

## LePage's v. 3M:

# Will the Third Circuit Make *Brooke Group* Stick in Assessing the Legality of a Monopolist's Bundled Discount Programs?

David L. Meyer and Raymond A. Atkins

The last year has been a very busy one for important monopolization cases. Prominent decisions such as the D.C. Circuit's *en banc* *Microsoft* opinion, and the lengthy district court *MasterCard/Visa* opinion, have explored the often challenging task of distinguishing the “willful acquisition or maintenance” of monopoly power, which is unlawful, from “competition on the merits,” which the antitrust laws encourage even when engaged in by a monopolist. The *en banc* Third Circuit will soon contribute its views in another important monopolization case that bears watching.

In its *en banc* review of *LePage's Inc. v. 3M*,<sup>1</sup> (*LePage's*), the Third Circuit will address when a monopolist is liable for the willful maintenance of monopoly power by offering retailers low prices on multiple product lines. The case grapples with how the antitrust laws should treat so-called “bundled discounts”—discount programs that link the level of discounts available on one product to purchases of separate but related products.

In *LePage's*, a panel of the Third Circuit considered several 3M discount programs that linked the level of rebates available to retailers for 3M's “Scotch-brand” transparent tape—products as to which 3M was alleged to have monopoly power—to their purchases of other 3M office products, including private-label tape products with which *LePage's* competed. Following a published opinion, which included an insistent call for *en banc* review by a dissenting judge, the Third Circuit decided to reconsider the viability of *LePage's*' claims *en banc*.

Because the crux of *LePage's*' antitrust claims challenged 3M's bundled discounts, the case would involve an inherently “sticky” issue even if it did not concern the market for transparent tape: will complex discount programs be treated the same as straightforward price reductions under the antitrust laws? On the one hand, discounts are unquestionably good for consumers, at least in the short run. The Supreme Court has instructed that a monopolist's low prices, even if aimed at maintaining a firm's monopoly share of the market, cannot be a predicate for Section 2 liability unless (1) “prices are below an appropriate measure of . . . cost,” and (2) the monopolist could raise prices in the future without fear of competitive challenge so as to recoup the losses incurred in its predatory pricing campaign. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1993).

On the other hand, low prices can make life difficult for a monopolist's would-be competitors, and those difficulties can be magnified if the monopolist provides incentives to purchase a bundle of products. The monetary value of the monopolist's slate of discounts may be difficult or impossible for a competitor to match if it produces only one part of the bundle. For this reason, some

■ **David L. Meyer** is a Partner in Covington & Burling, Washington, D.C. **Raymond A. Atkins** is an associate in Covington's antitrust group. Covington represents 3M on matters unrelated to the *LePage's* case.

<sup>1</sup> The now-vacated panel decision was reported at 277 F.3d 365 (3d Cir. 2002).

courts have refused to extend the traditional rule applicable in single-product predatory pricing cases to discount programs involving bundles of multiple products, even if each of the products is sold at a price above its cost. The leading case has been another Third Circuit decision decided long before Brooke Group—*SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056, 1065 (3d Cir. 1978). *SmithKline* affirmed a finding of Section 2 liability where the defendant maintained its monopoly power through an above-cost bundled rebate program. A handful of lower courts, including the district court in *LePage's*, have similarly concluded that above-cost bundled discounts can violate Section 2. See *Ortho Diagnostic Systems, Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 467–69 (S.D.N.Y. 1996); *LePage's Inc. v. 3M*, 1999-1 Trade Cas. (CCH) ¶ 72,538 (E.D. Pa. 1999) (denying summary judgment).<sup>2</sup>

Against this backdrop, the Third Circuit in *LePage's* was asked to review a jury's conclusion that 3M's bundled discount programs and related efforts to persuade retailers to purchase 3M's private-label tape unlawfully maintained 3M's monopoly power in the market for transparent tape. The case has become a battle between two warring visions of how the antitrust laws should treat bundled discount programs. The degree of tolerance the law affords to discounting by firms with significant market power—and indeed the way the law approaches Section 2 issues generally—may be greatly affected by the vision the Third Circuit adopts.

*The case has become  
a battle between two  
warring visions of  
how the antitrust laws  
should treat bundled  
discount programs.*

### **The *LePage's* Case**

By the 1990s, 3M had achieved spectacular success in the market for transparent tape. Its “Scotch” brand of tape products was familiar to all American consumers and accounted for over 90 percent of all transparent tape sales in the United States. Consumers did have options, however. Many large retailers—like Wal-Mart, Kmart, Staples, CVS, and others—sold “private-label” tape in addition to 3M's Scotch-brand products. This private-label niche attracted *LePage's*, an established office products company founded in 1876. *LePage's* also was quite successful. By 1992, it accounted for 88 percent of private-label tape sales in the United States, and those sales were eating into 3M's sales of branded tape.

3M responded. In the early 1990s it too entered the private-label business. And in 1993 it launched various marketing programs aimed at encouraging retailers to acquire all of their transparent tape—both branded and private-label—from 3M.

**Bundled Rebates.** 3M offered retailers a variety of rebate programs that provided strong incentives to acquire private label tape from 3M instead of *LePage's*. Although the details varied, the essence of those programs was to link the level of rebates on 3M branded tape—which “customers had to buy from 3M” (277 F.3d at 376)—to the retailer's purchases of 3M private-label tape and other 3M office products. Under one of 3M's programs, retailers became eligible for rebates only if they increased their *total* purchases of six separate 3M product lines by a target percentage. The magnitude of their rebate (ranging between 0.5 percent and 2 percent) would depend on the number of product lines for which the customer increased its purchases and the magnitude of the overall increase. *LePage's* contended that retailers were highly motivated to reduce their acquisition costs for the Scotch-brand tape they had to buy from 3M, and doing so under 3M's programs required that they purchase private-label tape from 3M instead of *LePage's*.

<sup>2</sup> See also Willard K. Tom, David A. Balto & Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615, 637–38 (2000).

**Other Conduct.** LePage's also argued that 3M entered the private-label segment "only to 'kill it'" (277 F.3d at 405 (dissent)), and that 3M's exclusive relationships with retailers foreclosed competition for private-label sales. For the most part, however, these arguments were merely a re-packaged version of LePage's' bundled rebate claims, since the alleged "exclusion" stemmed from decisions by certain retailers to drop LePage's' private-label tape products to maximize their 3M rebates. Two sets of alleged conduct went somewhat further: 3M entered one-year contracts with two retailers that conditioned discounts on 3M's being the exclusive supplier of private-label tape, and 3M offered a discount to the Office Buying Group in exchange for exclusive promotion of 3M products in their catalog.

**Procedural Posture.** LePage's challenged 3M's course of conduct by asserting three separate antitrust claims:

- (1) 3M's bundled rebates and other conduct illegally maintained 3M's monopoly power in the U.S. transparent tape market, in violation of Section 2 of the Sherman Act;
- (2) The same conduct constituted an illegal "attempted maintenance of monopoly power," also in violation of Section 2; and
- (3) 3M's arrangements with retailers constituted unlawful exclusive dealing, in violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act.

The district court permitted all of these claims to go to the jury, which found for LePage's on the Section 2 claims but rejected LePage's' remaining claims. LePage's was awarded over \$68 million in treble damages.

3M's post-trial motions challenged the legal sufficiency of the Section 2 verdict. The district court granted judgment as a matter of law as to LePage's' "attempted monopoly maintenance claim" but let the verdict stand as to the monopoly maintenance claim. The court concluded that LePage's' evidence satisfied the requirements laid down in *SmithKline* for an "intra-market monopoly leveraging claim." It specifically rejected 3M's contentions that: (1) LePage's failed to establish that 3M's customers were effectively forced to forgo purchases of LePage's' private label tape to obtain rebates on Scotch-brand tape; (2) the court should have required LePage's to prove that it was as efficient as 3M; and (3) the court should have required LePage's to prove that 3M could recoup the revenues it sacrificed through its rebate program by charging higher prices. 2000-1 Trade Cas. (CCH) ¶ 72,846, 84,287-88 (E.D. Pa. 2000). The district court did not even cite *Brooke Group*, having previously distinguished the case (in rejecting 3M's summary judgment motion) on the curious grounds that it involved a "predatory pricing" claim and did not address the pricing behavior of a monopolist. 1999-1 Trade Cas. at 84,849 & n.9.

On appeal, the case focused almost exclusively on whether 3M's conduct constituted the "willful maintenance" of monopoly power. Neither the market definition—which included both branded and private-label tape in a single market—nor 3M's monopoly power within that market were at issue.<sup>3</sup> The parties again presented diametrically opposed views of 3M's conduct. LePage's sought to invoke *SmithKline*, arguing that 3M's bundled rebates prevented it from competing on the merits for private-label sales. 3M defended its programs by invoking *Brooke Group*, arguing

---

<sup>3</sup> LePage's' success in establishing a market consisting of all transparent tape and limited to the United States fundamentally shaped the course of the case. Had 3M successfully proven a broader geographic market, its "monopoly power" would have vanished. Had 3M established that branded and private label tape were in separate markets, LePage's' monopoly maintenance claim based on *SmithKline* would have been transformed into a "monopoly leveraging" claim. LePage's' inability to prove that 3M had a dangerous probability of monopolizing a private label market—not least because LePage's still commanded a two-thirds share of such a market at the time of trial, 277 F.3d at 376 n.5—would probably have doomed such a claim. The law of the Third Circuit and most other federal courts does not permit a monopoly leveraging claim unless the plaintiff can prove a dangerous probability of successful monopolization in the "competitive" market. The Second Circuit is the

that its rebate programs were mere price competition insulated from antitrust scrutiny so long as prices remained above cost.

**The Majority Opinion.** The Third Circuit panel (Judges Greenberg, Alito, and Sloviter) was as deeply divided as the parties. Judges Greenberg and Alito found in 3M's favor and directed the district court to enter judgment for 3M. The majority decision rested on five principal conclusions:

- (1) First, the majority repeatedly alluded to the standard for testing predatory pricing claims established in *Brooke Group*. It noted that “LePage’s did not demonstrate that 3M’s pricing was below cost and, in the absence of such proof, the record does not supply a basis on which we can uphold the judgment.” 277 F.3d at 376; *see also id.* at 382, 384. The majority was careful to say, however, that it was not deciding “the effect of *Brooke Group* on *SmithKline*.” *Id.* at 380 n.10.
- (2) Second, the majority distinguished *SmithKline* based on LePage’s failure to prove the anti-competitive effects of 3M’s bundling. *SmithKline* upheld a finding that Lilly illegally maintained its monopoly in the market for cephalosporin antibiotic drugs by establishing a bundled rebate program that linked rebates on two patented Lilly products that faced no direct competition—Keflex and Keflin—to purchases of a third product—Kefzol—that faced competition from SmithKline. Companies might have read *SmithKline* to suggest a virtual per se rule against bundled discounts by monopolists.<sup>4</sup> But the majority in *LePage’s* focused on the court’s reference to the district court’s finding that “the effect” of Lilly’s rebate program was to “force SmithKline to pay rebates on one product, Ancef, equal to rebates paid by Lilly based on volume sales of three products,” and the related finding, “[o]n the basis of expert testimony, . . . that SmithKline’s prospects for continuing in the cephalosporin market under these conditions [were] poor.” 575 F.2d at 1065.<sup>5</sup> The *LePage’s* majority held that, unlike the plaintiff in *SmithKline*, LePage’s “did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled rebates.” 277 F.3d at 378.<sup>6</sup>

The *LePage’s* majority thus concluded that *SmithKline* could not be read to establish a per se rule against a monopolist’s use of bundled rebates because consumers would be harmed if “bundled rebates are illegal regardless of how competition is affected.” 277 F.3d at 381. Instead, echoing a predominant theme of recent antitrust jurisprudence, the plain-

---

one possible exception, where *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 275–76 (2d Cir. 1979), suggests the potential of a leveraging claim where a monopolist merely uses its power in one market to “gain a competitive advantage in another.” But the vitality of this aspect of *Berkey* is in grave doubt in light of the Supreme Court’s ruling in *Spectrum Sports v. McQuillan*, 506 U.S. 447, 459 (1993), that an indispensable element of any attempted monopolization case is proof of “a dangerous probability that [defendant] would monopolize a particular market.” *See Virgin Atlantic Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 272 (2d Cir. 2001).

<sup>4</sup> For example, the *SmithKline* court regarded Lilly as having abused its “awesome power of a monopolist” when it instituted its discount program, which “blatantly revised” the “economic laws of a competitive market.” 575 F.2d at 1065.

<sup>5</sup> Lilly offered a bundled rebate of 3% on a group of three products. SmithKline would have had to offer discounts of 16 to 35% on its competitive product to match the monetary value of the Lilly’s rebate program. *SmithKline*, 575 F.2d at 1062. The district court in *SmithKline* performed a detailed analysis of SmithKline’s cost structure and specifically concluded that, so long as Lilly’s discount program remained in place, SmithKline “could not remain in the market, even for the smaller accounts.” 427 F. Supp. at 1123.

<sup>6</sup> The Second Circuit recently distinguished *SmithKline* on the same basis, holding that it involved “expert testimony demonstrating the anti-competitive effects of a bundling arrangement.” *Virgin Atlantic*, 257 F.3d at 270. Ironically, the same case distinguished the district court’s decision in *LePage’s* on the same basis, noting (in sharp contrast with the *LePage’s* majority’s views) that LePage’s had “introduced exhibits showing that specific customers felt compelled to purchase products under the defendants’ bundling program because the plaintiff could not match the discounts.” *Id.*

tiff must show how competition—as distinct from the plaintiff’s own profit margins—would be harmed by the discount program. To make such a showing, the majority suggested that LePage’s burden was to prove that—taking into account its “relative efficiency or cost structure”—it would actually be “driven out of business” (*id.* at 380), and not merely suffer a reduction in its sales and profits.<sup>7</sup> The majority concluded that LePage’s had not satisfied that standard, since LePage’s was “able to retain some customers through negotiation” (*id.* at 382), and at the time of trial accounted for 67 percent of all private-label sales. *Id.* at 376 n.5.<sup>8</sup>

- (3) Third, the majority also reviewed the lawfulness of 3M’s bundled rebates under the assertedly “more stringent” standard established in the *Ortho* case, which required plaintiffs challenging bundled discounts to prove either that the discounts resulted in products being sold “below cost” or that the plaintiff was “at least as efficient a producer” as the defendant but could not compete profitably as a result of the defendants’ pricing. *Id.* at 380. LePage’s could not satisfy that standard either, because its economist had conceded that LePage’s was less efficient than 3M. *Id.*
- (4) Fourth, the majority gave weight to the fact that 3M’s bundled rebate programs served the business objective of increasing 3M’s sales and profits:

3M’s pricing structure and bundled rebates were not necessarily contrary to its economic interests, as they likely increased its sales. Furthermore, other than the obvious reasons such as increasing bulk sales, market share, and customer loyalty, there are several other potential ‘procompetitive’ or valid business reason for 3M’s pricing structure and bundled rebates: efficiency in having single invoices, single shipments and uniform pricing programs for various products.

*Id.* at 382. The majority specifically concluded that, even if 3M had intended to eliminate the “private label aspect of the transparent tape market,” its actions would be lawful because, “‘examined without reference to its effects on competitors,’ it is evident that in view of 3M’s dominance in brand tape, . . . it was rational for 3M to want the sale of tape concentrated in that category of the market.” *Id.* at 385.

- (5) Finally, the majority brushed aside LePage’s’ reliance on alleged exclusive arrangements with retailers, noting that 3M’s two exclusive agreements locked up at most a tiny fraction of the market, and did so for only one year at a time. *Id.* at 383–84.

**The Dissent.** Judge Sloviter vigorously disagreed with the majority’s reasoning. In a lengthy opinion, she made the following key points:

- (1) First, the dissent contended that the majority erred by analyzing 3M’s bundled rebates in isolation from the alleged exclusive contracts. The dissent asserted that courts must assess the legality of an alleged monopolist’s behavior by examining the entire “monopoly broth”<sup>9</sup> of its alleged conduct. Judge Sloviter also stated, however, that she believed 3M’s bundled rebates violated Section 2 even if considered independently.
- (2) Second, the dissent brushed aside the majority’s heavy reliance on *Brooke Group*. The dis-

<sup>7</sup> The majority observed that without such a rule “competitors unwilling to accept lower profits could use the [antitrust] law to insulate themselves from competition.” *Id.* at 380.

<sup>8</sup> The majority also noted that LePage’s lost sales for reasons unrelated to 3M’s conduct, such as LePage’s’ inferior service. *Id.* at 382.

<sup>9</sup> See *City of Mishawaka v. American Elec. Power Co.*, 616 F.2d 976, 986 (7th Cir. 1980). (“The [defendant] would have us consider each separate aspect of its conduct separately and in a vacuum. If we did, we might agree with the [defendant] that no one aspect standing alone is illegal. It is the mix of the various ingredients of [defendant] behavior in a monopoly broth that produces the unsavory flavor.”).

sent reasoned that *Brooke Group* did not apply for two reasons. First, it did not purport to address “bundled” rebates. Second, *Brooke Group* did not address the behavior of a monopolist. The defendant in that case—Brown & Williamson—was one of six manufacturers of cigarettes in the United States. Invoking the antitrust tenet that a monopolist is not permitted to engage in action that would be legal if undertaken by a firm with lesser power, the dissent therefore concluded that “[e]ven if *Brooke Group* could be read that all pricing action is legal if the company’s prices are not below costs, nothing in the Supreme Court’s decision suggests that its discussion of the issue is applicable to a monopolist with its unconstrained market power.” 227 F.3d at 400 (dissent).<sup>10</sup>

- (3) Third, the dissent believed that *SmithKline* was controlling. The dissent disagreed strongly with the majority’s efforts to distinguish *SmithKline* on the ground that LePage’s had not proven any anticompetitive effect. The dissent argued that there was abundant evidence in the record to support a jury finding that 3M’s bundled rebates prevented LePage’s from competing on the merits. The dissent pointed to the negative profits of LePage’s following the institution of 3M’s rebate program and evidence that the program caused retailers to displace LePage’s altogether or purchase significantly less from LePage’s. The dissent also noted that there was ample evidence that 3M desired to force LePage’s from the market.

### **Where Does the Third Circuit’s *En Banc* Review Leave Private Parties?**

The majority opinion was directionally pro-defendant and in that sense the Third Circuit’s decision to review the case *en banc* might be viewed as creating new uncertainties for firms employing or considering bundled discounting programs. On the other hand, the majority decision left open a number of questions, perhaps the most significant being how a court would deal with claims asserted by plaintiffs that did a better job of meeting the *SmithKline* test (as interpreted by the majority) by establishing that they could not compete in the face of the plaintiff’s bundled discount program. On the one hand, would the ultimate legality of the program be tested solely by reference to the defendant’s costs? On the other hand, might liability rest on some other, murkier standard, such as the plaintiff’s inability to compete successfully, the plaintiff’s relative costs, or the defendant’s intent as gleaned after the fact from company documents.

### **What Might the *En Banc* Third Circuit Do in *LePage’s*?**

The Third Circuit now has the opportunity to answer some of these questions. How many of them it addresses will depend on how it approaches the issues in the case.

We consider below the two principal sets of possibilities. The court may view bundled rebates

---

<sup>10</sup> In fact, however, courts have routinely applied the *Brooke Group* standard in cases where the defendant is alleged to be a monopolist. Indeed, as the Seventh Circuit has observed, “firms found guilty of attempting to monopolize are typically, and in predatory pricing cases must always be, monopolists.” *American Academic Suppliers, Inc. v. Beckley-Cardy, Inc.*, 992 F.2d 1317, 1320 (7th Cir. 1991). Examples of such cases include *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518, 528 (5th Cir. 1999) (discussing predatory pricing brought against an alleged monopolist, noting that “such a claim must demonstrate both that (1) the prices complained of are below an appropriate measure of the *alleged monopolist’s* costs, and (2) that the *alleged monopolist* has a reasonable chance of recouping the losses through below-cost pricing”) (emphasis added) (citing *Brooke Group*); *Morley-Murphy Co. v. Zenith Elecs. Corp.*, 142 F.3d 373 (7th Cir. 1998) (noting that problems of allocating fixed costs between products arises “in predatory pricing cases in the antitrust area, when courts try to figure out whether an *alleged monopolist* is selling a product below cost”) (emphasis added) (citing *Brooke Group*); and *Advo, Inc. v. Philadelphia Newspapers, Inc.*, 51 F.3d 1191, 1202 (3d Cir. 1995) (rejecting a “strategic entry deterrence” theory, under which “a *monopolist* who pursues predatory pricing with sufficient zeal and frequency will earn a reputation formidable enough to scare off all potential entrants indefinitely” as at odds with *Brooke Group*) (emphasis added);

of the sort engaged in by 3M as indistinguishable from the pricing behavior provided by *Brooke Group* and thereby explicitly demand that the plaintiff prove that prices were below cost. In the process, the Third Circuit may or may not see fit to overrule *SmithKline*. Alternatively, the court may see 3M's conduct through LePage's' lenses, and decline to apply *Brooke Group*. The court must then decide what standard ought to be applied to bundled rebates—the rule applied in *SmithKline* (whatever it was) or another standard.

**Will the Third Circuit Overrule Smithkline in Light of Brooke Group?** If the Third Circuit views 3M's bundled rebate programs as price reductions—which in substance they were—the stark legal question presented in *LePage's* is whether the Third Circuit should continue to treat single-product pricing differently than multiple-product pricing. A plaintiff bringing a monopolization claim based on allegedly anticompetitive single product rebates must, under the *Brooke Group* standard, present evidence of below cost pricing and the reasonable prospect that the monopolist could raise prices in the future to recoup the losses incurred. In contrast, under at least one reading of *SmithKline*, a plaintiff bringing a claim based on bundled rebates could prevail merely by showing that it could not compete against the defendant's pricing strategy. The *en banc* court must decide if a plaintiff states a Section 2 claim by showing that it could not compete profitably in the face of a bundled discount program, even if the monopolist's pricing was above cost and therefore contributed to its profits in the short term without regard to any adverse effect on the plaintiff.

Getting past the principal laid down in *Brooke Group* would require a considerably more robust effort than LePage's or the judges who agreed with it could muster below.<sup>11</sup> If the law intends to encourage—or at least not avoid chilling—price reductions by monopolists, why should it matter that a monopolist's discounts are structured in relatively complex ways? Single-product and multi-product discounts both have considerable potential to harm would-be competitors (especially inefficient ones) and deter entry, but also bring real value to consumers. If the law does not penalize a monopolist for cutting its prices to the bone on a single product in ways a competitor cannot match—which may be the case if a core group of the monopolist's customers have deeply-engrained brand loyalty, thereby giving the monopolist a built-in advantage in achieving scale economies—why should multi-product discounts be treated any differently?<sup>12</sup>

The *LePage's* majority adopted this basic view of the proper application of *Brooke Group* to 3M's conduct, but was constrained to attempt to distinguish *SmithKline* rather than to overrule it.<sup>13</sup> The *en banc* court should not feel similarly constrained because it has the power to overturn *SmithKline*.<sup>14</sup>

As it sorts out the reach of *Brooke Group*, one course the Third Circuit might take is to draw a distinction between “take-it-or-leave-it” price offerings (including discounts and rebates) and pro-

*If the law intends to encourage—or at least not avoid chilling—price reductions by monopolists, why should it matter that a monopolist's discounts are structured in relatively complex ways?*

<sup>11</sup> Both the dissent and district court in *LePage's* noted differences in the factual details of the cases—the fact that *Brooke Group* involved pricing of a single product by firms that were not monopolists—without any serious effort to analyze why those differences should be regarded as substantively meaningful. See 1999-1 Trade Cas. at 84,849 & n.9; 277 F.3d at 399–400 (dissent). The latter basis is particularly insubstantial. See *supra* note 10.

<sup>12</sup> See, e.g., PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749 (criticizing rule that would condemn above-cost bundled discounts).

<sup>13</sup> The majority implied (but did not decide) that *Brooke Group* might well have overruled *SmithKline*. It emphasized that it had not decided whether “if LePage's had supplied pricing information similar to that *SmithKline* presented our result would be different.” 277 F.3d at 380 n.10.

<sup>14</sup> In this scenario, whether the court overrules *SmithKline* would seem to depend on whether, like the panel majority, it sees a rational basis for distinguishing the effect of 3M's discount programs from that of Lilly's. If *Brooke Group* applies and *SmithKline* cannot be distinguished, *SmithKline* would have to be overruled. As suggested by the dissent, and the Second Circuit's observations in *Virgin Atlantic*, there is some reason to doubt the robustness of the majority's rationale for distinguishing the case.

*Under the average variable cost standard accepted by most courts, bundled rebates should avoid condemnation if the price charged for each of the elements of the bundle is above the average variable cost of that product. Yet the court must still decide how much of the total rebate should be attributed to the various components of the bundle.*

grams that involve restrictive agreements between an alleged monopolist and its customers. The former might be deemed to fall within the ambit of *Brooke Group*, while the latter might be viewed as traditional vertical restraints. For example, if a defendant persuades retailers to enter a binding commitment to purchase a high percentage of its needs from the defendant by offering the customer a significant monetary payment, the amount of the payment might not be viewed as the equivalent of a price reduction (even if denominated a “rebate”), but instead as consideration for a restrictive agreement. In contrast, if the defendant offered a rebate program under which the customer could earn the same sum by choosing to buy from the defendant, but had no obligation to make that choice, such a program might be viewed as a price reduction.

This line of reasoning would be consistent with the Eighth Circuit’s analysis in *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1043, 1063 (8th Cir.), cert. denied, 531 U.S. 979 (2000). *Concord Boat* overturned a jury verdict for plaintiffs on a Section 2 claim against an alleged monopolist’s voluntary market share discount programs. Under the defendant’s programs, retailers could earn increasingly large rebates by increasing the share of boat engines that they purchased from the defendant. Because retailers entered into no contractual commitment to purchase a particular percentage of engines from the defendant, the defendant’s programs were analyzed under the *Brooke Group* predatory pricing standard rather than under the rule of reason standard sought by plaintiffs.

Applying this reasoning in *LePage’s* should result in the application of *Brooke Group* to 3M’s rebated programs. The reported decisions contain no indication that 3M’s programs involved any agreement with retailers committing them to purchase any particular volume (or share) of 3M private-label tape.

If the court does apply the *Brooke Group* standard, the *LePage’s* case apparently would be over, because on appeal *LePage’s* dropped any contention that 3M’s prices were below cost. 277 F.3d at 380. Such a ruling, however, would leave open the very interesting question of how future plaintiffs might attempt to demonstrate that bundled rebates are below cost. Under the average variable cost standard accepted by most courts, bundled rebates should avoid condemnation if the price charged for each of the elements of the bundle is above the average variable cost of that product.<sup>15</sup> Yet the court must still decide how much of the total rebate should be attributed to the various components of the bundle.

For example, if a program is structured in such a way that a customer earns an incremental rebate on the “monopoly” product by purchasing some readily identifiable quantity of a “competitive” product, a plaintiff might attempt to demonstrate that the full monetary value of the incremental rebate is directly attributable to the incremental purchases that trigger the discount. Whether that value is characterized as a “cost” of the competitive product or as a reduction in the product’s price, it is conceivable that a plaintiff might succeed in establishing that the price received for those incremental quantities was less than the costs associated with selling those units.

Although such an argument would likely face considerable difficulties,<sup>16</sup> it would not be entirely unprecedented. For example, in its lawsuit challenging American Airlines’ alleged monopolization of the Dallas-Fort Worth Hub, the Department of Justice tried to prove that American

<sup>15</sup> As a proxy for marginal costs, average variable cost has emerged as the leading standard for determining whether a monopolist has engaged in predatory pricing. *E.g.*, *Advo, Inc. v. Philadelphia Newspapers, Inc.*, 51 F.3d 1191, 1198 (3d Cir. 1995); see generally *United States v. AMR Corp.*, 140 F. Supp 2d 1141, 1198 (D. Kan. 2001) (collecting cases).

<sup>16</sup> The *LePage’s* majority expressed doubts about the “validity of attributing all other rebates to the one competitive product.” 277 F.3d at 379.

engaged in predatory conduct when it added incremental capacity (additional aircraft in city pair markets) at prices that generated less incremental revenue than the cost of the additional capacity. The district court rejected this incremental cost measure, adopting instead average variable costs as the “only appropriate, credible measure of costs in the present action.” See *United States v. AMR Corp.*, 140 F. Supp 2d at 1196. But the Department has advanced a credible argument for its proposed standard in the pending appeal. See *United States v. AMR Corp.*, No. 01-3202, Brief for Appellant United States at 36–46 (10th Cir. filed Jan. 11, 2002).<sup>17</sup>

**Could the Third Circuit Fall Back on SmithKline?** If the Third Circuit is unwilling to apply the *Brooke Group* standard to bundled discount programs, it may seek to distinguish *Brooke Group* by characterizing 3M’s conduct as involving an undifferentiated mass—or “broth”—of behavior that was more akin to efforts to induce exclusive relationships with 3M than straightforward discounts. Such a distinction would seemingly ignore the substance of 3M’s rebate programs, which were very much the economic equivalent of price reductions on products sold by 3M. But it is conceivable that the court (like Judge Sloviter) would be sympathetic to the plight of firms like LePage’s that assert that they cannot economically match bundled rebate programs offered by multi-product firms like 3M.<sup>18</sup>

If the court does manage to get past *Brooke Group*, however, it must still address what standard to apply to test the legality of 3M’s programs. None of the available options offers the kind of certainty that antitrust law has recently sought in the predatory pricing context.

The most obvious potential source for such a standard is the Third Circuit’s own *SmithKline* decision. Any standard derived from *SmithKline* likely would focus on the impact of the bundled discount program on competitors. It would, however, place potential discounters in a difficult position. Companies might pull their punches to avoid offering discount programs that potential plaintiffs were ill equipped to match.

The court might look elsewhere for a standard. Two places the court might turn are the standards articulated in *Ortho*, which addressed bundled discounting, and *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001), which did not.

Under the *Ortho* test, a bundled rebate program would potentially establish Section 2 liability if the monopolist was either (1) charging a price for the competitive product below average variable cost, or (2) the competitor was as efficient as the monopolist but still could not afford to match the monopolist’s discount. This standard may provide a refuge for the *en banc* court if it wants to find in favor of 3M, since LePage’s conceded that 3M was the more efficient tape manufacturer.

---

<sup>17</sup> Virgin Atlantic made a similar effort to prove that British Airways’ discounts to travel agents and corporate customers, which bundled alleged monopoly routes with competitive routes, caused its prices on competitive routes to fall below cost. The Second Circuit rejected this contention without considering whether prices exceeded costs, because Virgin Atlantic failed to establish that the bundled rebates prevented it from competing effectively or that British Airways raised its prices on monopoly routes so as to recoup the alleged losses. *Virgin Atlantic*, 257 F.3d at 269–70.

<sup>18</sup> Basing liability on the allegedly “unsavory flavor” of the “monopoly broth” would entail significant pitfalls. At times, it is undoubtedly appropriate to consider the totality of an alleged monopolist’s conduct, as when aggregating the impact of numerous exclusive contracts with distributors. In cases like *LePage’s*, however, where the conduct at issue includes the kind of price-cutting encouraged by the law, attempting to discern the flavor of the alleged “broth” is more dangerous. First, it is difficult if not impossible to offer a clear standard for deciding such cases. What blend of ingredients suffices to establish antitrust liability? Second, but more fundamentally, such a standard may discourage price-cutting by a monopolist in response to competition. Most large companies employ a wide variety of marketing strategies. If such firms must be concerned that competitors might establish antitrust liability (and treble damages) for discounting practices by pointing to some number of other marketing practices that are likewise targeted at gaining sales from competitors, they may think twice before putting the screws to competitors by lowering prices. Such a result would seem inconsistent with the strong aim of the law to avoid chilling aggressive above-cost discounting.

However, this standard would do little to protect defendants from the sort of uncertainty that *Brooke Group* disfavors. It would be extraordinarily difficult for firms considering complex discount programs to make assessments about the relative efficiency of their rivals, even if it were crystal clear how the “efficiency” of two firms would be compared.

Alternatively, the Third Circuit may consider adopting the likely influential Section 2 standard articulated by the D.C. Circuit in *Microsoft*, which ultimately focuses on whether “the anticompetitive harm outweighs the procompetitive benefit.” *United States v. Microsoft Corp.*, 253 F.3d 34, 59 (D.C. Cir. 2001).<sup>19</sup> This is essentially the rule of reason standard. Such a standard seemingly would send the question of liability to the jury whenever there was evidence that a bundled rebate program impeded competition on the merits in some way. This would provide little guidance to businesses. Perhaps more importantly, however, it would beg the most important question: is an above-cost discount that provides economic value to customers “anticompetitive,” as LePage’s argues, or “procompetitive,” as 3M contends and *Brooke Group* (and the well-developed law of predatory pricing) seems to suggest.<sup>20</sup>

## Conclusion

*LePage’s* offers the Third Circuit a genuine and important opportunity to clarify the antitrust law that governs bundled rebates. In the panel decision, neither the majority nor dissent offered clear guidance to firms employing or considering complex bundled discount programs. Whatever standard the Third Circuit adopts, we expect the *en banc* court will offer a clearer standard to guide corporations in this controversial area. ●

---

<sup>19</sup> Applying such a standard to bundled discount programs would of course require a predicate conclusion that such programs are distinguishable from single-product discounting. The D.C. Circuit’s decision in *Microsoft* explicitly applied the full panoply of predatory pricing law (including the requirement that sales be below cost) in the context of Microsoft’s licensing of Internet Explorer to Internet Access Providers at no charge. *Microsoft*, 253 F.3d at 67. The D.C. Circuit disagreed with the district court’s condemnation of this conduct, writing that “[t]he rare case of price predation aside, the antitrust laws do not condemn even a monopolist for offering its product at an attractive price, and we therefore have no warrant to condemn Microsoft for offering . . . [Internet Explorer] free of charge or even at a negative price.” *Id.*

<sup>20</sup> If the Third Circuit chooses not to follow *Brooke Group* and adopts some middle ground or applies *SmithKline*, it might feel compelled to address an important subsidiary question debated by the majority and dissent in the panel decision: what is the role of the kind of “business justification” described by the *LePage’s* majority? A central element of any reasonableness inquiry is the business justification for the conduct in question. Does the desire to increase sales exonerate the defendant or merely avoid an inference that the defendants’ conduct was necessarily intended to achieve anticompetitive effects? We think that the court chose the latter course, and in fact a careful reading of the majority opinion suggests that it did not intend to go farther than that in holding that a desire to increase sales eliminates any potential for a successful monopolization claim. *See* 277 F.3d at 381 (“some cases suggest that when a company acts against its economic interests and there is no valid business justification, then it is a good sign that its acts were intended to eliminate competition”). Such a reading is consistent with other case law. The D.C. Circuit, for example, would have afforded 3M’s business justifications little weight under the standard articulated in *Microsoft* because it does not regard a monopolist’s desire to “preserve its power” as a “procompetitive justification” for conduct that tends to exclude competition. 253 F.3d at 71 (addressing exclusive dealing contracts with internet access providers).