

Client Alert

A report
for clients
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of the firm July 2004

Supreme Court Refuses to Hear Bundled Discounts Case

On June 30, 2004, the Supreme Court denied certiorari in *3M Company v. Lepage's Inc. et al.*, thereby letting stand a Third Circuit judgment holding that a monopolist that offers "package" discounts or "bundled" rebates across its product lines may violate antitrust laws even if the products are not sold below their costs. The Supreme Court's decision not to review the case means that sellers with dominant market shares will continue to risk treble damages liability without clear guidance from the Court regarding their use of pricing offers based on multi-product purchasing.

Background

The defendant 3M, which manufactures Scotch[®] brand transparent tape, had dominated the domestic market for transparent tape until the early 1990's with a market share above 90%. Plaintiff Lepage's began selling "second brand" and private label transparent tape around 1980. By 1992 it had 88% of the private label tape sales in the United States, or about 14% of the total transparent tape market. In response to a resulting decline in its market share, 3M decided to enter the private label business and also began selling tape under its own second brand.

LePage's brought an action in 1997 alleging that 3M engaged in exclusionary conduct aimed at restricting the availability of lower-priced transparent tape and keeping the price for Scotch[®] tape high. The conduct included 3M's use of a "bundled" rebate program, which offered higher rebates only if customers purchased products across a number of 3M's different product lines. 3M also offered large lump-sum cash payments, promotional allowances and other cash incentives to certain large customers for agreeing to carry 3M transparent tape exclusively.

Although 3M's prices remained above its costs, Lepage's alleged that, through these discount and rebate programs, 3M abused its monopoly for transparent tape and excluded Lepage's from the market in violation of the Sherman and Clayton Acts. A jury returned a verdict for Lepage's of over \$68 million after trebling.

The Third Circuit's Decision

The Court of Appeals for the Third Circuit, on rehearing *en banc*, ultimately upheld the jury's verdict. 3M's primary argument on appeal was that its practice of bundling products together by offering rebates and discounts if purchasers bought across multiple product lines could not be an antitrust violation as a matter of law because it never priced its products below cost. For this proposition it relied on *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), a case where the Supreme Court confirmed that to succeed on a predatory pricing claim, a plaintiff must prove both the defendant's below cost pricing and its recoupment of its short-term losses through subsequent higher prices. 3M asserted that as a consequence of *Brooke Group*, "above-cost pricing cannot give rise to an antitrust offense."

The Court of Appeals, however, rejected the claim that *Brooke Group* had changed the law on monopolization. First, *Brooke Group* was primarily concerned with a predatory pricing claim under the Robinson-Patman Act, not monopolization or exclusive dealing under the Sherman or Clayton Acts as alleged in *Lepage's*. Second, nothing in *Brooke Group* suggested that its analysis of predatory pricing was applicable to a defendant with monopoly power, a position which 3M had admitted it occupied in the transparent tape market.

The Court declined to analyze 3M's bundled rebate programs under the rubric of predatory pricing, but instead compared them with tying practices, where the foreclosure effects are similar. For this position, the Court relied on the following passage from one of the leading antitrust treatises, Phillip E. Areeda &

Herbert Hovenkamp, *Antitrust Law* ¶749, at 83 (Supp. 2002), which focuses on the practical business impact of “package” discounts:

The anticompetitive feature of package discounting is the strong incentive it gives buyers to take increasing amounts or even all of a product in order to take advantage of a discount aggregated across multiple products.

Depending on the number of products that are aggregated and the customer’s relative purchases of each, even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce.

The Court also emphasized that this view was consistent with its holding in *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978). In that case, to preserve its market position in brand name antibiotics and discourage sales of generics (even of its own), Lilly offered a 3% bonus rebate to hospitals that purchased specified quantities of any three of Lilly’s antibiotics. The effect of this bundled rebate was magnified by the volume of Lilly products sold so that “in order to offer a rebate of the same net dollar amount as Lilly’s, SmithKline had to offer purchasers of [its generic antibiotics] rebates of some 16% to hospitals of average size, and 35% to larger volume hospitals.”

The Third Circuit in *Lepage’s* noted that 3M bundled its rebates for Scotch® tape with other products it sold in much the same way that Lilly bundled its rebates for its brand name antibiotics with its generic. In both cases, the Court asserted, the bundled rebates reflected an exploitation of the seller’s monopoly power. In *Lepage’s* the evidence showed that Scotch® tape was indispensable to any retailer in the transparent tape market. In addition, the effect of 3M’s rebate program was even more powerfully magnified than in *SmithKline* because 3M required purchases bridging its extensive product lines, which included many products that *Lepage’s* did not sell.

The Court also emphasized that the foreclosure effects of 3M’s exclusive dealing practices, which included lump sum payments to encourage customers to deal exclusively with 3M, were exacerbated by 3M’s bundling programs. Some of 3M’s bundled rebates were “all-or-nothing” discounts, leading customers to deal exclusively with 3M in order to avoid being severely penalized financially for failing to meet their quota in a single product line.

The Third Circuit did not engage in any cost-based analysis to determine whether *Lepage’s*, or an equally efficient competitor to 3M, could in fact have competed on price to

match or overcome 3M’s rebate program, and it also did not state whether 3M had market power in any of its product lines other than Scotch® tape. The Court did conclude, however, that based on a consideration of 3M’s practices taken together, and despite the absence of below-cost pricing, there was sufficient evidence for a jury to find a violation of federal antitrust laws.

The Practical Effect of the Supreme Court’s Decision Not to Review

By denying certiorari, the Supreme Court has left it to the lower courts to continue to develop the legal and economic theories regarding bundled rebate programs and, one hopes, to identify and evaluate the weight of various factors that a seller with a dominant market share can apply to determine whether it can offer “package” discounts in particular circumstances. While other circuit courts may ultimately apply the *Brooke Group* approach, unless the Supreme Court intervenes, the Third Circuit’s approach may be binding on firms that do business in New Jersey, Pennsylvania or Delaware. The Third Circuit’s decision makes it clear that businesses with a high market share in any one product line may be vulnerable to actions under federal antitrust laws if they offer that product as part of a multi-product discount package, even if the pricing is not below cost. Businesses with that profile should consult counsel for a thorough analysis of how to construct any proposed “package” discounting to minimize antitrust exposure.

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