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Sixth Circuit Court of Appeals Adopts Below-Cost Standard for "Non-Explicit" Tying Arrangements

The United States Court of Appeals for the Sixth Circuit last week issued a significant opinion limiting the circumstances in which a defendant's pricing policies can be held to constitute unlawful tying arrangements under the antitrust laws.

In *Collins Inkjet Co. v. Eastman Kodak Co.*, No. 14-3306, the Sixth Circuit considered the standards applicable to claims of tying under Section 1 of the Sherman Act where the alleged tie is based on "differential pricing"—*i.e.*, "charging more for the tying product when the customer does not also purchase the tied product"—as opposed to an express contractual requirement that the customer purchase both products from the defendant. Slip Op. at 2. The Court held that where an alleged tying arrangement "is enforced solely through differential pricing, the tie is not unlawful unless the differential pricing is the economic equivalent of selling the tied product below the defendant's cost." *Id.* at 9. To meet that standard, the Court further held that plaintiffs would be required to show that the defendant's pricing policy fails the "discount attribution" test applied by the Court of Appeals for the Ninth Circuit to claims of bundled discounting under Section 2 of the Sherman Act, in *Cascade Health Solutions* v. *PeaceHealth*, 515 F.3d 883, 906 (9th Cir. 2008). Slip Op. at 10.

The Sixth Circuit's decision clarifies the legal standard applicable to tying claims based on differential pricing. The decision also is indicative of a broader trend in the treatment of antitrust claims based on allegedly "coercive" pricing policies. In a wide variety of contexts, including but not limited to tying and bundling, the federal courts have held that a defendant's unilateral pricing should not be penalized under the antitrust laws unless the prices customers are charged fall below an appropriate measure of the defendant's costs.[1]

Background

In certain circumstances, a seller's conditioning of the sale of one product (the "tied product") on the buyer's purchase from the seller of another product (the "tying product") may constitute a violation of the federal antitrust laws. To succeed on a tying claim, a plaintiff must show, among other things, that the

[1] Paul, Weiss counsel Daniel A. Crane, who is also the Frederick Paul Furth, Sr. Professor of Law at the University of Michigan Law School, has published extensively on the treatment of bundled discounts and other forms of discounting under the antitrust laws. Crane's academic work and amicus curiae brief played a prominent role in the Ninth Circuit's landmark decision in *PeaceHealth*.

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defendant has market power in the market for the tying product and that the defendant coerced the buyer into buying the tied product. *Id.* at 6. The Sixth Circuit and other federal courts have acknowledged that tying claims may be viable even in the absence of an express contractual provision requiring buyers to purchase both the tying product and the tied product from the defendant. In addition to "explicit" tying, tying claims may be based on various "non-explicit" mechanisms of coercion, which make it "unreasonably difficult or costly to by the tying product . . . without buying the tied product." *Id.* at 9.

Collins concerned an alleged non-explicit tying arrangement based on differential pricing. Specifically, plaintiff Collins Inkjet Corporation alleged that defendant Eastman Kodak Co. charged more favorable prices for refurbished commercial printer components for customers who also purchased ink from Kodak and less favorable prices for customers who purchased their ink from Collins. *Id.* at 2. Collins competes with Kodak in the sale of ink, but alleged that Kodak had no competitors for refurbished "printheads." Collins further alleged that Kodak had used its market power in the market for printheads (the tying product) to attempt to monopolize the ink market (the tied product). *Id.* In particular, Collins challenged a pricing policy that Kodak had adopted in 2013 under which customers who bought both ink and printheads from Kodak would receive a discount (of 4-6%) on the printheads, but customers who bought ink from Collins would see their printhead prices raised (by up to 30%). *Id.* at 4.

Collins sued Kodak, alleging violation of Section 1 of the Sherman Act, and sought a preliminary injunction to "prevent[] Kodak from charging Collins ink customers higher prices for refurbished printheads," among other things. *Id.* at 5. The district court granted the preliminary injunction holding that Collins had shown a substantial likelihood of success of proving that the increased price that Kodak customers would face for printheads if they did not also purchase Kodak ink coerced them into purchasing ink from Kodak instead of from Collins. *See id.*

The district court found that Kodak possessed monopoly power in the sale of refurbished printheads, a market in which Kodak conceded that it had 100% share. With respect to coercion, the district court found that "Collins had presented sufficient evidence to suggest that the additional cost of not switching to Kodak ink would be so great that all rational buyers of . . . ink would choose Kodak." *Id.*

The Court of Appeals Opinion

The Sixth Circuit agreed with the district court's conclusions, and affirmed the preliminary injunction. But, importantly, the Court of Appeals held that the lower court had used an incorrect standard in evaluating whether Kodak's pricing policy constituted unlawful coercion for purposes of a tying claim. Specifically, the Court held that the district court had erred "[b]y relying solely on its finding that Kodak's prices made buying Collins ink significantly more expensive than buying Kodak ink" to find economic coercion. *Id.* at 7.

In contrast to the standard applied by the district court, the Sixth Circuit held that "[i]n the special case of a tie enforced solely through differential pricing," the correct standard is that a "tie is not unlawful unless the differential pricing is the economic equivalent of selling the tied product below the defendant's cost." *Id.* at 9. "When differential pricing satisfies this test, it is functionally equivalent to the coercion present in an unlawful tying arrangement," *id.* at 7, assuming that the other elements of a tying claim (such as market power in the tying product) have been met. Absent evidence of below-cost pricing, however, the Court of Appeals held that a differential pricing policy—even by a defendant with market power—cannot be deemed to constitute unlawful tying.

The rationale for a below-cost standard in this context, the Court explained, is that differential pricing—"unlike other forms of indirect coercion"—is often procompetitive. *Id.* at 9. The Court emphasized that "[c]ompetitive sellers generally aim to make their products significantly cheaper than their competitors', and there is nothing inherently wrong with doing so via differential pricing." *Id.* at 7. For that reason, a standard that would not require proof of pricing below cost—like the one applied by the district court—"could too easily treat fair price competition as per se illegal under antitrust law." *Id.*

Having established a cost-based standard for determining when differential pricing can give rise to a tying claim, the Court went onto define a method for determining whether a differential pricing policy is "economically equivalent" to selling the tied product below cost. For this purpose, the Court expressly adopted the "discount attribution test" endorsed by the Ninth Circuit in *PeaceHealth* with respect to bundled discounts challenged as a form of monopolization under Section 2 of the Sherman Act. Under that test, the full amount of discounts given by the defendant on the bundle is allocated to the "tied" product, and the resulting effective price of the tied product is then compared to the defendant's incremental cost to produce that product. *See id.* at 10.

Applying the discount attribution test to Kodak's challenged pricing policy, the Court found enough evidence in the record to suggest that "Kodak was in effect selling ink below its incremental cost." *Id.* at 13. Having also found that Collins was likely to succeed in proving the other elements of a tying claim, and had satisfied the remaining requirements for a preliminary injunction, the Court of Appeals upheld the injunction.

Significance of the Decision

The *Collins* decision is notable for two principal reasons. First, the Sixth Circuit has now explicitly adopted a clear standard for evaluating tying claims where the tie is allegedly enforced through differential pricing: the tied product must be effectively priced below the defendant's cost. The Sixth Circuit's application of a cost-based standard in the context of tying claims based on differential pricing—and the Court's reasoning for applying such a standard, namely to avoid penalizing procompetitive conduct—is consistent with United States Supreme Court precedent holding that low prices do not violate the antitrust laws, regardless of the specific form they take. *See, e.g.*, *Atlantic Richfield Co.* v. *USA*

Petroleum Co., 495 U.S. 328, 340 (1990) ("Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. . . . We have adhered to this principle regardless of the type of antitrust claim involved."). The decision also is consistent with the Sixth Circuit's own precedents. For example, in *NicSand* v. *3M Co.*, 507 F.3d 442 (6th Cir. 2007) (en banc), a case involving "rebates and long-term exclusive contracts," the Court held that absent allegations that the defendant's pricing was "predatory or below cost," the plaintiff had failed to plead an antitrust injury. Slip Op. at 11-12. The *Collins* Court noted that even though the defendant's conduct had clearly injured the plaintiff in *NicSand*, "the point was that it was injured by *competition*, not by anticompetitive pricing or conduct." *Id.* at 12.

Second, the Sixth Circuit explicitly adopted the discount attribution test to determine whether the tied product is priced below cost in a tying arrangement based on differential pricing. In doing so, the Sixth Circuit aligned itself with the Ninth Circuit's (and other courts') approach to claims of bundled discounting, and expressly disagreed with the Third Circuit decision in *LePage's, Inc.* v. *3M*, 324 F.3d 141, 154-57 (3d Cir. 2003) (en banc), which held that proof of below-cost pricing is not required to establish a claim of unlawful bundling. *See* Slip Op. at 11.[2]

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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[2] The *LePage's* decision has been criticized by many courts and commentators, and its reach has been limited by the Third Circuit itself, which expressly adopted a below-cost standard for claims based on single-product "loyalty" or "market-share" discounts in *ZF Meritor* v. *Eaton*, 696 F.3d 254 (3d Cir. 2012).