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Antitrust Practice

**Ninth Circuit Issues Important Decision on Bundled Discounts in *PeaceHealth***

On September 4, 2007, the Ninth Circuit issued an important decision concerning the antitrust treatment of “bundled discounts,” the common practice of providing greater discounts in exchange for purchasing a range of products or services. In *Cascade Health Solutions v. PeaceHealth*, the court held that an antitrust plaintiff can “prove that a bundled discount was exclusionary or predatory” under § 2 of the Sherman Act only if the plaintiff establishes that, “after allocating the discount given by the defendant on the entire bundle of products to the competitive product or products, the defendant sold the competitive product or products below its average variable cost of producing them.” This standard is noticeably tougher to satisfy than the one applied by the district court (which was based on the Third Circuit’s *en banc* decision in *LePage’s Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003)), and brings the Ninth Circuit in line with the standard recently proposed by the Antitrust Modernization Commission.

The case arose from a challenge to the pricing practices of a hospital system in Lane County, Oregon. PeaceHealth operates three hospitals in Lane County, the largest of which provides “primary,” “secondary,” and “tertiary” hospital care. “Primary and secondary” care includes common medical services like setting a broken bone and performing a tonsillectomy, while “tertiary care” encompasses more complex services like invasive cardiovascular surgery and intensive neonatal care. PeaceHealth offered insurers (which are the effective purchasers of hospital services on behalf of patients) a discount on tertiary services if the insurers made PeaceHealth their sole preferred provider for *all* services—primary, secondary, and tertiary.

A rival hospital that provided only primary and secondary hospital care services, McKenzie-Willamette Hospital, brought suit against PeaceHealth, claiming that these bundled discounts (and other practices by PeaceHealth) were anticompetitive and constituted monopolization, attempted monopolization, conspiracy to monopolize, tying, and exclusive dealing in violation of the Sherman Act, and price discrimination and tortious interference in violation of Oregon law. The district court granted summary judgment in favor of PeaceHealth on the tying claim, but allowed the other claims to proceed to trial before a jury. Following the Third Circuit’s decision in *LePage’s*, the court instructed the jury that bundled discounts “may be anticompetitive if they are offered by a monopolist and substantially foreclose portions of the market to a competitor who does not provide an equally diverse group of services and who therefore cannot make a comparable offer.” The jury found for PeaceHealth on the monopolization, conspiracy to monopolize, and exclusive dealing claims. However, the jury found for McKenzie on its attempted monopolization claim and its Oregon state law claims.

The Ninth Circuit reversed, holding that the jury was incorrectly instructed about when bundled discounting can amount to anticompetitive conduct. As the court explained, “[b]undled discounts are pervasive” and “generally benefit buyers because the discounts allow the buyer to get more for less.” Thus,

“we should not be too quick to condemn price-reducing bundled discounts as anti-competitive, lest we end up with a rule that discourages legitimate price competition.” However, the district court’s bundling instruction—and the *LePage’s* standard on which it was based—would lead to precisely that deterrent effect, because it potentially allowed for liability even when the plaintiff was less efficient than the defendant, and “it does not consider whether the bundled discounts constitute competition on the merits, but simply concludes that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line.” Following the report of the Antitrust Modernization Commission, as well as the United States Supreme Court’s decisions in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), and *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007), the court concluded that bundled discounts cannot be considered exclusionary conduct under § 2 of the Sherman Act “unless the discounts result in prices that are below an appropriate measure of the defendant’s costs.”

Analyzing the various measures of costs set forth by the parties and amici, the Ninth Circuit adopted a “discount attribution” standard under which “the full amount of the discounts given by the defendant on the bundle are allocated to the competitive product or products. If the resulting price of the competitive product or products is below the defendant’s [average variable cost] to produce them, the trier of fact may find that the bundled discount is exclusionary for the purpose of § 2.” The court acknowledged that this discount attribution standard “has the potential to sweep more broadly” than other proposed standards. But it noted that there was limited judicial and academic experience with bundled discounts. “Pending further judicial and academic inquiry into the prevalence of anticompetitive bundled discounts, we think it preferable to allow plaintiffs to challenge bundled discounts if those plaintiffs can [meet the discount attribution standard] and prove a defendant’s bundled discounts would have excluded an equally efficient competitor.”

The court then held that application of this standard required vacatur of the judgment and a new trial on the attempted monopolization and Oregon state law claims, because it could not be presumed that the instructional error was harmless. The court also reversed the summary judgment in favor of PeaceHealth on the tying claim, holding that the tying claim should proceed to trial as well, because there was a genuine dispute of material fact whether insurers were “coerced” into purchasing bundled hospital care services.

The Ninth Circuit’s ruling in *PeaceHealth* will have a significant impact on bundled discounting cases. Up to now, many courts have followed *LePage’s* and allowed the jury to find bundled discounts exclusionary merely upon a showing that a competitor could not offer the same bundle as the defendant. *PeaceHealth* pointedly criticizes the *LePage’s* approach, joining the Antitrust Modernization Commission and many other commentators. The Ninth Circuit’s discount attribution standard is much tougher to satisfy and should provide a safe harbor for many forms of bundled discounts.

The *PeaceHealth* ruling also has considerable implications for other types of § 2 claims as well. The opinion stresses the importance of “clear standards” by which firms can assess the legality of their conduct and expresses the need for extreme caution before condemning the manner in which a firm prices its product(s), explaining that *Brooke Group* and *Weyerhaeuser* “show a measured concern to leave unhampered pricing practices that might benefit consumers, absent the clearest showing that an injury to

the competitive process will result.” These principles apply to a wide variety of § 2 claims and signal that the Ninth Circuit may be willing to adopt more objective—and permissive—antitrust standards than before.

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