

Bundled Discounts: The Ninth Circuit and the Third Circuit Are on Separate *LePage's**

*Cascade Health Solutions v. PeaceHealth*¹

I. INTRODUCTION

Most courts and commentators agree that the ultimate goal of antitrust is efficiency. Accordingly, an antitrust aim is to guarantee competitive markets, which both increases output and lowers prices to the benefit of consumers. Bundled discounts, packages of goods put together by a seller that are sold at a lower price than if each good were purchased separately, may provide a means of enhancing competition. Such bundles are prevalent in nearly every market including fast food value meals, season tickets to sporting events, and buy one, get one half-price schemes.

Sellers provide bundled discounts for a variety of reasons including the reduction of transaction costs, engendering customer loyalty, or sometimes in response to pressure from large, diversified buyers.² These discounts often result in increased output and decreased prices, which are consumer welfare increasing outcomes. However, it is possible for a seller who has multiple products to use bundled discounts to exclude an efficient competitor who only sells one product.³ This exclusionary conduct is exactly what antitrust laws are meant to discourage. However, because bundled discounts are so pervasive and are often procompetitive, any liability rules governing their legality should be narrowly drawn to avoid chilling such a desirable practice.⁴

In 2003, the Third Circuit decided a case, *LePage's, Inc. v. 3M*, involving a plaintiff that claimed the defendant's bundled discount was exclusio-

* A special thanks is necessary for Professors Thomas A. Lambert, D. Daniel Sokol, and Daniel A. Crane. Professor Lambert provided me with the case for this note, important insights into the Comment section of this paper, and a hard copy of the Law Professors' *Amicus* brief; Professor Sokol offered valuable feedback on the *PeaceHealth* decision; and Professor Crane was kind enough to furnish me with an electronic copy of the Law Professors' *Amicus* brief cited throughout the paper. All errors or omissions are my own.

1. Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229 (9th Cir. Sept. 4, 2007).

2. Brief of *Amici Curiae* Law Professors in Support of Defendant Appellant and Cross-Appellee PeaceHealth Supporting Reversal of the Verdict Concerning Bundled Discounts at 3, *McKenzie-Willamette Hospital v. PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229 (9th Cir. Sept. 4, 2007).

3. Judge Kaplan provides an oft cited example of such exclusionary conduct in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.* See *infra* notes 48-49.

4. Brief of *Amici Curiae* Law Professors, *supra* note 2, at 4.

nary.⁵ The Third Circuit held the bundling practices of office supply manufacturer 3M to be in violation of antitrust laws.⁶ However, in doing so, the court failed to set an effective standard to evaluate the anticompetitive nature of bundled discounts. In a recent decision, *Cascade Health Solutions v. PeaceHealth*, the Ninth Circuit strayed from the approach set forth in the *LePage*'s decision and set a cost-based standard to be used in the analysis of bundled discounts.⁷ While the standard set in *Peacehealth* is a positive step in analyzing bundled discounts, the Ninth Circuit may not have reached far enough. Because bundled discounting is typically a procompetitive practice, the court should fashion as narrow a rule as possible. It is possible to theorize a situation where, under the Ninth Circuit's standard, a competitor could bring a successful lawsuit against a bundled discounter even though the competitor could offer an equally competitive bundle if it collaborated with another firm. Therefore, the standard set forth by the Ninth Circuit falls short by ignoring the possibility of rival competitors collaborating to compete with a bundled discounter.

II. FACTS AND HOLDING

The primary actors in *Cascade Health Solutions v. PeaceHealth* are McKenzie-Willamette Hospital⁸ (McKenzie) and PeaceHealth. McKenzie and PeaceHealth are the sole providers of hospital care in Lane County, Oregon.⁹ McKenzie operates one hospital in Lane County with 114 beds, while PeaceHealth operates three facilities with a combined 464 beds.¹⁰ McKenzie and PeaceHealth both offer primary and secondary care,¹¹ but PeaceHealth offers tertiary care as well.¹² McKenzie brought a claim of attempted monopolization against PeaceHealth contending the healthcare provider was predatorily pricing them out of the market by offering discounts to insurers if they used PeaceHealth as their exclusive provider of hospital care.¹³

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

6. *Id.* at 169.

7. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *14 (9th Cir. Sept. 4, 2007).

8. McKenzie-Willamette Hospital was experiencing financial troubles during litigation of this claim and merged with Triad Hospitals, Inc. to form Cascade Health Solutions. *Id.* at *1 & n.1. The Court and the parties continually refer to Cascade Health Solutions as McKenzie in the briefs and opinion. *Id.* at n.1.

9. *Id.* at *1.

10. *Id.*

11. Primary and secondary care is defined as common medical services such as "setting a broken bone and performing a tonsillectomy." *Id.*

12. Tertiary care is defined as more complex services such as "invasive cardiovascular surgery and intensive neonatal care." *Id.*

13. *Id.* at *2.

In 2001, PeaceHealth was the only preferred provider of hospital care for Regence BlueCross BlueShield of Oregon (Regence).¹⁴ Later that year, McKenzie requested to participate in the Regence preferred provider plan (PPP) and offered Regence a ten percent discount off its standard rates.¹⁵ As Regence's contract with PeaceHealth approached its annual renewal, Regence solicited two proposals from PeaceHealth (one with PeaceHealth remaining as the exclusive provider and another including McKenzie).¹⁶ PeaceHealth offered a reimbursement rate of 90% if McKenzie was included in the PPP and 85% if they remained the exclusive provider.¹⁷ Regence then declined McKenzie's offer to be included in the PPP.¹⁸

Also in 2001, McKenzie requested admission into the preferred plan offered by Providence Health Plan (Providence) and was accepted.¹⁹ After McKenzie's admission to the plan, PeaceHealth increased its reimbursement rate with Providence from 90% to 93% for the following year.²⁰

Contending that PeaceHealth was tying its primary and secondary services with its tertiary services in order to obtain market power and exclude competitors, McKenzie filed a claim in the Ninth Circuit district court.²¹ The evidence produced at trial showed that insurers who used PeaceHealth exclusively for primary, secondary, and tertiary services paid lower reimbursement rates than insurers who purchased primary and secondary services from McKenzie and only tertiary services from PeaceHealth.²² This bundling of services in order to offer a discount was the main issue in the attempted monopolization claim.

The district court applied a jury instruction similar to the Third Circuit's decision²³ in *LePage's Inc. v. 3M*.²⁴ The jury was instructed that McKenzie was contending PeaceHealth bundled price discounts for its primary, secondary, and tertiary services, and "[b]undled price discounts may be anti-competitive if they are offered by a monopolist and substantially foreclose portions of the market to a competitor who does not provide an equally di-

14. *Id.*

15. Opening Brief of Appellant Peacehealth at 13, *McKenzie-Willamette Hospital v. PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229 (9th Cir. Sept. 4, 2007).

16. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *2 (9th Cir. Sept. 4, 2007).

17. *Id.*

18. *Id.*

19. Opening Brief of Appellant, *supra* note 15, at 16.

20. *Id.*

21. Complaint at 45-46, *McKenzie-Willamette Hospital v. PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229 (9th Cir. Sept. 4, 2007).

22. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *3 (9th Cir. Sept. 4, 2007).

23. *Id.* at *6.

24. 324 F.3d 141 (3d Cir. 2003) (en banc).

verse group of services and who, therefore, cannot make a comparable offer.²⁵ The jury returned a verdict in favor of McKenzie.²⁶

On appeal, however, the Ninth Circuit decided to part ways with the Third Circuit's decision in *LePage's* by adopting a cost-based standard to be applied in bundled discounting cases known as the "discount attribution" standard, instead of a formula that allows a firm to prove injury causally linked to an illegal presence in the market.²⁷ Under this standard, the entire amount by which the bundle is discounted is allocated to each of the competitive product or products.²⁸ If the price of the competitive product or products is below the defendant's incremental cost to produce them, the trier of fact may find the bundle exclusionary for purposes of section 2 of the Sherman Act.²⁹ This allows for a trier of fact to determine if an equally or more efficient producer of a similar good can be excluded from the market by a competitor who makes a more diverse line of products.³⁰ Furthermore, in determining the incremental cost in the cost-based standard, the Ninth Circuit decided the use of average variable cost was an appropriate measure.³¹ Therefore, the Ninth Circuit held that when a claim for attempted monopolization is brought with regard to bundled discounting practices, the court will apply a discount attribution standard to determine anticompetitive activity and utilize average variable cost in determining the incremental cost at issue.³²

III. LEGAL BACKGROUND

The starting point for any analysis of bundled discounts generally is *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, in which the Supreme Court set forth general standards for antitrust liability based on price cuts.³³ In that case, a cigarette manufacturer brought an antitrust action against its competitor for offering volume rebates that it claimed drove the price of its cigarettes below its cost.³⁴ *Liggett*,³⁵ a manufacturer of generic

25. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *7 (9th Cir. Sept. 4, 2007).

26. *Id.* at *1. The jury awarded \$5.4 million in damages to McKenzie which was trebled for a total of \$16.2 million as well as attorney's fees, costs, and expenses of over \$1.5 million. *Id.*

27. *Id.* at *9, *10.

28. *Id.*

29. *Id.*

30. *Id.* at *16.

31. *Id.* at *17.

32. *Id.*

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

34. *Id.* at 216-17.

35. *Brooke Group Ltd.* is referred to as *Liggett* in the case because this was its former corporate name. *Id.* at 212.

cigarettes, offered a variety of different products sold at a deep discount and with little or no advertising.³⁶ These generics accounted for approximately 4% of the cigarette industry's total sales.³⁷ One of Liggett's competitors, Brown & Williamson, saw a decline in its cigarette sales as Liggett's generics became more popular.³⁸ In response to declining sales, Brown & Williamson decided to enter the generics market with similar products.³⁹ Brown & Williamson's products were so similar to Liggett's that retailers had little incentive to carry both brands.⁴⁰ Therefore, although the cigarettes were priced similarly at the retail level, Brown & Williamson offered volume rebates to many wholesalers in order to carry its products over Liggett's.⁴¹ After a short price war, Liggett claimed its competitor was selling its generics below its costs in an attempt to pressure Liggett to raise its retail prices to more align them with prices of branded cigarettes that Brown & Williamson carried.⁴²

Although the claims brought and appealed in *Brooke Group* were Robinson-Patman Act claims, the Supreme Court reviewed this case in the same manner it would a violation of section 2 of the Sherman Act.⁴³ The Court noted that the standards for recovery are the same under each Act.⁴⁴ First, a plaintiff establishing competitive injury resulting from a competitor's lowered prices must prove the prices are below an appropriate measure of the competitor's cost.⁴⁵ Second, a plaintiff must demonstrate that the competitor had a reasonable prospect, under the Robinson-Patman Act, or a dangerous probability, under the Sherman Act, of recouping its investment of below-cost prices.⁴⁶ The Supreme Court found that although Liggett could establish competitive injury from below-cost prices, the cigarette company could not produce evidence sufficient to establish that Brown & Williamson could recoup its investment.⁴⁷ In holding as it did, the Supreme Court created safe harbors for above-cost price cuts.

While bundled discounts are essentially price cuts, they do raise some concerns that the broad safe harbors for above-cost discounts set forth in *Brook Group* should not apply. If the safe harbors applied to bundled discounts, certain exclusionary conduct would be under-deterred.⁴⁸ For this

36. *Id.*

37. *Id.* at 212-13.

38. *Id.* at 214-15.

39. *Id.* at 215.

40. *Id.*

41. *Id.*

42. *Id.* at 216-17.

43. *Id.* at 222.

44. *Id.*

45. *Id.*

46. *Id.* at 224.

47. *Id.* at 242-43.

48. Judge Kaplan's example in *Ortho* is explanatory of this principle:

Assume for the sake of simplicity that the case involved the sale of two hair products, shampoo and conditioner, the latter made only by A and the

reason, courts have subjected bundled discounts to enhanced scrutiny. Prior to *PeaceHealth*, three published federal decisions examined bundled discounts in detail.⁴⁹

The first case to give scrutiny to bundled discounts, without expressly saying so, was *SmithKline Corp. v. Eli Lilly and Co.*⁵⁰ That case entailed two manufacturers of antibiotic or anti-infective drugs, SmithKline and Eli Lilly (Lilly).⁵¹ SmithKline contended that Lilly violated section 2 of the Sherman Act by monopolizing the market for cephalosporin antibiotics by way of a price discounting scheme (i.e., bundled discount).⁵²

Between 1964 and 1973, Lilly enjoyed a monopoly in the market for cephalosporin antibiotics due to the patents it was holding.⁵³ In 1973, however, SmithKline entered the market with its own cephalosporin antibiotic, Ancef.⁵⁴ With SmithKline's cephalosporin Ancef identical to Lilly's drug Kefzol, the two pharmaceutical manufacturers were in direct competition with one another

former by both A and B. Assume as well that both must be used to wash one's hair. Assume further that A's average variable cost for conditioner is \$2.50, that its average variable cost for shampoo is \$1.50, and that B's average variable cost for shampoo is \$1.25. B therefore is the more efficient producer of shampoo. Finally, assume that A prices conditioner and shampoo at \$5 and \$3, respectively, if bought separately but at \$3 and \$2.25 if bought as part of a package. Absent the package pricing, A's price for both products is \$8. B therefore must price its shampoo at or below \$3 in order to compete effectively with A, given that the customer will be paying A \$5 for conditioner irrespective of which shampoo supplier it chooses. With the package pricing, the customer can purchase both products from A for \$5.25, a price above the sum of A's average variable cost for both products. In order for B to compete, however, it must persuade the customer to buy B's shampoo while purchasing its conditioner from A for \$5. In order to do that, B cannot charge more than \$0.25 for shampoo, as the customer otherwise will find A's package cheaper than buying conditioner from A and shampoo from B. On these assumptions, A would force B out of the shampoo market, notwithstanding that B is the more efficient producer of shampoo, without pricing either of A's products below average variable cost.

Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc., 920 F. Supp. 455, 467 (S.D.N.Y. 1996).

49. See *SmithKline Corp. v. Eli Lilly and Co.*, 575 F.2d 1056 (3d Cir. 1978); *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, 920 F. Supp. 455, 467 (S.D.N.Y. 1996); *LePage's, Inc. v. 3M*, 324 F.3d 141 (3rd Cir. 2003).

50. 575 F.2d 1056 (3d Cir. 1978).

51. *Id.* at 1059.

52. *Id.* at 1058.

53. *Id.*

54. *Id.*

er on one product line.⁵⁵ Lilly, however, carried five different versions of cephalosporin antibiotics, while SmithKline only carried two versions.⁵⁶

Prior to SmithKline's entry into the market, Lilly adopted the Cephalosporin Savings Plan, which offered rebates based on the amount of cephalosporin purchased.⁵⁷ As competition in the market increased, Lilly revised its savings plan to provide rebates at lower rates than before.⁵⁸ This included a 3% bonus rebate when a purchaser bought a set minimum quantity of three of Lilly's five cephalosporin antibiotics.⁵⁹ Essentially, this structured rebate scheme was a bundled discount. Lilly was discounting each product purchased when a minimum of three products were purchased.⁶⁰ SmithKline argued that this pricing package was exclusionary because it would be forced to offer hospitals a 16% to 35% discount in order to compete.⁶¹

The court found that the effect of Lilly's revised purchasing plan was to force SmithKline to pay rebates on one product, equal to those paid by Lilly on three products.⁶² The court held that Lilly was using its monopoly power to affect price, supply, and demand of its competitor's and its own cephalosporin antibiotics, thus violating section 2 of the Sherman Act.⁶³

The second case to examine bundled discounting was a New York district court decision, which was also discussed in relation to a section 2 violation of the Sherman Act.⁶⁴ *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.* involved two rival blood test manufacturers.⁶⁵ Abbott produced five different blood tests while Ortho produced three competing blood tests.⁶⁶ The behavior complained of by Ortho consisted of Abbott offering discounts to purchasers who bought four types of blood tests and steeper discounts to those who bought all five.⁶⁷ Thus, Ortho contended that Abbott improperly used its dominance in the market to compel purchasers to buy the discounted bundle and gain an improper competitive advantage in the market for the competing products.⁶⁸

In examining the claims, the court noted that Abbott was pricing above its average variable cost, but because it was a bundled discounting case, that measure may not have been entirely appropriate.⁶⁹ The court commented that

55. *Id.*

56. *Id.* at 1060.

57. *Id.* at 1059-60.

58. *Id.* at 1060.

59. *Id.*

60. *Id.*

61. *Id.* at 1062.

62. *Id.* at 1065.

63. *Id.*

64. *Ortho*, 920 F. Supp. 455 (S.D.N.Y. 1996).

65. *Id.* at 463.

66. *Id.* at 458-59.

67. *Id.* at 460.

68. *Id.* at 463.

69. *Id.* at 466.

although each product in a bundle may be priced above the average variable cost, the overall discount can still be used to exclude an equally efficient competitor.⁷⁰ This, the court said, distinguished the case from the Supreme Court's previous decision involving a single product in *Brooke Group*.⁷¹

The court in *Ortho* also examined the fact that Abbott was not only pricing above its average variable cost, but it was pricing above Ortho's costs as well.⁷² This led the court to hold that in a bundled discounting case, a plaintiff must allege and prove the monopolist priced below its average variable cost or prove that the plaintiff is at least as efficient a producer of the competitive product as the defendant, but the defendant's pricing makes it unprofitable for the plaintiff to continue producing the competing product.⁷³

The third case examining bundled discounts was a 2003 decision from the Third Circuit.⁷⁴ In that case, *Lepage's v. 3M*, there was a dispute between a company that manufactured private label tape for retailers and 3M, a producer of various office supplies including transparent tape.⁷⁵ In 1980, LePage's decided to sell private label tape to individual retailers, and ultimately to consumers, at a lower price than branded tape.⁷⁶ 3M then decided to enter the discount tape market with its own "second brand" tape, thereby competing with LePage's on a more direct level.⁷⁷ 3M also offered bundled rebates when retailers purchased other goods with which LePage's did not compete.⁷⁸ LePage's contended that 3M used the bundled rebates and exclusive dealings to maintain its monopoly in the transparent tape market.⁷⁹

The trial court allowed the case to go to the jury who returned a verdict favoring LePage's on the section 2 Sherman Act claim, as well as other claims.⁸⁰ The District Court granted 3M's motion for judgment as a matter of law on the section 2 claim, and LePage's cross-appealed.⁸¹ 3M's argument on appeal, quoting *Brooke Group*, underlined the fact that none of the products in their bundled rebates included prices that were below-cost.⁸² However, the Third Circuit rejected this argument as insufficient.⁸³ The court distinguished *Brooke Group* from this case by noting that 3M was a mono-

70. *Id.* at 467.

71. *Id.*

72. *Id.* at 469.

73. *Id.*

74. *Lepage's, Inc. v. 3M*, 324 F.3d 141 (3rd. Cir. 2003).

75. *Id.* at 144. 3M controlled approximately 90% of the market for transparent tape until the early 1990's. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 154.

79. *Id.*

80. *Id.* at 145.

81. *Id.*

82. *Id.* at 154.

83. *Id.* at 152.

polist, while Brown & Williamson was an oligopolist.⁸⁴ Further, the court held that 3M's conduct was anticompetitive.⁸⁵ Although in doing so, the court did not set out a clear test as to what defines the anticompetitive conduct. LePage's was only required to show that the bundled discount offered by 3M included products that it did not sell,⁸⁶ although 3M could rebut this presumption of anticompetitive behavior if its actions were carried out for valid business reasons.⁸⁷ The Third Circuit appears to hold that "bundled discounts are presumptively exclusionary if the discounter is bundling products not sold by its rivals and is winning business from those rivals, but [] the presumption may be rebutted if the discounter proves a business reasons justification for the bundled discounts."⁸⁸

IV. THE INSTANT DECISION

In the instant case, the Ninth Circuit addressed the issue of attempted monopolization by way of bundled discounts. To provide a prima facie case for attempted monopolization, the court noted that a plaintiff must show that the defendant engaged in predatory or anticompetitive conduct with the intent to monopolize and with a dangerous probability of achieving monopoly power.⁸⁹ The court focused on the first element of this test in addressing when bundled discounts amount to anticompetitive conduct.⁹⁰

The Ninth Circuit noted that bundled discounts are generally beneficial to consumers because they provide an immediate benefit in the form of lower prices.⁹¹ The court also stated that bundled discounts allow the seller to benefit from reduced transaction and distribution costs.⁹² However, the court noted that using bundled discounts can theoretically exclude an equally or more efficient competitor, reducing long term consumer welfare.⁹³

In determining the test to be used to establish the anticompetitive effect of a bundled discount, the court first examined the test set out by the Third

84. *Id.* at 151.

85. *Id.* at 163.

86. *Id.* at 155-57.

87. *Id.* at 163.

88. Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1721 (2005).

89. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *3 (9th Cir. Sept. 4, 2007) (quoting *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993), *Amarel v. Connell*, 102 F.3d 1494, 1521 (9th Cir. 1996)).

90. *Id.*

91. *Id.* at *4 (citing Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 MINN. L. REV. 1688, 1726 (2005)).

92. *Id.* (citing *United States v. Microsoft Corp.*, 253 F.3d 34, 87 (D.C. Cir. 2001) (per curiam)).

93. *Id.* at *5.

Circuit in *LePage's*.⁹⁴ *LePage's*, however, failed to set a below-cost pricing requirement to bundled discounting.⁹⁵ Citing the Antitrust Modernization Commission, the Ninth Circuit stated that by failing to set this below-cost standard, the Third Circuit was leaving open the ability for a less efficient producer to claim an anticompetitive injury simply because it does not produce an equally diverse product line.⁹⁶

Furthermore, the *PeaceHealth* court looked to the Supreme Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*⁹⁷ and its application of below-cost pricing requirements to predatory pricing and tying claims.⁹⁸ The Ninth Circuit noted the Supreme Court's emphasis on the broad application of the principle that only below-cost prices are anticompetitive and that the principle should be adhered to regardless of the antitrust claim involved.⁹⁹ Therefore, the Ninth Circuit rejected the Third Circuit's analysis, and reviewed other cost-based standards.¹⁰⁰

The first cost-based standard reviewed by the court was referred to as the "aggregate discount rule."¹⁰¹ Under this rule, bundled discounts would be deemed anticompetitive when the discounted price of the entire bundle does not exceed the bundling firm's incremental cost of producing the bundle.¹⁰² The court, however, rejected this theory because under some bundled discounting schemes, some firms could escape liability.¹⁰³ If a plaintiff is an equally or more efficient producer of one product, and the defendant is a producer of a diverse line of products, the defendant could bundle multiple products and discount each above incremental cost.¹⁰⁴ Theoretically, the defendant could then exclude the efficient plaintiff without pricing below an incremental cost.¹⁰⁵ Because of the ability for some anticompetitive conduct to escape liability and the fact that this could chill competition, the court explored whether a more efficient rule existed.¹⁰⁶

In searching for an alternative cost-based rule, the court turned to the decision in *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*¹⁰⁷ and the cost-

94. *Id.* at *6.

95. *Id.*

96. *Id.* at *8.

97. 509 U.S. 209 (1993).

98. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *9 (9th Cir. Sept. 4, 2007).

99. *Id.* (citing *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993)).

100. *Id.* at *11.

101. *Id.* at *12.

102. *Id.*

103. *Id.* at *13.

104. *Id.*

105. *Id.*

106. *Id.*

107. 920 F. Supp. 455 (S.D.N.Y. 1996).

based standard derived therefrom.¹⁰⁸ Under *Ortho*, a bundled discount is exclusionary if the plaintiff can show it is an equally efficient producer of the competitive product, but the defendant made it impossible to continue producing it profitably due to the bundled discount.¹⁰⁹ The plaintiff would have to show that either the monopolist competitor priced below its average variable cost or that the plaintiff is at least an equally efficient producer as the defendant, but the defendant's pricing makes it unprofitable for the plaintiff to continue producing.¹¹⁰ This standard is better at identifying bundled discounts that harm competition than the aggregate discount rule.¹¹¹ However, this standard is problematic because it looks to the costs of the actual plaintiff, and a potential defendant may not have access to information about competitors' costs.¹¹² Furthermore, a plaintiff might not be an equally efficient producer as the defendant, while another rival may be.¹¹³ Therefore, the court noted that this rule may require additional lawsuits to determine the legality of a single bundled discount, thereby encouraging more litigation than is necessary to stop anticompetitive practices.¹¹⁴ For these reasons, the court rejected the *Ortho* standard.¹¹⁵

Lastly, the court looked to the "discount attribution standard."¹¹⁶ Under this standard, the full amount of the discount given to the entire bundle is allocated to the competitive product or products.¹¹⁷ If the resulting price of the competitive product or products is then below the defendant's incremental cost to produce them, the judge or jury can find the bundled discount exclusionary and therefore anticompetitive.¹¹⁸ The discount attribution standard thereby makes a bundled discount legal unless it can exclude a hypothetically equally efficient producer of the competitive product or products from the market.¹¹⁹ The Ninth Circuit held this standard to be sufficient in recognizing anticompetitive behavior in bundled discounts and continued its analysis by determining the appropriate measure of incremental costs.¹²⁰

In determining the proper measure, the court considered marginal and average variable costs.¹²¹ The Ninth Circuit noted that marginal costs may be too difficult for firms to infer from business accounts, and therefore average

108. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *13 (9th Cir. Sept. 4, 2007).

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.* at *14.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* at *16-17.

121. *Id.* at *17.

variable costs would be a more practical measure.¹²² Further, the court commented that in a number of Circuits, average variable costs are used to indicate predation.¹²³ Thus, the court decided average variable costs as an appropriate measure to determine incremental costs in bundled discount cases.¹²⁴

V. COMMENT

The Ninth Circuit's decision in *PeaceHealth* and subsequent split from the Third Circuit's decision in *LePage's* is beneficial to antitrust law because it provides a standard by which firms and litigants can determine whether their conduct in bundling discounts is anticompetitive. Furthermore, *PeaceHealth* reaffirms the Supreme Court's decision regarding above-cost price discrimination in *Brooke Group*. However, the ultimate goals of antitrust law include providing increased output and lower prices to consumers. Therefore, decisions of the type in *LePage's* and *PeaceHealth* that deal with discounts to consumers, which are typically procompetitive, should be made and read narrowly so as not to chill competition and reduce consumer benefits. In moving away from the *LePage's* decision and applying a below-cost standard to bundled discounting cases, the Ninth Circuit is achieving the goals designed by antitrust law; however, it may be possible to theorize a situation where the court's standard falls short.

In *LePage's*, the Third Circuit provided little in the way of a standard for proving anticompetitive conduct in a bundled discounting case. This was problematic for various reasons. The court did not require *LePage's* to prove that it could not price its products at the same level as 3M and do so profitably. The court simply made it illegal to bundle discounts across varying product lines when a competitor does not have an equally diverse line without showing a business justification for doing so.¹²⁵ In applying this standard, consumers may be forced to bear the cost of less efficient producers. By allowing a less efficient producer to remain in the market because it does not have as diverse a product line as another competitor, the prices of the competing products will remain artificially high and passed to the consumer. Furthermore, the decision may chill competition and raise consumer prices by limiting the practice of bundling. Firms offering bundled discounts may be subject to antitrust lawsuits, and the consequences of treble damages, solely because they offer more products or services than certain competitors. Therefore, there is a disincentive for a firm to offer bundled discounts, volume purchase discounts across product lines, and other consumer welfare maximizing practices under the *LePage's* standard.

122. *Id.*

123. *Id.*

124. *Id.*

125. *LePage's*, 324 F.3d at 163.

The Ninth Circuit's split from the *LePage's* decision, then, provides a standard to which firms can look to structure bundled discounts without fear of unsubstantiated litigation. The discount attribution standard in *PeaceHealth* reduces the chance of applying liability to firms that are offering pro-competitive packages to purchasers because a seller can ascertain its own prices and production costs and calculate whether it is in violation of the court's decision.¹²⁶ Furthermore, in not adopting the standard in *Ortho*, the Ninth Circuit also avoided an approach that would be too burdensome on producers to assess the costs of all competitors when packaging a procompetitive bundle.¹²⁷ The discount attribution standard, as opposed to the *Ortho* approach, allows the producer to assess its own costs and therefore those of a hypothetically equally efficient producer. If a firm cannot exclude a hypothetically equally efficient competitor, then its bundle cannot be anti-competitive.

While the Ninth Circuit's decision is highly beneficial in standardizing antitrust law in the area of bundled discounts, a situation could be theorized where a producer's bundling practices are deemed anticompetitive although there are sufficient single-product rivals to compete with each individual product in the bundle.¹²⁸ For example, one could imagine a three-actor world where there is a manufacturer that produces two products A and B (Seller A-B), one equally efficient competitor that produces only A (Competitor A), and another equally efficient competitor that produces only B (Competitor B). In this world, Seller A-B could combine both products into a bundle and discount the bundle as to exclude Competitor A from the market.¹²⁹ Under the discount attribution standard in *PeaceHealth* as well as the standard in *Ortho*, this practice is illegal and violates antitrust law. However, the courts seem to ignore the existence of the ability for mutual rivals to collaborate. In this three-actor world, Competitor A may have the ability to collaborate with Competitor B to form a bundle that competes with Seller A-B's bundle, thereby benefiting consumers with lowered prices.

Although this is a hypothetical situation, it exists in practice and can be seen in the bundled discounting cases previously discussed. In *Ortho*, the plaintiff was able to collaborate with a manufacturer of blood tests that it did not produce in order to compete with the defendant.¹³⁰ At the time leading to trial in *PeaceHealth*, McKenzie-Willamette Hospital merged with Triad Hospitals, Inc. in order to provide tertiary care, the non-competing product in the

126. *PeaceHealth*, at *16.

127. *Id.* at *14.

128. See Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 EMORY L.J. 423, 480-81.

129. See Judge Kaplan's shampoo and conditioner example in *Ortho*. *Supra* note 49.

130. *Id.* at 461.

bundle.¹³¹ Some antitrust law professors have contended that a narrower standard than that in *PeaceHealth* is appropriate.¹³² For example, Professor Thomas A. Lambert has offered a narrower standard that would require proof by the plaintiff, prior to enjoining the discounts, that collaboration with sellers of products within the other product markets was impossible.¹³³ Further, Professor Daniel A. Crane suggests that there should be immunity for above-cost bundles where rivals compete in all covered markets.¹³⁴ This would insure that judicial condemnation of an above-cost bundle was a last resort.¹³⁵

To say the decision in *PeaceHealth* could be narrower is not to say it is an unhealthy standard for antitrust law. The standard as set out in *LePage's* gave little direction and standardization to bundled discounting cases. Therefore, the Ninth Circuit's split from the Third Circuit should be viewed as a step forward in advancing the ultimate goals of antitrust. However, a narrower rule would lessen the possibility of subjecting a bundled discounter to antitrust violations, when the discounter's competitors could collaborate with one another to compete with the discounter on price.

VI. CONCLUSION

In sum, the Ninth Circuit's decision in *PeaceHealth* is a positive development for antitrust law and encourages the goals that antitrust aims to promote, namely efficiency and competition in markets. By adopting the discount attribution standard, the Ninth Circuit not only provides a better standard for evaluating the liability of a typically procompetitive practice, it opens the door for the Supreme Court to review cost-based analyses of bundled discounts. However, the standard devised in *PeaceHealth* may not reach far enough. With a pervasive and consumer welfare increasing practice, such as bundled discounting, it is important to have a narrow rule. Therefore, the court falls short in assessing situations involving the possibility of collaboration when rivals compete in the markets covered by the bundled discounter.

BLAKE I. MARKUS

131. *PeaceHealth*, Nos. 05-35627, 05-35640, 05-36153, 05-36202, 2007 WL 2473229, at *1 (9th Cir. Sept. 4, 2007).

132. See Lambert, *supra* note 88. See also Crane, *supra* note 128.

133. Lambert, *supra* note 88, at 1747.

134. Crane, *supra* note 128, at 480-81.

135. Lambert, *supra* note 88, at 1747.