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Antitrust

Expert Analysis

Parallel Bundling In Surgical Products

The U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal of claims that leading medical-surgical product distributors violated antitrust laws by offering bundled package deals. The lawsuit asserted that the distributors designed their bundling arrangements to prevent customers from buying some types of surgical products from a smaller distributor offering a limited range of products at lower prices. The appellate court affirmed the lower court's ruling for defendants because the plaintiff could not demonstrate that defendants had the requisite market power to exclude competition and failed to establish antitrust injury.

While typical bundling and tying cases examine conduct by a single dominant firm, this decision tackles parallel tying and bundling by two competitors. The opinion also sets forth an analytic framework to evaluate tying claims under the rule of reason rather than the more commonly applied per se tying rule.

By **Elai Katz**

Med-Surg Distribution

Hospitals and other health care providers traditionally obtained medical-surgical (med-surg) products from regional or national broadline distributors, including defendants Owens & Minor Distribution (O&M) and Cardinal Health 200 (Cardinal), both of which distribute a full line of med-surg products, comprised of around 30 categories and hundreds of thousands of items. They maintain regional warehouses and deliver by truck. Plaintiff Suture Express entered the market in 1998 with a different business model. It distributes two categories of med-surg products, sutures and endomechanical (endo) products, which are typically lighter and smaller. Suture Express has been able to fill orders more quickly—a significant factor for hospitals—and charge lower prices by using a single warehouse and FedEx for delivery.

> The practice of selling products in bundles or packages poses complex challenges for antitrust courts and counselors.

In response to its disruptive success, according to Suture Express, O&M and Cardinal began to offer bundled packages that provided a substantial loyalty discount to customers who purchased all or most of their med-surg products from the same distributor. Put another way, if customers bought suture and endo products from another distributor, namely Suture Express, O&M and Cardinal required customers to pay more for other med-surg products.

Claims and Lower Court Opinion

Suture Express sued in 2012 alleging that O&M and Cardinal's contracts, which bundled the sale of suture and endo products with other med-surg products, constituted an illegal tying practice in violation of federal and state antitrust laws. Under these

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contracts, customers that bought their suture and endo products from Suture Express and other med-surg products from Cardinal or O&M paid more than those who bought all of their med-surg products from Cardinal or O&M, even though Suture Express charged a lower price for its suture and endo products. Suture Express claimed it had lost customers as a result of such contracts, and that these contracts harmed hospitals that lost access to Suture Express's distribution services and products.

The district court granted summary judgment to defendants and, applying the rule of reason, decided that the failure to prove that either defendant had sufficient market power in the tying market defeated Suture Express's tying claim. The district court added that Suture Express could not establish antitrust injury and that O&M and Cardinal had provided sufficient procompetitive justifications for their bundling contracts to overcome any anticompetitive effects. *Suture Express v. Owens & Minor Distribution*, No. 12-2760-DDC-KGS, 2016 WL 1377342 (D. Kan. April 7, 2016). On appeal, the Tenth Circuit affirmed on two grounds, but declined to determine whether procompetitive justifications for defendants' bundling contracts outweighed any anticompetitive effects. *Suture Express v. Owens & Minor Distribution*, No. 16-3065, 851 F.3d 1029 (10th Cir. March 14, 2017).

Market Power

The Tenth Circuit began by observing that very few tying cases have been decided under the rule of reason. Unlike price fixing, bid rigging and most other per se causes of action, per se tying requires a showing of market power. The Tenth Circuit assumed, without deciding, that under the rule of reason test, Suture Express was similarly required to establish that defendants had market power in the tying market, as all parties presumed that a showing of market power was required.

> Bundling often enhances competition by providing customers with a convenient, well-priced package. Yet, offering deep discounts only to those who buy the bundled package can also serve to exclude rivals who cannot offer all products in the bundle.

The appellate court then turned to the substance of the appeal. Suture Express argued that market power could be inferred from the effects of defendants' bundling contracts in the market. The court acknowledged that evidence of market effects in the tied market "can be appropriate evidence of tying market power in a rule of reason case," but noted that such evidence cannot be dispositive. In doing so, the Tenth Circuit referred to the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451 (1992) and the U.S. Court of Appeals for the Ninth Circuit's decision in *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2007), both of which, the appellate panel posited, suggest that tied market effects can be appropriate evidence of tying market power in a rule of reason case.

Here, the appellate court stated that persuasive evidence existed that defendants did not possess sufficient market power to exclude competition or control price. Specifically, the court noted that evidence showed that defendants could not exclude competition in the tying market, as regional and national competitors were growing and expanding. Nor were defendants excluding competition in the tied market, as other competitors also offered bundled discounts. Thus, competition in the tied market was not excluded, but took the form of "bundle-to-bundle competition." The court observed that customers did not face prohibitively high switching costs and that the record was filled with examples of customers switching distributors.

Further, Suture Express had not proven that defendants had the ability to control price. Rather, the evidence showed that defendants' declining profit margins in the market for other med-surg products suggested that defendants did not have the ability to control prices in the tying market. As a result, the appellate court concluded that these factors constituted "persuasive evidence of a lack of market power."

The Tenth Circuit also rejected Suture Express's argument that it should have survived summary

judgment based on defendants' market shares. Specifically, Suture Express argued that defendants' market shares were high enough to support a claim under the rule of reason. The court rejected this argument, explaining that market share alone is insufficient to establish market power and that it is insufficient to counteract other market realities present here that point to increased competition and lower prices.

Similarly, the Tenth Circuit rejected Suture Express's arguments that evidence of a lack of market power is misleading. For example, plaintiff's expert argued that defendants' bundles had a coercive effect, as 56-64 percent of the suture-endo market accepted the bundled packages from defendants. Quoting from *Fortner Enterprises v. U.S. Steel*, 394 U.S. 495 (1969), the court noted that there could be other explanations for buyers' purchase of bundled packages. Here, plaintiff's expert failed to account for these other explanations.

The appellate court also rejected plaintiff's use of a discount attribution test to demonstrate market power. Under this test, the amount of discounts given on the bundle is allocated to the competitive product, and the court then determines whether the resulting price of the competitive products is below defendant's incremental costs. In rejecting this test, the court stated that the test applies to the element of conditioning and not to an analysis of market power, and the test is only used where there is proof that the defendant is a monopolist.

Antitrust Injury

The Tenth Circuit also affirmed on the ground that Suture Express had not established antitrust injury—that is, that the challenged practices injured competition as opposed to merely harming a competitor. To establish antitrust injury, plaintiff's expert examined the contract terms for a number of the largest hospital systems serviced by Cardinal and O&M. The expert found that O&M's bundling programs restrained between 38-42 percent, and Cardinal's between 18-22 percent, of the suture-endo market. Thus, plaintiff argued, bundling restrained 56-64 percent of the suture-endo market from purchasing suture-endo products at a lower price from Suture Express.

The appellate court rejected this argument, noting that less than half of the "unrestrained" customers chose to purchase suture-endo products from Suture Express at its lower price. Thus, while acknowledging that not every unrestrained purchase would need to take advantage of the lower price offered by Suture Express for its harm theory to be viable, the court found that plaintiff's model could not conclusively show injury to competition instead of injury to one competitor.

The appellate court also emphasized that the record showed a market that was becoming more, not less, competitive. Overall med-surg revenues increased between 2007 and 2012, even as enhanced competition drove down Cardinal's and O&M's profit margins.

Uncertain Effects

The practice of selling products in bundles or packages poses complex challenges for antitrust courts and counselors. Bundling often enhances competition by providing customers with a convenient, well-priced package. Yet, offering deep discounts only to those who buy the bundled package can also serve to exclude rivals who cannot offer all products in the bundle. Courts hesitate to condemn such practices without strong evidence of competitive harm for fear of chilling legitimate pro-competitive conduct.

That conundrum is sharpened when the challenged conduct involves independent action by several companies that compete with one another, as the court determined was the case here, instead of a single monopolist facing limited competition. Although some scholars have argued that parallel exclusionary practices, including bundling, could lead to foreclosure and cause competitive harm—see C. Scott Hemphill & Tim Wu, "Parallel Exclusion," 122 Yale L.J. 1182 (2013)—courts have difficulty ruling against companies that engage in similar conduct independently without conspiring, when the same conduct would be lawful if undertaken by only one small company.