bundle to exclude equally efficient but less diversified rivals of competitive products within a given bundle, should prevent anticompetitive effects.²⁴

The discount attribution test empowers firms to assess the anticompetitive liability of bundled discounts prior to the litigation process. This is in contrast to the Third Circuit's foreclosure standard, which inhibits firms from assessing their liability because they may not reasonably be able to measure competitors' costs and, therefore, competitors' potential to sustainably match a bundled discount. The use of a "hypothetical" competitor in the discount attribution test instead of an

²⁰ *Id.* at 906–07 (citing 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749b2 at 335–36 (Supp. 2006)).

²¹ *Id.* at 910.

²² *Id.* at 905.

²³ *Brooke Group*, 509 U.S. at 222–23; AMC REPORT, *supra* note 13, at 100.

²⁴ See *PeaceHealth*, 515 F.3d at 909.

actual rival gives firms a potential guide by which to appraise antitrust exposure as part of its ordinary course business strategy.

Subsequent Application of *PeaceHealth* by Courts

Despite the attention that *PeaceHealth* received when issued, there has been limited discussion of the discount attribution test in the case law. In 2016, the Ninth Circuit in *Aerotec* determined whether *PeaceHealth* applies when the plaintiff can and does offer a bundle comparable to the defendant's bundle. The answer was no. The Ninth Circuit found (in a three-judge panel different from the *PeaceHealth* panel) that "invok[ing] the discount attribution framework [under these facts] yields an absurd result, and one that risks applying our bundled discount jurisprudence to conduct far afield from conduct resembling the behavior that the Supreme Court in *Brooke Group* identified as predatory."²⁵ Still, before coming to that conclusion, the Ninth Circuit again emphasized that the test is concerned with the "force out [of] a 'hypothetical equally efficient producer of the competitive product.'"²⁶ Thus, the opinion did not set out whether such a hypothetical equally efficient producer would be foreclosed. However, one could infer that the test is one that a defendant could apply before litigation, but it may be the case, as in *Aerotec*, that the eventual plaintiff cannot have suffered antitrust injury because of its own offerings. Similarly, according to the Tenth Circuit's 2017 decision in *Suture Express*, if the potential defendant can demonstrate that it is not a monopolist, the discount attribution test also does not apply, as a plaintiff cannot "show coercion by a nonmonopolist."²⁷

Other courts adopting the discount attribution test have highlighted that the test is designed so that a potential defendant may apply it to assess its offerings without knowing which potential plaintiff would challenge the practice in court. In *Collins Inkjet*, the Sixth Circuit affirmed the use of the test, finding:

In setting prices, it is important for companies to have clear guidelines. Every company knows its own cost of production, but the cost of production of its competitors may be less clear. Further, because competitors often do not sell exactly the same product, using the plaintiff's costs may ignore differences in the competitors' products' value to consumers that might affect the analysis."²⁸

The Sixth Circuit affirmed the lower court's application of the test in granting a preliminary injunction, even without full discovery of the defendant as part of preliminary injunction proceedings. Similarly, in a Report and Recommendation made by a panel of appointed Special Masters to the U.S. District Court for the Eastern District of Michigan in *Valassis*, the panel stated that where "the defending firm retains a product that customers 'must have' from the defendant, then the bundles cannot be equally effective or competitive, and the concerns articulated in *PeaceHealth* should apply in full force such that the attribution test will still apply."²⁹

In sum, these cases suggest that in certain situations a plaintiff's circumstances do matter in applying the test. However, courts recognize the benefits of a standard that is clear and has value to companies considering particular bundles of products.

²⁵ *Aerotec Int'l, Inc. v. Honeywell Int'l, Inc.*, 836 F.3d 1171, 1187 (9th Cir. 2016).

²⁶ *Id.* at 1187 (quoting *PeaceHealth*, 515 F.3d at 906).

²⁷ *Suture Express, Inc. v. Owens & Minor Distrib., Inc.*, 851 F.3d 1029, 1043 (10th Cir. 2017).

²⁸ *Collins Inkjet Corp. v. Eastman Kodak Co.*, 781 F.3d 264, 275 (6th Cir. 2015) (citations omitted).

²⁹ *Valassis Commc'ns, Inc. v. News Am., Inc.*, No. 2:06-cv-10240. 2011 WL 2420048 (E.D. Mich. Jan. 24, 2011) (adopted by district court on June 15, 2011).

Undesirable Outcomes to Avoid

Critics of the discount attribution test have pointed out that it may, in certain cases, fail to identify instances of predatory pricing (i.e., result in false negatives) or incorrectly identify bundled discounts as predatory (i.e., result in false positives). Various commentators have recognized the possibility for anticompetitive conduct that falls within the safe harbor zone, and for procompetitive discounts that appear problematic at first glance. *PeaceHealth*, despite addressing critical shortcomings of the *LePage's* standard, still exposes limitations of cost-based standards in bundled discount antitrust litigation.

The PeaceHealth standard risks false negatives, which underestimate harm to competition, by overlooking potential future anticompetitive ramifications of above-cost pricing.

The *PeaceHealth* standard risks false negatives, which underestimate harm to competition, by overlooking potential future anticompetitive ramifications of above-cost pricing. The *PeaceHealth* test looks only at current market conditions but does not take into account whether a pricing strategy that passes the test may nonetheless cause an apparently less efficient competitor to exit the market and subsequently allow the incumbent to raise prices. The court's opinion in *Ortho* provides an example of a scenario in which one firm produces both shampoo and conditioner and competes with a firm that produces only shampoo.³⁰ The multiproduct firm may establish a discount on a bundle of shampoo and conditioner that passes *PeaceHealth's* above-cost pricing requirement for an equally efficient rival, but makes it economically irrational for a consumer of both products to break the bundle and purchase the products separately if the rival cannot match the discount on the single product it sells.³¹ From a consumer welfare standpoint, while the discount is beneficial, the *PeaceHealth* test does not take into consideration either what will likely happen if the rival is driven from the market or what the potential is for the rival to become more efficient over time (i.e., the potential for the rival's cost conditions to change in the future).

Ignoring non-price variables, it would be irrational for shampoo-and-conditioner buyers to select the competitor's shampoo when the bundler's shampoo is cheaper. But buyers can access the discount only by selecting both products from the bundling firm, stipulating conditioner as a prerequisite to buying shampoo. The *PeaceHealth* bright line overlooks the de facto tying that results from the erosion of competition on shampoo and may allow the remaining firm to control future prices of both shampoo and conditioner.

An example of a false negative under the discount attribution test could arise when a firm achieves economies of scale.³² The firm may take advantage of its costs efficiencies by producing large quantities of its goods to decrease marginal costs and/or average variable costs—to the extent that it can implement significant bundled discounts while remaining above-cost and passing the discount attribution test. A smaller rival may appear less efficient due to its size and not due to inferior business acumen. Economies of scale accord the larger firm a structural advantage: potential new rivals may not be able to scale production sufficiently to compete with the dominant firm on price.³³ In practice, the leeway that the test affords the dominant firm in its dis-

³⁰ *Ortho Diagnostic Sys. Inc. v. Abbott Labs, Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

³¹ *Id.* at 467–68.

³² Economies of scale exist when a firm's output and average costs have an inverse relationship, so that as output rises, average cost decreases, and the firm's returns increase. This can occur when fixed costs of production do not change as output varies, or when increased output allows labor to be used more efficiently, among other reasons. See DENNIS W. CARLTON & JEFFREY A. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 35–36 (4th ed. 2005).

³³ To be clear, we are not suggesting an approach that artificially props up a rival that cannot achieve economies of scale. Rather, the approach should take account of the potential expected growth trajectory of the smaller, less diversified firm, as well as the likely effects of a multi-product bundle on long term pricing.

count strategy may be employed to deter market entry—a potentially exclusionary strategy that the *PeaceHealth* standard would be unable to detect.

It should be noted that the debate over the risk of false negatives under *PeaceHealth* is ongoing. A recent study suggests that industries prone to false negative results “are more common than the court in [*PeaceHealth*] could have imagined.”³⁴ However, the Department of Justice has also concluded, albeit in a withdrawn report, that “the risk of false negatives posed by employing [this test] is insufficient to warrant further consideration of conduct that comes within the safe harbor, given the administrative costs of proceeding, the risk of erroneous condemnations of conduct, and, perhaps most importantly, the potential chilling effect on legitimate price discounting.”³⁵

PeaceHealth’s omission of tests for both false positives and false negatives necessitates a deeper dive into the details that truly inform foreclosure, exclusion, and predation from an economic perspective.

The DOJ’s perspective underscores the balance between identifying false negatives and false positives—and that demonstrable harm to competition can exist if one side of the scale carries too much weight. False positives under the discount attribution test may arise when a firm attains economies of scope.³⁶ For example, a firm producing multiple goods can incur joint costs across its products and enjoy an average cost saving from producing multiple goods concurrently. Economies of scope can occur when a firm operates multiple production lines and can more easily shift resources from a declining product to a growing product as market conditions evolve. Firms with fewer production lines may be less agile in responding to changing market conditions and face higher costs of expansion or contraction within particular product lines.³⁷ A sufficient reduction in overall costs would allow the firm to profitably offer a discount that it could not have implemented by producing a subset of goods.

From a consumer standpoint, the cost efficiencies from economies of scope enhance welfare and the discount is desirable.³⁸ Yet, the discount could fail under *PeaceHealth* because the cost of producing a single good does not reflect joint cost savings.³⁹ *PeaceHealth*’s omission of tests for both false positives and false negatives necessitates a deeper dive into the details that truly inform foreclosure, exclusion, and predation from an economic perspective.

Economic analysis can help courts gauge the expected future consequences of a bundling firm’s conduct. The *PeaceHealth* standard, in rejecting future recovery of lost profits as a requirement for liability, misses an opportunity to properly appraise long-term competitive impact.

In rejecting the role of recoupment, the *PeaceHealth* opinion does not clearly consider the long-term ramifications of bundles that successfully exclude rivals. The court assumes that profitability analysis can only be relevant if a firm is willing to endure adverse short-term losses to capture

³⁴ Bradley Pollina, *False Negatives Under a Discount Attribution Test for Bundled Discounts*, 22 COMMLAW CONSPPECTUS 74, 79 (2014), <https://scholarship.law.edu/cgi/viewcontent.cgi?article=1508&context=commlaw>.

³⁵ U.S. Dep’t of Justice, Antitrust Div., *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act 102* (2008), <https://www.justice.gov/sites/default/files/atr/legacy/2009/05/11/236681.pdf>. This report was subsequently withdrawn by the Department of Justice, Antitrust Division, with AAG Christine Varney finding that the report “raised too many hurdles to government antitrust enforcement and favored extreme caution and the development of safe harbors for certain conduct within reach of Section 2.” See Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), <https://www.justice.gov/opa/pr/justice-department-withdraws-report-antitrust-monopoly-law>.

³⁶ Economies of scope occur when it is cheaper to produce two products together than it is to produce them separately because the products require a common input that the producer can obtain at a lower price by sourcing a higher volume. See OECD, GLOSSARY OF INDUSTRIAL ORGANIZATION ECONOMICS AND COMPETITION LAW 40–41, <http://www.oecd.org/regreform/sectors/2376087.pdf>.

³⁷ Other examples of economies of scope include firms that are able to use a by-product from one production line as an input to another production line, or which are able to leverage resources such as market intelligence, strategy, or branding across multiple product lines.

³⁸ CARLTON & PERLOFF, *supra* note 32, at 19–20.

³⁹ See Eric Hovenkamp & Herbert Hovenkamp, *Exclusionary Bundled Discounts and the Antitrust Modernization Commission*, 53 ANTITRUST BULL. 517, 527 (2008).

profits from future exclusion.⁴⁰ However, bundlers stand to benefit from the effects of less competitive markets even if their discounts are not predatory, and the freedom to reap additional profits from the absence of competitors can factor into strategic decision making. The viability of a bundled discount may be dependent on the residual profits that can be accessed when a firm eventually monopolizes a competitive market—regardless of whether the discount in the short-term is profit-maximizing or even above cost. While a simple cost standard for liability accounts for the potential for only immediate foreclosure, assessing potential long-range profit recovery would allow courts to evaluate a key objective of an effective, sustainable legal standard: whether a firm is capable of reaping the benefits of its exclusionary conduct.

PeaceHealth's impact is less clear on the topic of innovation. In addition to reducing price, spurring innovation, according to one school of thought, is a central tenet of protecting market competition for the benefit of consumer welfare.⁴¹ According to this theory, barriers to competitor entry limit a dominant firm's need to improve quality, develop differentiated goods, or invent new products altogether.⁴² The relationship between competitive impact and competitor entry under this standard is mixed. For example, some bundled discounts erect barriers by exploiting economies of scale that entrants cannot access in the short term but may incorrectly be granted safe harbor under the discount attribution test. In such cases, effects on incentive to innovate can be subjectively balanced with price competition to measure overall harm to competition. The impact of bundled discounts upon innovation constitutes an open question, but an important one to consider as a matter of competition policy in antitrust law.

Courts may also wish to entertain an argument that, under the facts of a given case, an application of the *PeaceHealth* test results in one of the false negative or false positive scenarios discussed above. Entertaining the possibility of false negatives or false positives lessens the useful, ex ante predictability of the test and complicates its usefulness to the court as well. In the circumstances, the party claiming the test generated a false positive (or negative) should have the burden of proving so. For instance, if a defendant fails the test under the court's application but puts forth evidence that substantiates that consumers would not have tried a new product but for the bundle, then that should be considered as a procompetitive justification. Conversely, if a defendant passes the test but there is evidence in the record that consumers were induced to accept the bundle because of a "must have" product offered by the defendant, then this may be cause for concern.

Recommendations

The above limitations underscore that while *PeaceHealth* is a superior test for the legality of bundled pricing, there remains a need for further improvement in price/cost tests used for determining the competitive impact of bundled discounts.

⁴⁰ The court in *PeaceHealth* considered the possibility that a recoupment test may not be necessary if a firm offering a bundled discount does not suffer actual losses because the price of the bundle is above the discounting firm's incremental cost of producing and selling the bundle. See *PeaceHealth*, 515 F.3d at 910 n.21 ("[I]n such a case we do not think it is analytically helpful to think in terms of recoupment of a loss that did not occur.").

⁴¹ There are at least two competing theories on the effects of barriers to entry on innovation. One theory, described above, is that barriers to entry reduce competition and firms' incentive to innovate. See Pollina, *supra* note 34, at 98. A competing theory holds that barriers to entry facilitate innovation as they allow firms to build up profits that can be spent as R&D expenditures. See CARLTON & PERLOFF, *supra* note 32, at 536.

⁴² Pollina, *supra* note 34, at 98.

The impact of bundled discounts upon innovation constitutes an open question, but an important one to consider as a matter of competition policy in antitrust law.

As a start, we recommend that courts affirm that the discount attribution test as set out by *PeaceHealth* applies to multiproduct bundles regardless of the specific circumstances of an individual plaintiff. Even if application of the test produces an “absurd result,” as the *Aerotec* court found when the plaintiff offered a comparable bundle to the defendant, it is helpful for the business community to know if a hypothetically equally efficient plaintiff may have suffered an antitrust injury. A core strength of the discount attribution test is the ability it affords a prospective defendant to assess its bundling practices under an ex ante standard, and courts still have the ability to identify bundles that fail discount attribution to prevent “more antitrust litigation than is reasonably necessary to ferret out anticompetitive practices.”⁴³ One should determine if there are one or more scenarios in which a given bundle fails the test, depending upon which product the penalty/discount is applied (the terminology depending on whether the plaintiff or defendant is describing it, with plaintiff claiming it suffers an a la carte penalty and defendant claiming a bundled discount). The outcome may also depend upon how narrowly the product or service market is drawn, and if a given bundle fails the test, then a court can move onto the specific circumstances of the plaintiff to determine if antitrust injury has been sustained.

The discount attribution test should not be applied mechanically. There is a balance to be struck between the ex ante predictability of the test and an application of the law to the facts of a given case that is done in every antitrust case, taking care to avoid both false negatives and false positives. Courts and parties should be aware of this balance and strive to reach results that achieve both goals. A consideration of the likely long-term competitive effects of the pricing practices at issue will allow a better balancing of short-term efficiency against future competitive harms. ●

⁴³ *PeaceHealth*, 515 F.3d at 905–06.