

LePage's v. 3M: A Reality Check

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The year 2004 was a big one for antitrust at the Supreme Court. *Trinko*,¹ *Empagran*,² *Intel*³—three antitrust cases in one term. A Supreme Court antitrust renaissance. But the Court also decided not to hear a fourth antitrust case, *3M v. LePage's*.⁴ Unfortunately, *LePage's* was at least as important a case for the Court to hear as any of the other three.

The Third Circuit en banc decision in *LePage's* is a giant step backwards in Section 2 jurisprudence. In an almost visceral reaction to 3M's insistence that the case should be resolved as a matter of law under *Brooke Group*,⁵ the Third Circuit literally rejected the relevance of price in assessing 3M's bundled rebates. Far from applying below-cost pricing analysis as 3M advocated, the en banc court said that the appropriate inquiry is whether 3M's bundled rebates constituted exclusionary conduct. That, of course, begs the question of *how* to determine whether or not a bundled rebate is simply a form of price competition or is exclusionary. According to the en banc court, a bundled rebate is exclusionary whenever a rival simply can't match the rebate because it doesn't offer a comparable breadth of products. That view, with no further analytical guidance by the court, appears fundamentally to turn back the antitrust clock to the days of protecting competitors rather than competition.

In deciding whether to grant cert. in *LePage's*, the Supreme Court was presented with three very different perspectives on bundled rebates: 3M focused on *Brooke Group* and below-cost pricing; the Third Circuit centered its inquiry on exclusionary bundling conduct; and finally, the United States' amicus brief found merit in both arguments, but recommended that the Court wait for another day and another case to consider bundled rebates after judges and scholars gave the matter more thought. The Court accepted the government's recommendation.

This article reviews the three different perspectives on bundled rebates and offers a reality check in the wake of the Court's denial of cert. In particular, the article suggests that there is a right test for reviewing bundled rebates like those in *LePage's*.

Background

3M, with its Scotch brand tape, is a conceded monopolist in the transparent tape market. Until the early '90s, 3M had over 90 percent of the market. 3M's share of the tape market began to erode in the early '90s with the advent of office superstores and mass merchandisers, which were fond of the lower-priced private label tape. By 1992, 3M's main competitor, LePage's, had nearly 88 per-

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¹ Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, 124 S. Ct. 872 (2004).

² F. Hoffmann-La Roche Ltd v. Empagran, S.A., 124 S. Ct. 2359 (2004).

³ Intel Corp v. Advanced Micro Devices Inc., 124 S. Ct. 2466 (2004).

⁴ LePage's Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003), cert. denied, 124 S. Ct. 2932 (2004).

⁵ Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

cent of the private label segment of transparent tape, but still only about 14 percent of the overall tape market.

3M responded to the changing marketplace in two ways. 3M introduced its own private label product as well as offered a second less expensive brand, “Highland,” to compete with LePage’s cheaper private label offering. 3M also initiated pricing programs, including a bundled rebate program, aimed at the large superstores. The rebate program offered higher discounts when customers purchased products across a number of 3M’s different product lines. The bundled rebate program linked products across six of 3M’s product lines and set customer specific target growth rates in each product line. The size of the discount was linked to the number of product lines in which targets were met.

LePage’s competes against 3M in only one product—transparent tape. Specifically, only in lower-priced private label tape. LePage’s alleged that it couldn’t possibly match 3M’s multiple discounts on multiple products. LePage’s cried foul and filed an antitrust suit.

Three Different Perspectives

3M Position. 3M unwaveringly maintained that the case was only about price and contended that it should prevail because its price for transparent tape was always above any measure of cost (e.g., average variable cost).⁶ *Brooke Group, Brooke Group, Brooke Group*. According to 3M, there was nothing more to be said because Brooke Group’s bright line above-cost test for predatory pricing in the single-product context was an equally appropriate test for bundled rebates in the context of multi-product offerings. Because LePage’s claim did not satisfy the *Brooke Group* standard, 3M argued that it should win as a matter of law.⁷

Admittedly, I am partial to 3M’s argument to extend *Brooke Group* into the context of multi-product bundled rebates. It is important to recognize, however, that 3M offers at least two different tape products, Scotch Brand tape and private label tape. These tapes are sold at very different prices. 3M’s monopoly is in branded tape. LePage’s offers only one type of tape, private label tape, and thus competes against 3M only in private label tape. Private label tape, not all transparent tape, is the relevant product on which the analysis of above-cost pricing should focus.

Third Circuit En Banc Decision. The Third Circuit completely disagreed with 3M. The en banc court said the case is not about pricing at all. Rather, it’s about exclusionary conduct—bundling conduct.⁸ Specifically, the case is about multi-product bundled discounts that had the effect of excluding a smaller rival, LePage’s, which couldn’t offer the same breadth of products. According to the Third Circuit, LePage’s was competitively disadvantaged because it didn’t have a similar breadth of products on which to offer discounts.⁹ It just couldn’t match 3M’s bundled rebates with its one product—private label tape.

The Third Circuit observed that Section 2 addressed exclusionary conduct much broader than simply predatory pricing.¹⁰ In fact, the Third Circuit said *Brooke Group* isn’t even relevant to this case, pointing out that LePage’s didn’t allege predatory pricing.¹¹ It alleged exclusionary conduct.

⁶ Petitioner’s Brief at 14–21, *3M Co. v. LePage’s Inc.*, 124 S. Ct. 2932 (2004) (No. 02-1865).

⁷ *Id.*

⁸ *LePage’s Inc. v. 3M*, 324 F.3d 141, 154–55 (3d Cir. 2003), *cert. denied*, 124 S. Ct. 2932 (2004).

⁹ *Id.* at 162.

¹⁰ *Id.* at 152.

¹¹ *Id.* at 151–52.

The Third Circuit also concluded that 3M was without a legitimate business justification for its exclusionary bundling conduct, a conclusion easily reached after the court rejected lower prices to consumers as a justification.¹²

The Government Position. In its amicus brief, the United States took the position that both 3M and the Third Circuit decision were partially right. *LePage's*, the government argued, is about both price discounts and bundling conduct—it's about multi-product bundled rebates.¹³ The case is more complicated than single product above-cost pricing—straight *Brooke Group*.¹⁴ It's about rebates that give customers an incentive to buy multiple products.

The government was generally critical of the court's assessment of 3M's bundled rebates, observing that the court had failed to explain “what precisely rendered 3M's conduct unlawful.”¹⁵ The government also disagreed with the Third Circuit's conclusion that *Brooke Group* and price-cost analysis couldn't apply to a monopolist.¹⁶ Overall, the government said that the en banc decision provided “few useful landmarks” on how Section 2 should be applied to bundled rebates.¹⁷

But the government concluded that the case does not provide a “suitable vehicle” for the Court to provide guidance on bundled rebates.¹⁸ The government argued that the record below was spotty relating to potentially important facts in the case. In addition, there was no split in the circuits, and the case law and academic literature was not well-developed. Moreover, there was no demonstrated business urgency. Consequently, the government recommended that the Court deny cert.¹⁹

The Court accepted the government's recommendation. *LePage's* stands as good law in the Third Circuit.

A Reality Check—Life After *LePage's*

Not-So-Subtle Reminder. One legacy of *LePage's* is the not-so-subtle reminder of the practical significance of “bad” documents. Setting aside the obvious questions about Section 2 jurisprudence and sophisticated economic bundling theories, one simple lesson from *LePage's* is that bad documents can color the jury's and even the judge's view on what is “really going on.”

The en banc court, for example, noted that “[t]here is considerable evidence in the record that 3M entered the private-label market only to ‘kill it.’”²⁰ The court went on: “That's precisely what Section 2 of the Sherman Act prohibits by covering conduct that maintains a monopoly.”²¹ A business document that says “kill” unbranded is just not helpful to a conceded monopolist. It leaves the unmistakable impression that the monopolist is doing something malicious to take out a smaller competitor, which must be “wrong.”

¹² *Id.* at 163–64.

¹³ Amicus Brief of the United States at 12, 3M Co. v. LePage's Inc., 124 S. Ct. 2932 (2004) (No. 02-1865) [United States Amicus Brief].

¹⁴ *Id.*

¹⁵ *Id.* at 16.

¹⁶ *Id.* at 14 n.11.

¹⁷ *Id.* at 16.

¹⁸ *Id.* at 8.

¹⁹ *Id.*

²⁰ *LePage's Inc.* 324 F.3d at 164.

²¹ *Id.* at 164.

But on another level, it evidences absolutely nothing. Of course 3M would prefer not to face lower-priced, unbranded tape in the market. 3M enjoys higher margins on its Scotch Brand tape, and obviously would want to and should maximize sales of its highest margin products. That's not anticompetitive. But once the jury and even the judge believe they understand what's "really going on" through the lens of a business person's puffery, the case law, and the economic theory that help us understand the conduct's competitive significance, mean much less.

We, of course, can debate and even disagree on the relevance of "intent" in Section 2 analysis. But that's precisely the point. Once out in the open before judge and jury, it's out to stay. And it will have an effect, as *LePage's* reminds us.

Unequivocal Message. The unequivocal message of *LePage's*: Bundle at your own risk! If you are a multi-product firm with a significant position in one or more products, and engage in bundled rebates, you face treble damages if your smaller rival can't keep up—period. *LePage's* can be read to stand for the proposition that Section 2 will protect the smaller rival. That's a terribly unfortunate step backwards for Section 2 jurisprudence.

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Some might argue that it's not that bad, suggesting that *LePage's* can be distinguished on various grounds. The government in its amicus brief, in fact, did not so much argue that the Third Circuit's decision was right as it explained that it wasn't necessarily wrong. The government plainly was uncomfortable with the Third Circuit's sweeping condemnation of 3M's bundled rebates without explaining what exactly was anticompetitive about them.²² And the government noted that bundled rebates no doubt often are procompetitive.²³

The government, in large part, recommended denying cert. because of the insufficient record on which to properly assess the competitive effects of the bundled rebates.²⁴ In addition, the government suggested that there was no business urgency, no split in the circuits and limited scholarly scrutiny to understand bundled rebates.²⁵

But regardless of whether *LePage's* can be legally distinguished, the decision will have a real impact on business conduct. Bundled rebates are a common form of price competition. After *LePage's*, any firm with a significant position in one or more products likely will avoid offering bundled rebates rather than risk treble damage liability. Consumers will not receive the benefit of lower prices through these programs.

A Right Test. In its amicus brief, the government lamented the absence of sufficient experience with bundled rebates to be able to derive a bright line test for bundled rebates.²⁶ The Court would benefit, the government maintained, from further development of the case law and academic scholarship on bundled rebates.²⁷ No doubt that is true, but we do have significant understanding and experience to guide us in assessing at least the type of bundled rebates involved in *LePage's*. And that experience tells us that the test actually doesn't have to be that complicated.

²² United States Amicus Brief at 16.

²³ *Id.* at 12.

²⁴ *Id.* at 8.

²⁵ *Id.*

²⁶ *Id.* at 14.

²⁷ *Id.* at 19.

Two cases, *SmithKline*²⁸ and *Ortho*,²⁹ both applied a similar test for assessing the competitive effect of bundled rebates that are comparable to those in *LePage's*. Both cases, in the pharmaceutical industry, involved rebates earned through the purchase of bundled pharmaceuticals. The bundler had monopoly power on certain of the bundled drugs, and the rival competed on certain other products in the bundle. As in *LePage's*, the rival alleged that it couldn't match the bundled rebate with its limited offering.

In both cases, the courts used an "attribution" test to assess whether the smaller rival was unfairly disadvantaged by the bundled rebates. The attribution test, in simplest form, takes the entire bundled rebate and attributes it to the relevant product on which the rival competes. The test then asks whether the rival can still profitably compete in the relevant product after the discount is attributed. In *SmithKline* the answer was no.³⁰ For *Ortho*, the answer was yes.³¹

Applying the same test to *LePage's*, 3M's entire bundled rebate would be attributed to the relevant product on which *LePage's* competes with 3M, and ask if *LePage's* could still profitably compete in the relevant product. Two important clarifications are necessary.

Equally Efficient Competitor. The attribution test doesn't actually look at whether the rival could profitably compete based on its own cost position. Rather, the test is focused generally on a rival of equal efficiency as the bundler for the relevant product. There are at least two reasons for this. First, the test would be of little guidance to the bundler were it based on the rival's costs. How would the bundler know its rival's costs on the relevant product? Second, the judgment, consistent with the test in *Brooke Group*, is that the antitrust laws are not intended to protect a less efficient rival.

Relevant Product. The relevant product is the product on which the rival competes. So in *LePage's*, the relevant product is not all transparent tape, but rather private label tape. That's the single product on which *LePage's* competes with 3M.³²

In sum, the attribution test would ask the following: Can an equally efficient competitor in private label tape profitably compete if the entire bundled rebate were attributed to that product? Put differently, would the equally efficient competitor's price for private label tape be above some measure of cost (e.g., average variable cost) if the entire bundled rebate were attributed to that product? Still slightly differently, would 3M's price for private label tape be above some measure of its cost (e.g., average variable cost) if the entire bundled rebate were attributed to that product?

LePage's may or may not have come out differently if the Third Circuit had used this test. But we at least would have precedent that would be consistent with *SmithKline* and *Ortho* and that could be relied upon for guidance. The attribution test, of course, may not work for all types of bundling practices. But that doesn't mean it shouldn't be used in situations where it does. ●

²⁸ *SmithKline Corp. v. Eli Lilly & Co.*, 427 F. Supp. 1089 (E.D. Pa. 1976), *aff'd*, 575 F.2d. 1056 (3d Cir. 1978).

²⁹ *Ortho Diagnostics Sys., Inc. v. Abbott Lab.s, Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

³⁰ *SmithKline Corp.*, 427 F. Supp at 1125.

³¹ *Ortho Diagnostics*, 920 F. Supp at 471.

32 Barry Nalebuff, *Comments, Product Bundling in Communications Markets*, ANTITRUST SOURCE, November 2004, at 7-8, at www.antitrustsource.com.