IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 05-36153
No. 05-36202

CASCADE HEALTH SOLUTIONS
fka McKENZIE-WILLIAMETTE HOSPITAL,

Plaintiff-Appellee and Cross-Appellant,

v.

PEACEHEALTH,

Defendant-Appellant and Cross-Appellee.

On Appeal from the United States District Court
District of Oregon
Case No. CV-02-06032-HA

BRIEF OF AMICI CURIAE AMERICAN ANTITRUST INSTITUTE, CONSUMER FEDERATION OF AMERICA AND CONSUMERS UNION SUPPORTING MCKENZIE-WILLIAMETTE AND AFFIRMANCE

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DISCLOSURE OF CORPORATE AFFILIATIONS AND FINANCIAL INTEREST

Pursuant to Fed. R. App. P. 26.1, *amici* make the following disclosure:

1. Is said party a subsidiary or affiliate of a publicly owned corporation? No.

2. Is there a publicly owned corporation, not a party to the appeal, that has a financial interest in the outcome? No.

_____ Date _____
Andrew M. Kepper

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I. STATEMENT OF THE CASE

Amici accept the parties' statements of the case, as presented in their Opening Briefs on Appeal.

II. STATEMENT OF INTEREST

The American Antitrust Institute ("AAI") is an independent, nonprofit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. *See* http://www.antitrustinstitute.org. The Advisory Board of AAI, which serves in a consultative capacity,[1] consists of prominent antitrust lawyers, law professors, economists, and business leaders. AAI's Board of Directors has authorized the filing of this brief.

The Consumer Federation of America ("CFA") is the nation's largest consumer-advocacy group, composed of over 280 state and local affiliates representing consumer, senior citizen, low income, labor, farm, public power and cooperative organizations, with more than 50 million individual members. CFA represents consumer interests before federal and state regulatory and legislative agencies and participates in court proceedings. CFA has been particularly active on antitrust issues affecting health care and high technology industries in which bundling can be a critical issue.

[1] The AAI is managed by its Board of Directors. The individual views of members of the Advisory Board may differ from the positions taken by AAI.

Consumers Union is a nonprofit membership organization which provides consumers with independent expert information about goods, services, health, and personal finance. Consumers Union's income is solely derived from the sale of *Consumer Reports* and *ConsumerReports.org*, its other publications and from noncommercial contributions, grants and fees. Consumers Union's products have a combined paid circulation of approximately 7.3 million consumers. *Consumer Reports* and *ConsumerReports.org* regularly carry articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare.

As representatives of the public interest, *amici* have two common, primary concerns. First, although bundling arrangements may offer some procompetitive benefits, bundling can be used to harm competition by excluding innovative and efficient rivals from the market. This is particularly a concern in health care markets where significant innovation and rivalry may be produced by firms that offer a limited range of products. It is not surprising that much of the most significant litigation involving bundling is in pharmaceutical, medical device and other health care markets. These cases, like the one before the Court, involve efforts by dominant firms to exclude rivals on a basis other than efficiency. The rule of law advocated by the petitioner in this case would create a rule of virtual

per se legality and would ultimately harm consumers through higher prices, less innovation and less service.

Second, this case reaches to the heart of how antitrust law should treat conduct by dominant firms under Section 2 of the Sherman Act. *Amici* believe that the *Brooke Group* rule of virtual immunity that was developed in the predatory pricing context should not be extended to monopolization claims that allege multi-product bundling.[2] The rule of law advocated by petitioners would limit the critical antitrust inquiry to a simple calculation of whether the pricing of a bundled product was below cost. Although such a rule may appear administratively attractive, it is wholly inconsistent with over a century of antitrust jurisprudence that requires a careful scrutiny of the purpose and effect of a dominant firm's conduct. The rule has no basis in economics or antitrust policy and would create an unwarranted safe harbor for dominant firm conduct.

III. STATEMENT OF ISSUES

When a jury finds liability for attempted monopolization based upon evidence that (a) a monopolist in one market, the tertiary-neonatal and cardiac services market, discounted its services only to those purchasers that also bought the monopolist's services in an entirely distinct market, namely the general acute-

[2] As used in this brief, multi-product bundling refers to a practice of a dominant firm whereby it sells its dominant products at a discount only to those purchaser who also purchase other products from the dominant firm, in which the dominant firm faces competition from rivals. This practice can have serious adverse effects on competition when

care services market, and that (b) the monopolist's conduct threatened monopolization of the second market (here, the general acute-care services market), should the jury's verdict be overturned simply because the total price of the defendant's hospital-services "bundle" was not below its total cost of supplying the bundle?

This Court should answer, "No."

IV. ARGUMENT

A. Standard of Review

This case arises from the district court's denial of the defendant's motion for a judgment notwithstanding a jury's verdict. The jury found the defendant liable for, *inter alia*, attempted monopolization of the general acute-care hospital-services market in Lane County, Oregon. A district court's order denying JNOV is reviewed *de novo*, applying the same standard as the district court. *Vollrath Co. v. Sammi Corp.*, 9 F.3d 1455, 1460 (9th Cir. 1993). JNOV is proper only if the evidence, when viewed in the light most favorable to the nonmoving party, permits only one reasonable conclusion, and that conclusion is contrary to the jury's. *Id.*

B. Section 2 Liability may Exist Whenever a Monopolist Competes Through Exclusion Rather Than on the Merits.

A firm may be liable for attempted monopolization under Section 2 of the Sherman Act, 15 U.S.C. § 2, if it has (1) engaged in predatory or anticompetitive

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no rival can match the breadth of the dominant firm's product offering. *Amici* limit their discussion in this brief to

conduct, (2) with a specific intent to monopolize, and that conduct carries (3) a dangerous probability of success. *Spectrum Sports v. McQuillan*, 506 U.S. 447, 456 (1993).

In its order of March 20, 2007, this Court asks *amici* to interpret prong (1), the conduct element of attempted monopolization. It is well established that conduct can form the basis for Section 2 liability if it creates, enhances or threatens to create monopoly power through exclusion "as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Microsoft*, 253 F.3d 34, 58 (D.C. Cir. 2001) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966)). The Supreme Court and Ninth Circuit have consistently held that a plaintiff may prove a monopolization claim under the well established Rule of Reason framework, which focuses on whether particular conduct harms competition. *Glen Holly Entertainment, Inc. v. Tektronix, Inc.*, 352 F.3d 367, 373 (9th Cir. 2003); *see also Eastman Kodak Co. v. Image Tech. Serv.*, 504 U.S. 451, 467 (1992).

This Court has recognized that "the means of illicit exclusion, like the means of legitimate competition, are myriad." *Microsoft*, 253 F.3d at 58; *see also Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1478 (9th Cir. 1997). This Court also recognized that harm to competition occurs when a dominant firm "use[s] its monopoly power

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those instances.

in one market to gain a competitive advantage in another." *Image Tech. Servs. Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1209 (9th Cir. 1997). Similarly, this Court denied summary judgment for a monopolist insurer based on the plaintiff's evidence that the monopolist "increased the operating costs" of its competitors and "threatened physicians who disagreed with their monopoly." *Forsyth*, 114 F.3d at 1478. Allowing a broad range of conduct to support Section 2 liability is wholly consistent with competition policy, which recognizes that "the presence of substantial market power" provides a firm with many ways to create or sustain a monopoly. *See* Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 651 (2d ed. & 2006 Supp.).[3] No Supreme Court or Ninth Circuit case holds otherwise.

Defendants now invite this Court to reverse these firmly established precedents and the important competition policies that undergird them. Defendants desire a near *per se* rule, granting monopolists nearly virtual immunity from bundling-based monopolization claims that do not result in the monopolist pricing below its costs. This argument is based on an impermissibly broad reading of the Supreme Court's decisions in *Brooke Group* and *Weyerhaeuser* that ignores the

[3] Many courts recognize the breadth of conduct that can form the basis for a Section 2 claim. *Microsoft*, 253 F.3d at 58-78 (holding that various contracting and licensing practices violated Section 2); *Conwood Co. v. United States Tobacco Co.* , 290 F.3d 768, 783-91 (6th Cir. 2002) (holding that evidence that monopolist removed plaintiff's moist-snuff products from stores, trained store employees to destroy plaintiff's in-store display racks, provided misleading information about its products, and entered into exclusivity agreements supported Section 2 jury verdict); *LePage's, Inc. v. 3M*, 324 F.3d 141, 154-55 (3rd Cir. 2003) (*en banc*) (holding that jury could reasonably find that exclusionary conduct, including bundled rebates and exclusive dealing, violated Section 2); *Avery Dennison Corp. v. Acco Brands, Inc.*, 2000 U.S. Dist. LEXIS 3938 at *53 (C.D. Cal. Feb. 22, 2000) (concluding that evidence of the "range of illegal conduct" precluded summary judgment).

competitive differences between predatory pricing and other forms of monopolistic exclusion. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 127 S.Ct. 1069 (2007). Thus, because the defendant's proposed standard is not supported by precedent or sound antitrust policy, this Court should reject it.

C. The Brooke Group/Weyerhaeuser Standard was Developed in the Specific Context of Predatory Pricing and Bidding Cases.

The *Brooke Group* and *Weyerhaeuser* precedents were not intended to, and do not, apply outside the narrow context of predatory pricing and predatory bidding cases in which they arise.

1. The *Brooke Group/Weyerhaeuser* Standard Addresses the Peculiar Characteristics of Predatory Pricing and Predatory Bidding.

a. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*

Liggett, the plaintiff in *Brooke Group*, "pioneered the development of the economy segment of the national cigarette market" by introducing and marketing a line of "black and white" generic cigarettes. 509 U.S. at 212. Liggett sold these generic cigarettes at 30% below the price of competing branded cigarettes. *Id.* at 214. Losing market share and profits in its branded products to Liggett's generic cigarettes, the defendant responded by entering the generic-cigarette market and engaging Liggett in a price war. *Id.* at 215-16. The defendant's tactics greatly

reduced Liggett's sales. Liggett responded by filing a lawsuit alleging that the defendant tacitly colluded with other cigarette companies to pressure Liggett into raising its prices, and then to recoup the group's collective losses through supracompetitive oligopolistic pricing. *Id.* at 216-217. The jury found for Liggett.

The Supreme Court addressed the issue of whether a reasonable jury could reach a conclusion that the defendant's price-cutting conduct led to or had a reasonable possibility of leading to antitrust injury. *Id.* at 230. The Court held that, in order to show injury to competition in a predatory-pricing case, a plaintiff must show (1) that the defendant has charged prices below an appropriate measure of its costs and (2) that the defendant will be able to raise prices in the future to recoup its losses through the exercise of market power. *Id.* at 222-24. The Court affirmed the judgment as a matter of law for the defendant because Liggett failed to prove the second prong. *Id.* at 232. Due to the difficulty of proving below-cost pricing and recoupment, the practical effect of the Court's holding was to nearly eliminate plaintiffs' ability to prove exclusion through a predatory-pricing theory.[4]

b. *Weyerhaeuser v. Ross-Simmons Hardwood Lumber Co.*

In *Weyerhaeuser*, the Supreme Court extended the *Brooke Group* test to competitors' allegations of predatory bidding. 127 S.Ct. 1069. Ross-Simmons and

[4] Historical evidence confirms that, *Brooke Group* has had the effect of greatly limiting a plaintiff's ability to prevail on a predatory-pricing theory. In the six years immediately following the *Brooke Group* decision, plaintiffs did not prevail in a single federal predatory-pricing case. Patrick Bolton, et al., *Predatory Pricing: Strategic Theory*

Weyerhaeuser both operated sawmills that bought logs and processed them into finished lumber. *Id.* at 1072. Ross-Simmons claimed that Weyerhaeuser overpaid for sawlogs, which artificially increased sawlog prices, as part of a plan to drive Ross-Simmons out of business. *Id.* at 1073. In its unanimous opinion, the Supreme Court held that judgment as a matter of law for the defendant was appropriate, given the similarities between predatory pricing and predatory bidding and the close theoretical connection between monopoly and monopsony. *Id.* at 1076-78. The Court therefore applied a modified version of the *Brooke Group* test to predatory bidding claims. Because Ross-Simmons conceded that it had not satisfied the *Brooke Group* standard by showing a probability of recoupment, the Court remanded the case. *Id.* at 1078.

2. The *Brooke Group* and *Weyerhaeuser* Decisions Assumed That Predatory Pricing and Bidding Were Rarely Tried and Rarely Successful.

The Supreme Court has assumed that predatory pricing is rare because "[t]he predator must make a substantial investment with no assurance that it will pay off." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986); *cf. Weyerhaeuser*, 127 S.Ct. at 1077.[5] In order to make this scheme succeed, however,

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and Legal Policy, 88 Geo. L.J. 2239, 2258-59 (2000). According to a study of post-*Brooke Group* cases, defendants won 36 of 39 reported cases during that period, all of which were decided as a matter of law. *Id.*

[5] To be certain, scholars continue to disagree over the frequency of predatory pricing and its competitive effects. Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?*, 2006 Utah L. Rev. 863, 869 & n.35-36 (2006) (citing Richard O. Zerbe, Jr. & Michael T. Mumford, *Does Predatory Pricing Exist*? *Economic Theory and the Courts offer Brooke Group*, 41 Antitrust Bull. 950, 952 (1996)). *Amici* accept the reasoning of

the predator must raise its price long enough and high enough to recoup its lost profits and then some, without inviting entry. *Brooke Group*, 509 U.S. at 225-26. Similarly, a firm engaged in predatory bidding must drastically lower the price paid for inputs to recover its losses, without attracting competitors. Areeda and Hovenkamp, Antitrust Law ¶ 723; Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 Antitrust L.J. 669, 679 (2005). Because of what it labels as the heavy losses inflicted and the uncertainty of recoupment, *Brooke Group* and *Weyerhaeuser* assume that predatory pricing and predatory bidding are rare.

Brooke Group and *Weyerhaeuser* further assume that, even if a firm chooses to engage in predatory pricing or bidding, it is unlikely to be a successful strategy. The theory behind *Brooke Group* posits that a firm loses proportionately more money than each of its competitors in the market when it lowers its prices below its competitors and below its own cost. Mark I. Schwartz, *The Brooke Decision: The Supreme Court Revisits Predatory Pricing*, 99 Com. L.J. 276, 289 (1994).

The theory reasons that, for a predatory-pricing or bidding scheme to be successful, the predator must exclude or neutralize competitors for a period of time long enough to recoup losses as well as some additional gain to cover lost interest. *Matsushita*, 475 U.S. at 589. This recoupment may be difficult as the predator begins pricing at supracompetitive levels or buying at below-competitive levels,

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Brooke Group, for purposes of this brief only, in order to show that the assumptions underlying *Brooke Group* and

and potential new entrants are lured into the market by the potential for monopoly/monopsony profits. *Brooke Group/Weyerhaeuser* therefore assume that, without strong barriers to entry, recoupment of the losses incurred in the predation stage is difficult. *Brooke Group*, 509 U.S. at 225-26; Salop, 72 Antitrust L.J. at 679.

3. *Brooke Group/Weyerhaeuser* Assume That the Conduct They Address – Cutting Prices or Increasing Bid Amounts – Is Generally Procompetitive.

As the Court stated in *Matsushita*, "cutting prices in order to increase business often is the very essence of competition." 475 U.S. at 594. Overbidding on inputs may also be procompetitive. *Weyerhaeuser*, 127 S.Ct. at 1077. Thus, *Brooke Group* and *Weyerhaeuser* stand on the assumption that condemning predatory pricing will "court intolerable risks of chilling legitimate price-cutting." *Weyerhaeuser*, 127 S.Ct. at 1077; *Brooke Group*, 509 U.S. at 223. But commentators acknowledge that the *Brooke Group/Weyerhaeuser* cost-based standard will excuse some conduct that is anticompetitive. Herbert Hovenkamp, *Discounts and Exclusion*, 2006 Utah L. Rev. 841, 842 (2006). *Brooke Group*/*Weyerhaeuser* accept this risk of "false negatives," however, because they believe it is outweighed by the risk of "false positives"[6] and reason that, in any

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its progeny are inapplicable in multi-product bundling cases.

[6] A "false negative," describes an instance in which a court allows a practice that actually is anticompetitive, while a "false positive" occurs when a court condemns a practice that is in fact procompetitive. Commentators generally agree that antitrust policy should be designed to reduce the risks of both false positives and false negatives. Andrew

case, the underlying conduct – aggressive price cutting – is something the law should encourage.

D. The Policy Justifications Behind the *Brooke Group* and *Weyerhaeuser* Decisions do not Apply in Multi-product Exclusionary Bundling Cases.

1. *Brooke Group* was not Intended to turn all Section 2 cases into Predatory Pricing Cases.

Expanding the reach of *Brooke Group* beyond the predatory-pricing context, however, would be making the empirical judgment that – as the Court assumed for predatory pricing – bundling and other forms of exclusionary conduct rarely or never harm consumers and competition. *See* Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?*, 2006 Utah L. Rev. 863, 885 (2006) (discussing single-product discounting). But while the Court's decision in *Brooke Group* was influenced by its view that the plaintiff posited an improbable theory of competitive harm, courts and the antitrust agencies agree that above-cost bundling, loyalty discounts, and market-share rebates may in fact harm competition when used by a monopolist. *Compare Brooke Group*, 509 U.S. at 230-31; *with LePage's, Inc. v. 3M Co.*, 324 F.3d 141, 154-55 (3rd Cir. 2003); Br. for the United States as *amicus curiae*, *3M Co. v. LePage's, Inc.*, No. 02-1865, at 8-9 (U.S. 2004) (hereinafter "DOJ/FTC Br."). Even the Department of Justice and FTC noted the uncertainty over the competitive effects of bundling when they

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I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 Antitrust L.J. 3, 30-

urged the Supreme Court not to grant *certiorari* of the Third Circuit's decision for the plaintiff in *LePage's*. DOJ/FTC Br. at 12 & n.9. The expansion of *Brooke Group/Weyerhaeuser* beyond their narrow contexts is not warranted because it contradicts economic theory, empirical evidence, and antitrust jurisprudence in the lower courts.

Given that there is substantial economic and empirical evidence that bundling can and does substantially impair competition, this Court should not close the door to Section 2 bundling claims. Broad grants of immunity are especially inappropriate in the context of Section 2 of the Sherman Act. This is so, in part, because a violation can be established only when the plaintiff proves *both* that a firm willfully engaged in exclusionary conduct *and* that the defendant possesses monopoly power or has a dangerous probability of acquiring it. *Spectrum Sports*, 506 U.S. at 456; *Grinnell*, 384 U.S. at 570-71.

In light of the developing nature of bundling jurisprudence and scholarship, monopolists that consider adopting bundling programs surely know that their programs may run afoul of the antitrust laws and cannot credibly express surprise when they end up on the wrong side of the rule of reason. Nor is today's state of the law of bundling a cornucopia of treble damages for plaintiffs. Rather, as the recent defense verdict in *Applied Med. Resources Corp. v. Ethicon, Inc.*

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64 (2004).

demonstrates, dominant firms are more than capable of presenting arguments that their bundling practices do not always harm competition. *See* 03-1329 JVS (C.D. Cal. Feb. 3, 2006) (Order granting in part and denying in part Def.'s Mot. Sum. J.); *J&J Wins Rival's Antitrust Lawsuit,* L.A. Times, Aug. 30, 2006, at C4.

E. The Competitive Effects of Bundling Differ From the Competitive Effects of Predatory Pricing and Predatory Bidding.

1. Federal Courts Recognize the Competitive Difference Between Predatory Pricing and Bundling.

Recent federal-court decisions recognize that the differences in competitive effects between bundled discounts and predatory-pricing schemes mandate different antitrust treatment. In *LePage's,* the Third Circuit sitting *en banc* confronted a 3M multi-product bundling program in which retailers were rewarded for increasing their purchases of 3M products along multiple product lines. One of 3M's bundled products was transparent tape, in which 3M faced competition from LePage's. *LePage's*, 324 F.3d at 154-55. 3M structured the rebates such that retailers would lose the entire rebate if they failed to meet their target in any one product line. *Id*. at 154. Not surprisingly, 3M's bundling program greatly increased its market share in private-label tape at the expense of LePage's. *Id*. at 157. The court rejected 3M's *Brooke Group*-based argument that its discounts were legal *per se* because they were above 3M's cost. *Id*. at 155. The court found that *Brooke Group* did not overrule the general monopolization standard that assigns liability

when a monopolist "competes on some basis other than the merits." *Id*. at 147 (citing *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 n.32 (1985)). The court implicitly concluded that when a monopolist uses its product portfolio to foreclose a single-product rival, the monopolist is using its size rather than its "superior product [or] business acumen" to gain a competitive advantage. *Id*. at 149 (quoting *Grinnell*, 384 U.S. at 570-71). And while some commentators have criticized some aspects of the *LePage's* opinion, the court's basic premise that single-product and multi-product discounts deserve different treatment is widely accepted. *See* Areeda & Hovenkamp, Antitrust Law ¶ 794; Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 U. Chicago L. Rev. 229, 234 (2005) ("Bundling is analytically similar to tying.").

Similarly the Southern District of New York distinguished "bundled pricing of a package of complementary products" from single-product discounting cases, such as *Brooke Group* and the Eighth Circuit's later decision in *Concord Boat*.[7] *Ortho Diagnostic Sys., Inc. v. Abbott Labs*, Inc., 920 F. Supp 455, 466 (S.D.N.Y. 1996). In that case, Abbott had large market shares in five different blood tests that blood-donation centers needed to test donors' blood. Abbott was the sole producer of two of those tests. *Id*. at 458. It offered bundled pricing across all five tests,

[7] *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1061 (8th Cir. 2000). In that case, the court applied a below-cost test to reject a boat assembler's claim that a boat-engine manufacturer's single-product discounting scheme anticompetitively excluded rivals from the market. *Id*. Even though the court applied a below-cost standard,

which made it difficult for Ortho, its rival in three of those tests, to offer a competitive rebate. *Id*. The court noted that analyzing these discounts under a predatory-pricing framework was inappropriate because loyalty rebates can raise rivals' costs, prevent them from reaching efficient scale, or exclude them for the market altogether. *See id*. at 467. The court further explained that the pricing scheme on bundled discounts can make it unprofitable for the rival to continue to produce the product, reducing competition and harming equally efficient competitors. *Id*. at 469-70. Thus, even though the court granted summary judgment for Abbott on Ortho's Section 2 claim, the court noted that a *Brooke Group* analysis was inappropriate in a bundled rebate case.

2. "Tying" is the Proper Analogy for Bundling Cases.

Bundling and predatory pricing cause two different types of competitive harm. Barry Nalebuff, *Exclusionary Bundling*, 50 Antitrust Bull. 321, 322-327 (2005). Bundling therefore necessitates an antitrust analysis that is tailored to the harm it can cause. By analogizing multi-product bundling to tying (at least when the rival cannot match the breadth of the monopolist's product offering), one of America's leading antitrust scholars argues against the *Brooke Group* standard in those cases. Hovenkamp, 2006 Utah L. Rev. at 852.[8] When dominant firms engage

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it specifically distinguished multi-product bundling from single-product rebating by noting how the latter resembled tying more than predatory pricing. *Id*. at 1062.

[8] In a typical tying case, the dominant firm has a monopoly in one product market (product A) but faces competition from rivals in another market (product B). In order to increase its market share of B, the dominant firm

in tying, consumers who demand A are coerced into also accepting B from the dominant firm, which necessarily harms rivals' ability to compete in B. Compared to predatory pricing, tying allows dominant firms to exclude competition fairly inexpensively because it can immediately recoup its "losses" in B by earning supracompetive profits in A. *See* Nalebuff, *Exclusionary Bundling*, 50 Antitrust Bull. at 327.[9]

The competitive harm in tying arises from the fact that the dominant firm can coerce consumers into purchasing its tied product because the rival cannot duplicate the tying product. *See id*. at 851. Importantly, this harm arises independently of the monopolist's cost structure. Because the monopolist's costs are not relevant to the harm imposed on competition, courts evaluate tying arrangements based upon the effects they impose on competition rather than the costs they impose on monopolists. *See, e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16 (1984).

As with tying, the competitive harm in bundling arises not from the low price itself but from making that low price contingent on the consumer purchasing the entire bundle from the monopolist. Posner, 72 U. Chi. L. Rev. at 234. In a

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sells A only in conjunction with B, and therefore prevents its rivals in B from selling to those consumers who need both products. Id. at 851.

[9] Tying therefore resembles a form of "cheap exclusion," similar to the single-firm conduct on which the antitrust agencies have recently focused. Susan Creighton, et al, *Cheap Exclusion*, 72 Antitrust L.J. 975 (2005).To be certain, Ms. Creighton, speaks of two types of "cheap" exclusion. The first type is "cheap" because it does not require the dominant firm to sustain large losses to attain its exclusionary goals. The second type is "cheap" because

bundling case, the consumer essentially pays a "penalty" for buying rivals' products because doing so forces it to lose the attractive, bundled price. This penalty therefore coerces the consumer into purchasing competitive products from the monopolist. Hovenkamp, 2006 Utah L. Rev. at 853. A single-product rival can compete in this environment only by assembling its own bundle or offering an equally large rebate on its single product. *Id*. at 852. For a rival with a small range of products, matching the bundle could require the rival to overcome significant barriers to entry and price significantly below cost, which the rival is not likely to be able to sustain. *See id.* As with tying, but unlike predatory pricing, a monopolist can exclude competition through bundling independently of its ability to operate efficiently. *Id.*; Lande, 2006 Utah. L. Rev. at 888 (discussing the inappropriateness of cost-based test in discounting cases). Because of this coercive element, tying is *per se illegal* in some cases. *Jefferson Parish*, 466 U.S. at 9. Defendants now seek a rule of law that makes similar conduct nearly *per se legal*. Extension of *Brooke Group* to bundling cases in this manner defies logic.

3. Bundling can Exclude an Equally Efficient Rival.

One of the key assumptions behind the holdings in *Brooke Group* and *Weyerhaeuser* – that only less efficient rivals could be excluded by the conduct at issue – is absent in the context of multi-product bundling. In a predatory-pricing or

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it never, or almost never carries countervailing benefits to competition. Bundling falls into the first, but not the second, category of "cheap exclusion." *See id.* at 976-78.

predatory-buying case, courts generally assume that the rival cannot match the monopolist's pricing because it is unable to operate as efficiently as the monopolist. *See* Hovenkamp, 2006 Utah L. Rev. at 846-47 (citing *Concord Boat*, 207 F.3d at 1062). In a multi-product bundling case, however, the defendant excludes competitors through the breadth of its product offering rather than through its supposed efficiency advantage. *See LePage's*, 324 F.3d at 155 (citing Areeda & Hovenkamp, Antitrust Law ¶ 794); *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3rd Cir. 1978). If the monopolist increases its market share in this way, that increase is not based on its efficiency but rather its large size and broad product line. *LePage's*, 324 F.3d at 125; *see also Aspen Skiing*, 472 U.S. at 605 (finding monopolization liability when dominant firm enhances market power through means other than efficiency); Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 320 (2003). Thus, even by the logic of *Brooke Group* and *Weyerhaeuser*, the fact that a rival was excluded does not necessarily imply that the rival operated less efficiently than the monopolist. Because the bundling monopolist is not necessarily operating more efficiently than the rival, the law would not encourage efficiency by encouraging monopolists to bundle.

Contrary to the Supreme Court's assumption in *Brooke Group* and *Weyerhaeuser*, bundling can harm consumers even if the excluded rival does not

have the monopolist's economies of scale. This harm stems from the fact that multi-product bundling, like other forms of nonprice exclusion, raises the rival's costs of doing business. Elhauge, 56 Stan. L. Rev. at 320. In the case of multi-product bundling, the rival's costs are raised because it must offer the same rebate amount as the monopolist but does not have the ability to spread the discount over many products. *Ortho*, 920 F. Supp. at 466-68. Thus, the rival's per-product costs of offering rebates becomes higher than those of the monopolist. And unlike predatory-pricing, nonprice exclusion does not carry a countervailing short-term benefit to competition. *See Brooke Group*, 509 U.S. at 256; Nalebuff, 50 Antitrust Bull. at 321. The situation is even worse when one considers new entry into the market. The increased costs can prevent a new entrant from ever gaining the sales it needs to reach its minimum efficient scale. If the rival is prevented from reaching this scale, the efficiency-promoting intentions of *Brooke Group* and *Weyerhaeuser* will necessarily suffer. *See* Elhauge, 56 Stan. L. Rev. at 320-21.

F. This Court Should Adopt the Structured Rule-of-Reason Analysis Typically Used in Section 2 Cases, Such as That Used by the D.C. Circuit in the *Microsoft* Case.

As the cases and commentary above show, multi-product discounting is but one exclusionary arrow in the monopolist's quiver. *Conwood Co. v. United States Tobacco Co.*, 290 F.3d 768, 783-91 (6th Cir. 2002). Because bundling allows the monopolist to prevail based on its size rather than efficiency, it is well suited to the

Section 2 rule of reason framework. *Aspen Skiing*, 472 U.S. at 605; *see also* Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 Antitrust L.J. 435, 460 (2006). Because bundled discounts need not necessarily be below cost to harm competition, the proper legal standard should focus on the conduct's effect on competition rather than its relationship to the defendant's cost structure.

The proper test for bundling should also refrain from issuing unwarranted rulings of either *per se* liability or *per se* immunity, as these rules distract from the fact-based inquiry that is needed to differentiate procompetitive from anticompetitive conduct. *Id.* at 437. At the same time, *amici* recognize the importance of crafting a structured standard that provides courts with guidance in their attempts to balance anticompetitive effects against efficiencies. *See Microsoft*, 253 F.3d at 45. For these reasons, *amici* believe that the structured rule-of-reason analysis set forth in the D.C. Circuit's *Microsoft* opinion should form the analytical basis for bundling and other monopolization cases. *Amici* also believe that, in the case of bundling, this structured analysis can be applied in a manner that assists courts and companies in determining the bounds of legal competition.

1. Step One – The Plaintiff Must Demonstrate Harm to Competition.

As in any Section 2 case, the *Microsoft* test first requires that that plaintiff prove that the defendant is a monopolist in a particular relevant market (actual

monopolization case) or has a dangerous probability of becoming a monopolist (attempted monopolization case). *Id.* at 50. After the plaintiff has satisfied its burden on this threshold issue, it then must introduce evidence that the monopolist's conduct has harmed both competition and consumers. *Id.* at 58. This initial inquiry serves as a filter to dispose of cases before trial if the plaintiff has not made a credible showing of anticompetitive effects. *See* Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 Antitrust L.J. 3, 62 (2004).

a. Cost-based tests may – but need not necessarily – be used to evaluate bundled discounts

While *amici* do not believe that cost-based tests should be dispositive in a rule-of-reason monopolization case, they may certainly assist a court or jury in determining whether the plaintiff has met its burden under step one. For example, the plaintiff may make its *prima facie* showing of harm to competition by showing that the defendant's practices would prevent an equally efficient single-product rival from competing. *See Ortho*, 920 F. Supp. 2d at 469-70. This inquiry should be tailored to the evil of bundling–that monopolists are able to use their product breadth to exclude smaller rivals, irrespective of the price or quality of the monopolist's or rival's products. *Id.*; Areeda & Hovenkamp, Antitrust Law ¶ 794.

The *Ortho* decision provides a good model for a test that can evaluate bundling behavior. In addition to having been applied in a district court, *Ortho*'s

measurement of below-cost pricing was adopted by the Antitrust Modernization Commission.[10] Under the *Ortho* test, the court first calculates the entire value of the monopolist's bundled discount. *Ortho*, 920 F. Supp.2d at 769-70. That discount amount is then compared to the monopolist's cost of producing the competitive product.[11] *Id*. If the value of this discount exceeds the monopolist's cost of producing this product, the bundle should be considered to be anticompetitive because it prevents firms that are as efficient as the monopolist from competing. *Id*.; Areeda & Hovenkamp, Antitrust Law ¶ 794. This test is advantageous because it both protects single-product firms from unfair competition and allows the monopolist – who presumably knows its own costs – to determine whether its conduct violates this test.

Of course, the defendant could also use cost-based evidence to refute the plaintiff's case at stage one. If, for example, the alleged bundle is merely a package price on multiple products, and the consumer has a meaningful opportunity to purchase products separately, the fact that an equally efficient single-product rival

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[10] The Antitrust Modernization Commission ("AMC") was appointed by the President and Congress in 2002 to make recommendations about "modernizing" the antitrust laws. Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, §§ 11051-60, 116 Stat 1856. The Commission consists of 12 members that were appointed in 2002: four of these were appointed by the President, four of these were appointed by the leadership of the Senate, and four of these were appointed by the leadership of the House of Representatives. *Id*. § 11054(a).

[11] Economists and antitrust scholars generally advocate using "average variable cost" as the appropriate measure of costs in pricing-based antitrust cases. This measure can significantly understate the defendant's costs in such industries as software and prescription drugs, which are characterized by large up-front investments in research and development and low marginal costs. Thus, in markets characterized by heavy up-front investments in intellectual property, the defendant's costs of developing the product at issue should be figured into the relevant measure of cost. Hovenkamp, 2006 Utah L. Rev. at 858 n.9.

could match the defendant's prices would certainly weigh against competitive harm. Likewise, if the defendants can show that a consumer can purchase a competitive product without paying a "penalty" in the form of losing significant benefits of the bundle, that fact would also suggest a lack of competitive harm.

Amici disagree with the AMC's suggestion that a cost-based test be the exclusive means for a plaintiff to demonstrate harm to competition through bundling. The central problem with making a cost-based test the exclusive method for proving a case, as even the AMC recognizes, is that it "permit[s] bundled discounts that exclude a less efficient competitor, even if the less efficient competitor had provided some constraint on the pricing of the competitive product." AMC Report at 100. The AMC's suggestion also ignores the fact that dominant firms prefer to engage in exclusionary conduct that is "cheap," in that it does not require them to sustain revenue losses, but is no less harmful to competition. Nalebuff, 50 Antitrust Bull. at 321, 327; Susan Creighton, et al, *Cheap Exclusion*, 72 Antitrust L.J. 975, 977 (2005). Finally, over-reliance on a cost-based standard also makes it harder for the plaintiff to recover when bundling is combined with, and its effects magnified by, other forms of exclusion. *See LePage's*, 324 F.3d at 159 (noting exclusionary effect of bundling when combined with exclusive dealing); *Conwood*, 290 F.3d at 783-91.

The AMC's apparent premise – that competition is never harmed by the exclusion of a less-efficient rival – ignores the benefits that consumers receive from even a less-efficient rival in the marketplace. Gavil, 72 Antitrust L.J. at 59. Rivalry from a less efficient competitor can lead to lower prices, better service or greater innovation. Moreover, the rival may be operating less efficiently *because of* the monopolist's exclusionary conduct. *See, e.g., United States v. Dentsply*, 399 F.3d 181, 192 (3rd Cir. 2005); Gavil, 72 Antitrust L.J. at 59. If the monopolist's conduct prevents the rival from reaching efficient scale, its conduct should be checked by the antitrust laws. Gavil, 72 Antitrust L.J. at 59. The AMC also ignores the market reality that monopolists are most likely to attempt to exclude competition through "cheap" means that do not cause them to forego significant profits. *See* Nalebuff, 50 Antitrust Bull. at 321, 327 (2005). Thus, although the plaintiff should be allowed to show competitive harm through below-cost pricing, the defendant should not be absolved of liability *per se* merely because the plaintiff cannot demonstrate this particular form of exclusion.

b. The plaintiff need not demonstrate a possibility of recoupment.

The AMC (and Defendants in this case) steer even further off course by recommending that plaintiff also be required to show that "the defendant is likely to recoup these short-term losses" and to make this standard the exclusive means by which a plaintiff can establish liability for exclusionary bundling. AMC Report

at 100. A recoupment requirement is inappropriate because it incorrectly likens bundling to predatory pricing instead of tying. Because bundling more closely resembles tying, the law should not impose a recoupment requirement that is absent from the tying law. The recoupment requirement also fails to address instances of "cheap" bundling, in which the dominant firm has nothing to recoup because it never sustained losses.

2. Step Two – The Defendant May Present a Procompetitive Justification.

If the plaintiff establishes its *prima facie* case, the burden shifts to the defendant to prove a "procompetitive justification" for its conduct. *Microsoft*, 253 F.3d at 59. Burden shifting is appropriate at this stage because the monopolist is in the best position to know the reasons behind its conduct, as well as the costs and efficiencies of the conduct. The monopolist's procompetitive justification must relate "directly or indirectly to the enhancement of consumer welfare." *LePage's*, 324 F.3d at 163-64. If the defendant fails to put forth a cognizable efficiency-based justification for its conduct, a court can comfortably condemn it, knowing that the conduct caused harm that outweighed any benefits to competition.

3. The Burden Shifts Back to the Plaintiff.

If the defendant puts forth a cognizable welfare-enhancing justification for its conduct, the burden then shifts back to the plaintiff, who retains the ultimate burden of proof to show that the defendant's justification was pretextual. *Kodak*,

504 U.S. at 484; *Microsoft*, 253 F.3d at 59; *Image Tech. Servs.* 125 F.3d at 1212. If the plaintiff proves that the justification was pretextual, the inquiry should end and the plaintiff should prevail. If the plaintiff fails to rebut the defendant's justification the court must determine whether the plaintiff has demonstrated that the anticompetitive harm from the defendant's conduct outweighs its benefits. As one commentator has noted, no exclusionary conduct cases have ever reached the balancing inquiry, so few courts will need to proceed to this final, fact-intensive stage. *See* Gavil, 72 Antitrust L.J. at 79.

G. Under the *Microsoft* Analysis the Jury's Verdict Should be Upheld.

Under the *Microsoft* burden-shifting test, the jury was presented with sufficient evidence that PeaceHealth engaged in exclusionary conduct to support its attempted-monopolization verdict. By nearly any measure, PeaceHealth had a dangerous probability of attaining monopoly power by virtue of its 75 percent market share in general-acute-care-service markets and 90 percent in tertiary markets.[12] McKenzie-Williamette demonstrated harm to competition by submitting evidence that, among other things, (1) it was a more efficient provider of primary and secondary services than PeaceHealth,[13] (2) that PeaceHealth excluded McKenzie from the market by pricing select birth services below cost in the late

[12] (SER 0832-0833).

[13] (SER 317; 0322-0323).

1990s,[14] (3) that these pricing practices were magnified by PeaceHealth's status as exclusive or sole-preferred provider to significant employers and heath plans,[15] *cf. LePage's*, 324 F.3d at 154-55 (noting that exclusivity added to anticompetitive effect of bundled rebates), and (4) that PeaceHealth forced Regence – which had previously accepted McKenzie as an equal provider – out of Lane County,[16] c*f. Aspen Skiing*, 472 U.S. at 608 (finding discontinuation of previously profitable joint skiing pass to be exclusionary). In light of the extensive evidence supporting an inference of harm in the relevant market, the jury correctly concluded that PeaceHealth's actions imposed harm on competition that outweighed any cognizable efficiencies.

V. CONCLUSION

For all the reasons set forth above, the Court should decline PeaceHealth's invitation to extend *Brooke Group* and uphold the jury's Section 2 verdict.

Date: April 19, 2007.

Respectfully Submitted,

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[14] (SER 0539, 0541, 0606, 0618-19,0625-26,0637-38,0682-0688, 0699-0700, 0705, O709-0711, 0841-42, 1035, 1155, 1161, 1213, 1393).

[15] *Id.*

[16] (SER 0106, 0108, O538-0542 0639-40, 0680,O688, 1044, 1047, 1049, 1067).

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CASCADE HEALTH SOLUTIONS fka McKENZIE-WILLIAMETTE HOSPITAL	)	Case No.05-36153
	)	Case No.05-36202
Plaintiff-Appellee and Cross-Appellant	)	
v.	)	
PEACEHEALTH	)	
Defendant-Appellant and Cross-Appellee	)	

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 29(d) and 9th Cir. R. 32-1, the attached amicus brief is proportionally spaced, has a typeface of 14 points or more and contains 7000 words or less.

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Andrew M. Kepper Date