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Cascade Health Solutions v. PeaceHealth

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Life is but a bundled discount. From fast food value meals to cable packages, bundled discounts permeate nearly every facet of consumer consumption up and down the distribution chain.[1] Bundled discounting is the practice of selling a group or collection of products at a price that is less than the total price for which the products are sold separately.[2] At first blush, bundled discounts appear to embrace the values of antitrust law by enhancing competition[3] and benefiting the consumer by making products available at a lower price.[4] However, bundled discounts also have the potential to be anticompetitive and cause harm.[5] Courts have only recently, with any regularity, addressed the legality of bundled discounts and attempted to create a workable legal test to determine whether bundling violates antitrust laws.[6]

In *Cascade Health Solutions v. PeaceHealth*, the Ninth Circuit addressed whether a hospital's deep discounts to insurers for making it their sole preferred provider for all hospital care services constituted anticompetitive behavior in violation of section 2 of the Sherman Antitrust Act ("Sherman Act").[7] Defendant PeaceHealth allegedly used its monopoly market power[8] in tertiary care services to squeeze out competition

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1. *See* Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 905 (9th Cir. 2007) (providing a list of examples of common bundled discounts and noting that bundled discounts are a pervasive pricing strategy used by a wide range of entities from large corporations involved in various industries to food-cart street vendors).

2. *Id.*

3. *See* Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F.Supp. 455, 465 (S.D.N.Y. 1996) ("Price cutting is a classic, and a socially desirable, form of competition.").

4. Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 Minn. L. Rev. 1688, 1698 (2005) ("[B]undled discounts are, first and foremost, discounts. They always benefit consumers in the short term."). Usually, lower prices are a valued byproduct of competitive behavior. *Id.* at 1726 (noting that bundled discounts drive prices closer to actual costs, which is where prices would be if there were perfect competition). However, the short term lowering of prices is not the objective of competition laws. *See Cascade Health Solutions*, 502 F.3d at 912–13. *But cf. id.* at 906 ("[B]ecause of the benefits that flow to consumers from discounted prices, price cutting is a practice the antitrust laws aim to promote." (citing Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986))).

5. *Cascade Health Solutions*, 502 F.3d at 906 ("[I]t is possible, at least in theory, for a firm to use a bundled discount to exclude an equally or more efficient competitor and thereby reduce consumer welfare in the long run."); *see also infra* p. 342 and note 63 for a discussion and examples of how above-cost pricing can be harmful.

6. *See Cascade Health Solutions*, 502 F.3d at 918–19 (noting that the judiciary has limited experience with bundled discounts); Brief for the United States as Amicus Curiae Supporting Respondent at 12 n.9, LePage's Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003) (No. 02-1865) (providing general outline of judicial history of bundled discounts and related practices); Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 Emory L.J. 423, 425 n.4 (2006) (providing a list of recent cases and cases pending before various courts).

7. *See Cascade Health Solutions*, 502 F.3d at 904–05.

8. Monopoly market power alone is not *per se* unlawful. *See* U.S. v. Grinnell Corp., 384 U.S. 563, 570–71 (1966) (noting that monopoly power, without willful acquisition or maintenance of that power, is not necessarily unlawful); LePage's, Inc. v. 3M, 324 F.3d 141, 148 (3d Cir. 2003) (noting that, as applicable to the Sherman Act, it has long been accepted that a company with a monopoly need not necessarily have monopolized the market); Masimo Corp. v. Tyco Health Care Group, L.P., No. CV 02-4770, 2006 U.S. Dist. LEXIS 29977, at *30 (C.D. Cal. Mar. 22, 2006) ("The possession of monopoly power in and of itself does not amount to a section 2 violation; the monopoly power must be maintained unlawfully.").

in primary and secondary care services.[9] The court held that bundled discounting is not an exclusionary practice in violation of section 2 of the Sherman Act unless the discounts result in prices below an appropriate measure of the discounter's cost.[10] Section 2 of the Sherman Act prohibits an attempt "to monopolize any part of the trade or commerce among the several States, or with foreign nations."[11] To establish an attempt to monopolize claim, the plaintiff bears the burden of proving, "that the defendant has engaged in predatory or anticompetitive conduct."[12] In determining whether bundled discounting is anticompetitive, courts have applied either a cost-based analysis or a market-based analysis. A cost-based analysis focuses on the discounter's package pricing relative to production costs. The market-based approach, on the other hand, focuses less on the discounter's individual pricing schemes and instead focuses on the structure of the relevant product market and the competitors in that market.

This case comment contends that, while the court correctly noted that a market-based test which finds bundled discounts presumptively illegal is too broad, so too is the cost-based discount attribution standard adopted by the Ninth Circuit. Instead of applying a broad test, courts would be better served by adopting a cautious approach to assessing liability, and should apply a test that presumes bundled discounts are lawful. A cautious approach prevents the unnecessary chilling of competitive behavior while still actively monitoring and preventing anticompetitive behavior.[13]

Cascade Health Solutions (f/k/a McKenzie-Willamette Hospital ("McKenzie"))[14] and PeaceHealth are the only two providers of hospital services in Lane County,

9. *See Cascade Health Solutions*, 502 F.3d 895.

10. *Id.* at 913–14. Because a bundled discounter may force an efficient competitor from the market without pricing the individual products in the bundle or the bundle as a whole below the cost, determining the "appropriate measure" of cost is difficult. *Id.* at 914.

11. 15 U.S.C. § 2 (2000).

12. *Cascade Health Solutions*, 502 F.3d at 904 (quoting Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 456 (1993)). Engaging in anticompetitive conduct has the tendency to impede rivals because the defendant is not engaging in competition on its merits or is engaging in conduct more restrictive than necessary. *Id.* (citing Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 n.32 (1985)).

13. *Cascade Health Solutions*, 502 F.3d at 913 ("[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition, and therefore, mistaken findings of liability would chill the very conduct antitrust laws are designed to protect." (quoting Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069, 1075 (2007))); *see also id.* at 915 (noting that in developing a rule, a balance should be sought between a test that identifies anticompetitive behavior and results in minimal harm to competition); Crane, *supra* note 6, at 427–28 (noting that courts initially imposed "draconian liability" on tying behavior that was usually benign, and they should learn from past mistakes and begin all Sherman Act analysis with an "inquiry into the reasons firms engage in that conduct").

14. Subsequent to the initiation of this litigation, McKenzie-Willamette Hospital merged with Triad Hospitals, Inc. in an effort to stymie financial losses and add tertiary care services to its product mix. As a result of this merger, McKenzie's name changed to Cascade Health Solutions. *Cascade Health Solutions*, 502 F.3d at 902 & n.1.

Oregon.[15] McKenzie operates one 114-bed hospital and offers only primary and secondary acute care hospital services ("ACHS").[16] In contrast, PeaceHealth operates three hospitals, the largest of which is a 432-bed facility offering primary, secondary, and tertiary ACHS.[17] While PeaceHealth has only 75% of the market share for primary and secondary ACHS, it has 90% of the market share for tertiary neonatal services and 93% of the market share for tertiary cardiovascular services.[18]

In the hospital services market, the primary consumers are the insurance companies that purchase health services from hospitals at a designated fee on behalf of their insured.[19] The relationship between the insurance companies and hospitals is usually a contractual arrangement in which the parties agree on a reimbursement rate (i.e., a percentage discount from the hospital's regular service rates).[20] In 2001, PeaceHealth was the sole preferred provider under several insurance companies' preferred provider plans ("PPPs"), including Regence Blue Cross Blue Shield ("Regence").[21] PeaceHealth offered Regence a 24% discount on all services. McKenzie subsequently petitioned the same insurance companies to be added as a preferred provider.[22] When McKenzie petitioned for preferred provider status, PeaceHealth penalized Regence by adjusting the discount available to it to 15% if PeaceHealth remained the sole preferred provider for all services, but only offered it a 10% discount if it added McKenzie as a preferred provider for primary and secondary ACHS.[23] Similarly, other insurance providers that added McKenzie to their PPP saw their discounts from PeaceHealth decrease.[24] In effect, PeaceHealth was using its market power in tertiary care services to offer financial incentives to insurance companies to keep PeaceHealth as its exclusive preferred provider for all services.

In January 2002, McKenzie filed a complaint in the United States District Court for the District of Oregon alleging, among other things, that PeaceHealth's attempt to monopolize the primary and secondary ACHS market violated section 2 of the

15. *Id.* at 901.

16. *Id.* at 902.

17. *Id.*

18. *Id.*

19. *See id.*

20. *Id.* For example, if the parties have a contract establishing a 90% reimbursement rate, when a patient (a client of the insurance company) seeks hospital services, then the insurance company will receive a 10% discount from the market price of the particular hospital service. *Id.*

21. *Id.* at 903.

22. *Id.*

23. *See id.*

24. *Id.* Overall, insurers who maintained an exclusive PPP with PeaceHealth were given a greater percentage discount than insurers who purchased some ACHS from McKenzie. *Id.*

Sherman Act.[25] Relying on the Third Circuit's *en banc* decision in *Lepage's Inc. v. 3M*, the District Court provided the following jury instructions: "[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 diverse group of services and who therefore cannot make a comparable offer."[26]

On appeal, PeaceHealth objected to these instructions, arguing that they made bundled discounts illegal *per se* based purely on market structure.[27] Specifically, PeaceHealth argued that the application of the *LePage's* test would prohibit a company from offering a bundled discount simply because its competitor offered a less diverse scope of products.[28] PeaceHealth suggested that a cost-based analysis of the discount was the correct basis by which to analyze a section 2 violation.[29] It proposed that the appropriate test was either (i) a modified application of the single product predatory pricing test established in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.* or (ii) the full attribution test set forth by the court in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*[30]

In *Brooke Group*, the United States Supreme Court held that single product predatory pricing is exclusionary under section 2 of the Sherman Act when (i) a discounter prices below its production cost and (ii) the discounter is able to recoup its short term losses once the predation period has ended.[31] Extending this reasoning to multiple product bundling, the *Brooke Group* analysis leads to the conclusion—or so PeaceHealth and the amici supporting PeaceHealth argue—that bundled discounts are exclusionary only where the price of the bundled products is less than the total cost of producing those products.[32] PeaceHealth argued that this bright-line test has two benefits: protecting the competitive process and clarity.[33] First, PeaceHealth asserted that antitrust laws were designed to protect the competitive process by encouraging aggressive competition.[34] Pricing is the primary means of economic rivalry

25. Civil Complaint at 3, McKenzie-Willamette Hosp. v. PeaceHealth, 2003 U.S. Dist. LEXIS 16203, No. 02-6032 (D. Or. Jan. 28, 2002).

26. *Cascade Health Solutions*, 502 F.3d at 909.

27. *Id.*

28. *Id.*

29. Opening Brief of Appellant PeaceHealth at 19–20, Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007) (No. 05-35640) [hereinafter PeaceHealth Brief].

30. *Id.* at 47–48.

31. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222–24 (1993). The predation period is the time period in which the defendant retains an artificially low price, enabling them to absorb market share from their competitors. *See id.* at 222.

32. *Cascade Health Solutions*, 502 F.3d at 914; *see also* PeaceHealth Brief, *supra* note 29, at 48.

33. PeaceHealth Brief, *supra* note 29, at 49.

34. *Id.*

and the basis for competition.[35] Thus, it would be counterproductive to cap discounts without proof that pricing was below cost.[36] Second, a bright-line rule was preferable for clarity and administrative efficiency.[37] PeaceHealth argued that because there was insufficient evidence that its services were priced below cost, McKenzie's bundled discount claim would fail under the modified *Brooke Group* analysis.[38]

Alternatively, PeaceHealth argued the court should apply the *Ortho* full attribution test.[39] This test compares prices to production costs and attributes the discount of all products in the bundle to the competitive product(s).[40] If the price of the competitive product, with the bundled discount allocated exclusively to it, is below the product's production cost for an equally efficient competitor, then the discount may be found exclusionary.[41] Under the *Ortho* full attribution test, the plaintiff has the burden of proving that it is an equally efficient competitor.[42] PeaceHealth argued that because McKenzie had not proven that it was an equally efficient competitor, PeaceHealth was absolved from liability under this test.[43]

In response, McKenzie asserted that the *LePage's* market structure test was the correct analysis by which to measure the legality of bundled discounts.[44] McKenzie argued that monopolists should not be allowed to bundle products, but rather their services should be sold on their individual merits.[45] It contended that pricing incentives should rest on sales volumes and not be conditioned on an exclusionary

35. *Id.*; *see also Ortho Diagnostics Sys.*, 920 F. Supp. at 465.

36. PeaceHealth Brief, *supra* note 29, at 49.

37. *Id.* at 49–50. Regulating above cost prices is "beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting." *Brooke Group*, 509 U.S. at 223.

38. PeaceHealth Brief, *supra* note 29, at 50–51.

39. *Id.* at 51.

40. *Id.* at 48. For example, suppose Company *A* produces products *X* & *Y* and Company *B* produces only product *X*. Company *A* individually prices *X* at $4.00 and *Y* at $3.00, but the bundled discount when purchasing the products together is $6.00. Under the discount attribution test, the $1.00 cost differential between purchasing the products individually as opposed to a bundle would be attributed to Product *X* only because it is the competitive product.

41. *Cascade Health Solutions*, 502 F.3d at 909.

42. *Ortho Diagnostic Sys.*, 920 F.Supp. at 469.

43. PeaceHealth Brief, *supra* note 29, at 52–53. Had the Ninth Circuit's test with a hypothetical equally efficient rival been applied, then McKenzie would only have had to show that no competitor could compete with the discount, rather than showing that McKenzie specifically was unable to compete. *See* Lambert, *supra* note 4, at 1734–35.

44. Combined Opening Brief and Answering Brief of Plaintiff-Appellee/Cross Appellant McKenzie-Willamette Hospital at 53–56, Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007) (No. 02-06032) [hereinafter McKenzie Brief].

45. *Id.* at 54.

relationship of preferred provider status.[46] Thus, McKenzie asserted that this straight-forward, simplistic test would facilitate the competitive process by creating transparency in pricing and would avoid the exclusion of single-product competitors.[47]

McKenzie also contended that *Brooke Group* should not be the basis for any rule regarding bundled discounts because of the fundamental distinction between predatory pricing of a single product and discounts of multiple products.[48] McKenzie argued that *Brooke Group* was a narrow holding, tailored to below-cost pricing of a single product, and therefore did not encompass the practice of above-cost discounting across multiple product lines.[49] Additionally, McKenzie argued that even if the court were to apply a cost-based analysis, PeaceHealth's discount should be held exclusionary.[50] McKenzie asserted that it was a more efficient provider of primary and secondary care services than PeaceHealth.[51] Therefore, it was excluded from the market for reasons related to anticompetitive behavior rather than its own inefficiencies.[52]

The Ninth Circuit reviewed the jury instruction de novo.[53] It rejected all three tests offered by the parties, and instead applied the discount attribution test.[54] The court began its analysis by comparing bundled discounts to two related, yet distinguishable exclusionary practices: tying arrangements and single product predatory pricing.[55] Like tying arrangements, bundled discounts are incentives for consumers to accept products in a group rather than individually.[56] The court, however, distinguished the practice of tying, acknowledging that as a general practice bundled discounts provide an option—the consumer may purchase desired products as a group or purchase them individually.[57] However, with tying the consumer is forced to ac-

46. *See id.* at 58.

47. *Id.* at 54.

48. *See id.* at 57; *supra* text accompanying notes 31–32.

49. *See* McKenzie Brief, *supra* note 44, at 56–57.

50. *Id.* at 56.

51. *Cascade Health Solutions*, 502 F.3d at 907.

52. *Id.*

53. *Id.* at 909.

54. *Id.* at 914–16.

55. *Id.* at 910–11.

56. *Id.*

57. *Id.* at 911.

cept all products with the discount.[58] Thus, the court declined to apply the rules applicable to tying arrangements to bundled discounts.[59]

The Ninth Circuit also rejected the single product predatory pricing analysis employed in *Brooke Group* because of the fundamental differences in the two types of discounts.[60] In a single product predatory pricing analysis, the relevant relationship compares one price to one cost, whereas with bundled discounts the relevant comparison is one price to multiple product costs.[61] The court recognized that it is possible for a bundled discounter to charge a price that is above production costs of the products, yet still excludes equally efficient competitors who produce fewer product lines.[62] Thus, the traditional below-cost pricing standard articulated in *Brooke Group* could fail to indicate when a bundled discount is anticompetitive and exclusionary.[63] For that reason, the court declined to use the *Brooke Group* test to evaluate bundled discounts.[64]

The court did hold, however, that to determine if a discount was exclusionary under section 2 of the Sherman Act, the discount must resemble the *behavior* that the Supreme Court deemed predatory in *Brooke Group,* specifically preventing competition on its merits.[65] Thus, it refused to adopt a rule that found a discount exclusionary simply because the end result pushes rivals from the market. Rather, it required an analysis of the means by which rivals were pushed from the market to determine whether the discounting behavior was exclusionary.[66] The court held that

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58. Philip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 749b, at 332 (2d. ed. Supp. 2006) ("[T]he traditional tying contract typically forces the buyer to accept both products, as well as the cost savings.").

59. *Cascade Health Solutions*, 502 F.3d at 920. McKenzie alleged a tying violation, which the court addressed in a separate part of the opinion. *Id.* at 925.

60. *See id.* at 915–16.

61. *See id.* at 915.

62. *See id.* at 906–07; *Ortho Diagnostic Sys.*, 920 F.Supp. at 467 (articulating the seminal hypothetical example of how a discounter can price a bundle of products above the cost of production and still exclude an equally efficient rival). *See generally* Barry Nalebuff, *Exclusionary Bundling*, 50 Antitrust Bull. 321, 323–27 (2005) (illustrating how the pricing mechanism of bundled discounts can squeeze competitors from the market without engaging in the predatory pricing practices of selling the product below cost).

63. *Cascade Health Solutions*, 502 F.3d at 914. The court concluded that, unlike predatory pricing where the above-cost discounts would not be considered exclusionary conduct, bundled discounts can be exclusionary when the discounts are above-cost because the depth of the discount can be spread across numerous products instead of a single product. *Id.*

64. *Id*.

65. *Id*. at 913. The court noted that the reasoning and conclusions in *Brooke Group* "show[ed] 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." *Id.*

66. *Id.* at 913–14. Generally, pricing that is above the discounter's cost but below the rival's cost and/or the market level is permissive. *Id.* at 911 (noting that as a general rule such behavior represents competition on its merits (citing *Brooke Group*, 509 U.S. at 223)); *see also id.* at 906 ("[C]utting prices in order to

exclusionary conduct under section 2 of the Sherman Act occurs when "the discounts result in prices that are below an appropriate measure of the defendant's cost."[67]

The court adopted the discount attribution test, a cost-based approach to determine if prices are below an appropriate measure.[68] Like the *Ortho* full attribution test, the discount attribution test compares prices to production costs and attributes the entire discount of the bundle to the competitive product(s).[69] However, the discount will be found impermissible if a *hypothetically* efficient competitor is potentially excluded,[70] as opposed to the *Ortho* full attribution test that requires the plaintiff to prove it is efficient.[71] The court noted that this discount attribution standard had been utilized in two other Second Circuit cases, *Information Resources, Inc. v. Dun & Bradstreet Corp.* and *Virgin Atlantic Airways Ltd. v. British Airways PLC.*[72] Furthermore, the court relied upon the bipartisan Antitrust Modernization Committee 2007 Report endorsement of this standard.[73] The AMC Report asserted that a plaintiff must prove that "after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product."[74] The Ninth Circuit held that bundled discounts are exclusionary when, after allocating the discount to the competitive product, the plaintiff can show that the resulting price of the competitive product(s) is below the discounter's incremental production cost.[75] Thus, bundled discounts are an unfair pricing tactic only when they would exclude an equally efficient producer of the competitive product(s).[76]

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increase business often is the very essence of competition." (quoting *Matsushita Elec. Indus. Co.*, 475 U.S. at 594)).

67. *Id.* at 913–14.

68. *Id.* at 916. In academic literature this test is also referred to, among other things, as the discount allocation standard. *Id.* at 916 n.14.

69. *Id.* For example, suppose Company *A* produces products *X* & *Y* and Company *B* produces only product *X*. Company *A* individually prices *X* at $4.00 and *Y* at $3.00, but the bundled discount when purchasing the products together is $6.00. Under the discount attribution test, the $1.00 cost differential between purchasing the products individually as opposed to a bundle would be attributed to Product *X* only because it is the competitive product.

70. *Id.* at 916–17; *see, e.g.*, *id.* at 917 n.15.

71. *Id.* at 915.

72. *Id.* at 917–18 ("When price discounts in one market are bundled with the price charged in the second market, the discounts must be applied to the price in the second market in determining whether that price is below that product's average variable cost." (quoting Info. Res. Inc., v. Dun & Bradstreet Corp., 359 F.Supp.2d 307, 307 (S.D.N.Y. 2004))).

73. *Cascade Health Solutions,* 502 F.3d. at 918. The Antitrust Modernization Committee was the product of a statute mandating bipartisan effort to review U.S. antitrust law and determine if it should be modified to reflect modern trends. ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS (2007) [hereinafter AMC REPORT]; *see also Cascade Health Solutions,* 502 F.3d. at 910 n.10.

74. *Cascade Health Solutions,* 502 F.3d. at 918 (quoting AMC REPORT, *supra* note 73, at 99).

75. *Id.* at 919.

76. *Id.*

Under *Cascade Health Solutions* all bundled discounts are evaluated using a cost-based discount attribution test.[77] In analyzing exclusionary conduct, the discount must be measured against the costs of a hypothetical equally efficient competitor.[78] Compared to the *LePage's* market structure test, the discount attribution test narrows the scope of what would be considered an unfair bundling practice by looking beyond market structure and engaging in a price-cost analysis that underpins competition.[79] This case comment contends that the discount attribution test is too broad in determining liability and will chill potentially competitive behavior. A more appropriate test would find discounts presumptively legal and attribute the discount to the entire bundle. This case comment sets forth an alternative cost-based analysis called the aggregate test. Instead of attributing the discount exclusively to the competitive product(s), the aggregate test may find discounts permissible if the total production cost is less than the price of the discount.

The discount attribution test, like many initial tests analyzing competitive behaviors, too broadly condemns potentially pro-competitive behavior.[80] Section 2 of the Sherman Act protects the competitive process.[81] While the Ninth Circuit aims to protect this competitive process by ensuring an equally efficient competitor is not squeezed from the market,[82] it does so at the expense of other competitive pro-

77. *Id.* at 916. In academic literature this test is also referred to, among other things, as the discount allocation standard. *Id.* at 916 n.4.

78. *Id*. at 916.

79. *See id.* at 913–14.

80. *See* Crane, *supra* note 6, at 427–28 (noting that courts initially imposed "draconian liability" on tying behavior that was usually benign, and they should learn from past mistakes and begin all Sherman Act analysis with an "inquiry into the reasons firms engage in that conduct"). Similarly, the Supreme Court initially broadly condemned vertical price restraints (as they related to resale price maintenance). *See* Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 59 (1977) (holding that there was a *per se* prohibition against vertical price restraints, but non-price restraints should be subject to the rule of reason). However, the Supreme Court has slowly chipped away at this broad condemnation. *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S.Ct. 2705, 2710 (2007) (holding that minimum price restraints are subject to the rule of reason); State Oil Co. v. Kahn, 522 U.S. 3, 22 (1997) (stating that minimum price restraints were subject to a *per se* prohibition, but maximum price restraints should be subject to the rule of reason because they could be found to benefit consumers and competition); *see also Cascade Health Solutions*, 502 F.3d at 918 (noting that this test sweeps more broadly than the aggregate discount rule or the actual plaintiff test that the Second Circuit articulated in *Ortho Diagnostic Systems*).

81. *See Spectrum Sports*, 506 U.S. at 458 ("[The Sherman Act] is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself."); *see also Cascade Health Solutions*, 502 F.3d at 912 (reinforcing that the objective of antitrust laws is to protect the process of competition rather than individual competitors).

82. *See Cascade Health Solutions*, 502 F.3d at 915–19 (distinguishing the discount attribution test from the full attribution test (articulated by the Second Circuit in *Ortho Diagnostic Systems*) and suggesting why the discount attribution test is better at addressing the need to protect equally efficient competitors); Lambert, *supra* note 4, at 1697.

cesses.[83] The discount attribution test ignores an integral component of competitive behavior—utilizing economies of scale and scope.[84]

By attributing the discount exclusively to the competitive product(s), the discount attribution test penalizes a company that is able to offer consumers a lower price because the company has reduced the total cost of its complete product array.[85] The discount attribution test requires a cap on the amount of the discount equal to the difference between the competitive product's cost and the competitive product's price.[86] It forces the common denominator to be an efficient producer of one product, rather than an efficient producer of multiple complimentary products.[87] Though this test appropriately focuses on equally efficient competitors, it too narrowly focuses competition on one specific product rather than the total array of products.[88] Ultimately the discount attribution test prevents consumers from reaping the benefits of an expansive product offering by eliminating the incentive to offer a bundled discount, and thus chilling competitive behavior.

The discount attribution test also directly contradicts Areeda and Hovenkamp's leading treatise regarding package price discounts, a form of bundled discounts.[89]

83. *See Cascade Health Solutions*, 502 F.3d at 906 n.6 ("[A] seller's decision to offer such packages can merely be an attempt to compete effectively—conduct that is entirely consistent with the Sherman Act." (quoting Jefferson Parrish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12 (1984))); Crane, *supra* note 6 (discussing procompetitive rationale for bundled discounts).

84. *See Cascade Health Solutions*, 502 F.3d at 906 (explaining that bundled discounts benefit sellers because "it usually costs a firm less to sell multiple products to one customer at the same time than it does to sell the products individually"); AMC Report, *supra* note 73, at 95 (noting that the likely motivation for companies to offer bundled discounts is efficiencies, not schemes to acquire market power); Crane, *supra* note 6, at 430–33 (articulating the cost efficiencies to the discounter, including economies of scope, productive efficiencies and transactional cost efficiencies); Lambert, *supra* note 4, at 1736–37.

85. *See generally* Lambert, *supra* note 4, at 1736–37. Lambert critiques multiple proposals relating to how courts, academics, and law makers evaluate bundled discounts. One of the approaches he critiques is the proposal articulated in the leading treatise, *Antitrust Law*, addressing the "difficulties associated with Ortho Diagnostic's evaluative approach." *Id.* at 1730. The antitrust law approach critiqued by Lambert is similar to the discount attribution test adopted by the Ninth Circuit.

86. *Id.* at 1737.

87. *Id.*

88. *See generally id.* at 1738 (discussing tensions within treatises and case law surrounding predatory pricing and bundled discounts).

89. *See* 3A Areeda & Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 749c, at 313 (3d ed. 2006). In discussing the general problem associated with package pricing Areeda and Hovenkamp note that

> courts should not entertain claims that, while a defendant's overall price is remunerative, the separate "price" for one particular component in which it lacks monopoly power is unlawful. Admitting such claims unreasonably restricts one of the most beneficial avenues along which firms compete . . . [specifically by] improving the quality of the product rather than cutting the price.

Id. However, in discussing the court's decision in *Cascade Health Solutions*, the authors noted that while the decision was more sound than the *LePage's* decision, a test determining the legality of bundled discounts "requires a showing of pricing below cost when all discounts are attributed to the excluded product, but only as a threshold." *Id.* ¶ 749d, at 338; *see also* Lambert, *supra* note 4, at 1733–36.

The authors argue that the appropriate measure for package price analysis is to ensure that the *total* price of the package is greater than the *total* cost of producing the packaged products.[90] The discount attribution test, however, forces one product (or group of products) to bear the burden of the discount. Arguably this prevents a competitor who is equally efficient at producing the competitive product(s) from being forced out of the market.[91] However, this test does not address the problem of bundled discounts in terms of the objectives of the Sherman Act to determine if a discount is exclusionary and anticompetitive because it attempts to monopolize a competitive market.[92] The discount attribution test fails to protect the consumer or the competitive process and forces a contrived market structure that discourages competitors from discounting and encourages them to cap discounts.[93]

A more appropriate test, the proposed aggregate test, would push prices towards cost while preventing prices from escalating once inefficient competitors have been driven from the market.[94] The aggregate test reflects the presumptions set forth by Thomas A. Lambert in *Evaluating Bundled Discounts,*[95] as well as the principles articulated in *Brooke Group*.[96] The aggregate test proposes that bundled discounts are presumptively legal so long as the aggregate price is greater than the aggregate cost. This presumption of legality could be rebutted if a plaintiff can prove there are (i) barriers to entry in the competitive market that allow the discounter to increase prices above a supracompetitive amount once the competitor has been eliminated from the market, and (ii) barriers to entry that prevent the plaintiff or other potential competitors from entering the market of the noncompetitive product(s).[97]

Both the *Cascade Health Solutions* court and the *Ortho Diagnostic Systems* court rejected any test that aggregated the discount, because such a discount would allow

90. *See* 3A Areeda & Hovenkamp, *supra* note 89, ¶ 749c, at 314; *see also* Lambert, *supra* note 4, at 1733 & n.187.

91. *See Cascade Health Solutions*, 502 F.3d at 915–19.

92. *See Spectrum Sports*, 506 U.S. at 458; *Cascade Health Solutions*, 502 F.3d at 912..

93. *See generally* Lambert, *supra* note 4, at 1736–37. The objective is to protect the consumer from the inefficiencies of the market. Thus, capping discounts that would otherwise go to consumers is directly contrary to the purpose of pushing prices as close to cost as possible.

94. In this context an inefficient competitor is one that can not offer a similar discount because they do not offer as broad a scope of product, compared to an economic definition which determines efficiency on a product by product basis.

95. *See* Lambert, *supra* note 4, at 1739–56.

96. *Cascade Health Solutions*, 502 F.3d at 910–11 (citing *Brooke Group,* 509 U.S. at 222).

97. Thomas Lambert's proposal would require the plaintiff to also show (i) that they could not coordinate with other competitors to create the necessary bundle and (ii) that they could not become a supplier to the discounter. Lambert, *supra* note 4, at 1742. It was shown that McKenzie-Willamette Hospital did, in fact, attempt to coordinate with other competitors to offer a competitive bundle by merging with Cascade Health Solutions. *See supra* text accompanying note 14. However, as a practical matter, this places too much of a burden on the plaintiff to find a merger or cooperative solution with competitors that forces a contrived competitive landscape rather than a competitive landscape determined solely on the merits of a company's competitive ability.

above-cost pricing that had an anticompetitive effect.[98] However, the United States Supreme Court has strongly cautioned against condemning above-cost discounts.[99] The aggregate test's requirement that the plaintiff must overcome the presumption that the discounting practice is permissible[100] heeds the Supreme Court's caution, while still addressing the concerns of the second and ninth circuits' concerns.[101] The rebuttal qualification would prevent both the exclusion of competitive product rivals[102] and the manipulation of the market structure,[103] thus ensuring that the competitive process is not undermined. The application of an aggregate test would be significantly easier to administer than other tests, and would ensure the competitive process is protected.

A plaintiff can overcome the presumption of legality in the aggregate test by showing that barriers to market entry preclude all future competition.[104] If the plaintiff were to show that the competitive product market had high barriers to entry, then the inference would be that few or no mechanisms were in place to prevent the discounter from increasing prices once the competitor had been forced from the market.[105] In contrast, if the plaintiff were unable to show significant market barriers, it could be argued that the impact on the competitive process (i.e., increased prices once competition has been squeezed out) would be minimized.[106] With no or low barriers to entry, if a monopolist begins raising prices, rivals will enter the market and the resulting competition will force prices back below a supracompetitive level.[107]

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98. *Cascade Health Solutions*, 502 F.3d at 914; *Ortho Diagnostic Sys.*, 920 F.Supp. at 469.

99. *Cascde Health Solutions*, 502 F.3d at 912; *see also Brooke Group*, 509 U.S. at 223. The court noted:

> As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting.

Id.

100. *See supra* note 97 and accompanying text.

101. *See* cases cited *supra* notes 98–99 and accompanying text.

102. *See generally Cascade Health Solutions*, 502 F.3d at 918–19 (noting that the discount attribution test's objective is to prevent the exclusion of an equally efficient producer of the competitive product).

103. *See id.* at 908 (articulating the Third Circuit's concern in *LePage's* that by virtue of the market structure a monopolist's behavior is unconstrained enables the elimination of rivals).

104. *See supra* note 97 and accompanying text.

105. *See* Lambert, *supra* note 4, at 1745 (noting that the plaintiff should show that the product market in question is actually susceptible to monopolization).

106. *See id.* at 1744–45. *See generally Cascade Health Solutions*, 502 F.3d at 910–11. The opportunity to recoup losses was a consideration in *Brooke Group* when determining if a pricing scheme was exclusionary. *Id.* The Ninth Circuit sought to address the competitive behavior concerns *Brooke Group* sought to protect and this test provides an analogous measure of the behaviors affecting competition for bundled discounts. *See supra* text accompanying note 65; *see also Ortho Diagnostic Sys.*, 920 F.Supp. at 466 (acknowledging that sacrificing current profits for later gain is what "separates the competitive sheep from the anticompetitive goats").

107. *See Ortho Diagnostic Sys.*, 920 F.Supp. at 466.

Thus, the aggregate test is more appropriate than other tests because it limits the scope of inquiry to whether an equally efficient competitor will be able to compete if the market were to become inefficient.

The aggregate test also requires the plaintiff to show that there are high barriers to entry in the non-competitive product market.[108] In cases where a monopolist controls the non-competitive market, a two-fold inquiry is required.[109] First, a court must examine why the plaintiff is prevented from entering the market and second must ask whether the discounter will ever face competition in the non-competitive market.[110] Taken together, these inquiries identify when the discounter has the ability to abuse its monopoly power by permanently preventing competition across both the competitive and non-competitive product markets.[111]

The Sherman Act prohibits exclusionary practices. Removing inefficient rivals is an acceptable competitive behavior, but removing rivals through exclusionary practices or brute force manipulation is prohibited by the Sherman Act.[112] The appropriate test for evaluating bundled discounts should be narrowly tailored to prevent the unnecessary condemnation of competitive pricing practices. While some cost-based analysis is necessary, evaluating bundled discounts is complicated when the courts must analyze multiple products and product markets. However, this complication should not disproportionately affect one product.[113] Instead, the analysis should measure the total bundle of products sold to the consumer. The aggregate test addresses the objectives of the Sherman Act and the Ninth Circuit.[114] It prevents discounts that manipulate the market structure and avoids the overly broad condemnation of potentially competitive behavior of a discounter.[115] The test permits discounts that benefit consumers and are the result of cost efficiencies and product variety.

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108. *See supra* note 97 and accompanying text.

109. *See* Lambert, *supra* note 4, at 1744–45.

110. *Id.*

111. *Id.* at 1744 & n.225 (acknowledging that when capital markets are functioning properly investments will be made in any market capable of generating competitive returns).

112. *See Brooke Group*, 509 U.S. at 223–26. Antitrust law forbids a profitable/large company, capable of financially sustaining a loss for longer than its smaller rival, from engaging in pricing practices that will cause a short term loss in exchange for the ability to subsequently recoup any losses by raising the price above the level the market would normally endure. *Id.*

113. *See generally* Lambert, *supra* note 4, at 1726 (discussing the shortcomings of discount attribution standards).

114. *See supra* notes 100–11 and accompanying text.

115. *See supra* notes 100–11 and accompanying text.