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Antitrust Modernization Commission Declares Antitrust Need Not be Modernized, But Does Suggest a Few Tweaks

By Thomas A. McCann

In 2002, the United States Congress created the Antitrust Modernization Commission to wage a comprehensive review of U.S. antitrust laws to determine whether they need to adapt to keep pace with the changing business world.⁴⁶ After conducting 18 hearings over 13 days, hearing testimony from 120 witnesses and receiving comments from 126 people and organizations, the commission released its much awaited 540-page report in April 2007, concluding on balance that U.S antitrust law is fundamentally sound and that no significant changes are required.⁴⁷

Despite recommending no wholesale changes to the current antitrust enforcement system, the commission did make several suggestions for improvement, and the courts are just beginning to apply some of the commission's more progressive ideas to the antitrust cases on their dockets.⁴⁸

The U.S. House Committee on the Judiciary specifically asked the Commission to analyze three main issues: (1) whether U.S. antitrust law must be changed to address the role of intellectual property; (2) whether enforcement priorities should change to reflect the global economy; and (3) whether the state attorneys general should play more of a role in antitrust enforcement.⁴⁹ The commission responded "no" to all three questions.⁵⁰

⁴⁶ Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, § 11054(h), 116 Stat. 1856, 1857 (2002).

⁴⁷ Charles Freed, *The Antitrust Modernization Commission: "If It Ain't Broke..."*, ANTITRUST, Summer 2007, at 7.

⁴⁸ *Cascade Health Solutions v. PeaceHealth*, No. 05-35627, (9th Cir. Sept. 4, 2007).

⁴⁹ Freed, *supra* note 47, at 7.

⁵⁰ *Id.*

The commission concluded there is no need to change the antitrust laws to deal with “industries in which innovation, intellectual property, and technological change are central features.”⁵¹ The commission recommended that in analyzing the competitive effects of new economy industries, enforcers simply should give due weight to market dynamics, just like any traditional antitrust case.⁵² The commission further concluded that globalization should not affect U.S. antitrust enforcement, but instead recommended that there be greater cooperation among international antitrust authorities and greater coordination of different nations’ antitrust laws, including a call for a centralized pre-merger notification system.⁵³ The commission finally recommended that there be no change in the role of the state attorneys general, but advised that they should stick to local antitrust violations and there should be more coordination between the federal and state enforcement agencies.⁵⁴

Notwithstanding the report’s “don’t change a thing” tenor, the commission did make one novel recommendation regarding “bundling” violations under § 2 of the Sherman Act.⁵⁵ That section of the Sherman Act “forbids ‘monopolization’ and ‘attempted monopolization’ (as well as combinations and conspiracies to monopolize) of any part of the trade or commerce of the United States.”⁵⁶ In addition to traditional schemes to acquire monopoly power, courts have recognized that companies can also utilize “bundled discounts” to drive away competition, using schemes in which they offer a discount or rebate to customers if they buy a package of products in an effort to deter entry into the market, to use it as predatory pricing or as a form of illegal “tying,” which violates antitrust law.⁵⁷ However, the commission recognized that bundling is exceedingly common in today’s economy, from cell phone products

⁵¹ ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS, at 32 (2007) [hereinafter AMC REPORT], available at <http://www.amc.gov>.

⁵² *Id.*

⁵³ AMC REPORT, *supra* note 51, at 232.

⁵⁴ *Id.* at 187.

⁵⁵ Freed, *supra* note 47, at 7; *See also* 15 USC § 2.

⁵⁶ AMC REPORT, *supra* note 51, at 84; *See also* 15 USC § 2.

⁵⁷ Freed, *supra* note 47, at 7.

to car/home/life insurance packages, and it can significantly lower costs for consumers.⁵⁸

The commission report proposed an “objective, cost-based approach” for determining the legality of companies offering “bundled” discounts.⁵⁹ First, a court should take the entire discount or rebate of the product bundle and deduct it just from the price of the product on which the defendant competes with the plaintiff.⁶⁰ If, after that calculation, the price of the defendant’s product is still above its incremental cost of production, the defendant wins.⁶¹ Even if the plaintiff establishes that prices are below the defendant’s incremental cost of production, the defendant still wins unless the plaintiff can prove that the defendant is able to recoup its losses from the pricing scheme, and that the scheme causes harm to competition.⁶²

The Ninth Circuit recently applied this cost-based test to an antitrust case involving the healthcare market.⁶³ The appellate court chose to follow the commission’s recommendation and to reject the more ambiguous approach adopted by the Third Circuit, an approach that did not consider whether the bundled discounts constituted competition on the merits, but simply concluded that all bundled discounts offered by a monopolist are anticompetitive with respect to its competitors who do not manufacture an equally diverse product line.⁶⁴ The Third Circuit standard would not require a cost-based analysis and would allow the jury to find bundled discounts exclusionary merely upon a showing that a competitor could not offer the same bundle as the defendant.⁶⁵

PeaceHealth and McKenzie are two hospital care providers in Lane County, Oregon. PeaceHealth provides basic care and more advanced “tertiary care” services while McKenzie provides only basic care service. PeaceHealth has more than 90 percent of the

⁵⁸ AMC REPORT, *supra* note 51, at 95.

⁵⁹ *Id.* at 89, 99.

⁶⁰ *Id.* at 99.

⁶¹ *Id.*, *See also* Freed, *supra* note 47, at 7.

⁶² *Id.*

⁶³ *See* Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).

⁶⁴ *Cascade Health Solutions*, 502 F.3d at 910; *See also* LePage’s Inc. v. 3M, 324 F.3d 121 (3d Cir. 2003).

⁶⁵ *Id.*

county's market for advanced care and about 75% for basic care.⁶⁶ McKenzie alleged in its complaint that PeaceHealth offered insurers 35 to 40 percent discounts on advanced care if the insurers made PeaceHealth their exclusive preferred provider.⁶⁷ Further, McKenzie alleged that it could offer basic care services at a lower cost than PeaceHealth, but because of the bundled discounts, McKenzie was driven out of the market for those services.⁶⁸ The district court instructed the jury to apply the Third Circuit standard, and the jury awarded the plaintiff \$5.4 million, which the court trebled to \$16.2 million.⁶⁹

In vacating the district court's judgment, the Ninth Circuit analyzed both tests and came out on the side of the Antitrust Modernization Commission. The court said that while bundling can be anticompetitive in certain situations, the majority of businesses, both big and small, use bundles to instill customer loyalty, lower net prices to consumers, increase demand in lieu of advertising, encourage use of a new product, or enter a new market.⁷⁰ The court said that the Third Circuit prohibited some competitive business behavior and that "we think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct... unless the discounts result in prices that are below an appropriate measure of the defendant's costs."⁷¹

The court then considered several tests to determine which bundling schemes were bad and adopted the commission's "discount attribution" standard.⁷² The court reasoned that this standard makes the defendant's bundled discounts legal unless the discounts have the potential to exclude a hypothetical equally efficient producer of the competitive product, i.e. it that pretends that the actual plaintiff is equally efficient to the defendant.⁷³ The court provided this example of how the test works:

⁶⁶ *Cascade Health Solutions*, 502 F.3d at 902.

⁶⁷ *Id.* at 903.

⁶⁸ *Id.* at 907.

⁶⁹ *Id.* at 901, 904-5.

⁷⁰ *Id.* at 906.

⁷¹ *Cascade Health Solutions*, 502 F.3d at 913.

⁷² *Id.* at 916.

⁷³ *Id.* at 916-17.

A [is] a firm that makes both shampoo and conditioner. A's incremental cost of shampoo is \$1.50 and A's incremental cost of conditioner is \$2.50. A prices shampoo at \$3 and conditioner at \$5, if purchased separately. However, if purchased as a bundle, A prices shampoo at \$2.25 and conditioner at \$3. Purchased separately from A, the total price of one unit of shampoo and one unit of conditioner is \$8. However, with the . . . discount, a customer can purchase both products from A for \$5.25, a discount of \$2.75 off the separate prices, but at a price that is still above A's variable cost of producing the bundle. Applying the discount attribution rule. . . we subtract the entire discount. . . , \$2.75, from the separate per unit price of the competitive product, shampoo, \$3. The resulting effective price of shampoo is thus \$0.25. If a customer must purchase conditioner from A at the separate price of \$5, a rival who produces only shampoo must sell the shampoo for \$0.25 to make customers indifferent between A's bundle and the separate purchase of conditioner from A and shampoo from the hypothetical rival.⁷⁴

The court said the pricing scheme has the effect of excluding any potential rival who produces only shampoo, and does it at an incremental cost above \$0.25.⁷⁵ Thus, the bundling excludes potential competitors that could produce shampoo more efficiently (i.e., at an incremental cost of less than \$1.50).⁷⁶

The court also approved of the scheme because it "provides clear guidance for sellers that engage in bundled discounting practices. A seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the rule we have outlined."⁷⁷

Going back to the other facets of the Antitrust Modernization Commission, the body advocated leaving well enough alone. The commission rejected any wholesale changes to the current enforcement system, which is quite harsh by international standards,

⁷⁴ *Id.* at 917.

⁷⁵ *Id.*

⁷⁶ *Cascade Health Solutions*, 502 F.3d at 917.

⁷⁷ *Id.* at 918.

with treble damages, and jail terms for major violations.⁷⁸ The commission said “[o]n balance, the current scheme appears to be effective in enabling plaintiffs to pursue litigation that enhances the deterrence of unlawful behavior and compensates victims.”⁷⁹ The commission did recommend that Congress enact legislation that would permit non-settling defendants to obtain a more equitable reduction of the judgment against them and allow for contribution among non-settling defendants.⁸⁰

The commission was critical of the current merger review process, advocating stricter rules and a tighter timeline for getting the process done.⁸¹ The commission also was critical of antitrust exemptions and immunities granted by the federal government.⁸² The report pounded home that Congress must stop granting special industry exemptions and reevaluate existing exemptions to see if the reasons for them, such as societal goals, still outweigh the harm to competition.⁸³ The Commission also recommended that federal antitrust agencies have full merger enforcement authority over regulated industries and should exclusively conduct the analysis, instead of having it redone and second-guessed by the industry’s regulatory authority.⁸⁴

The Antitrust Modernization Commission’s long-awaited report was short on pizzazz but did provide a useful top-down review of the antitrust regime in the United States.⁸⁵ Courts are already applying the body’s recommendations in the bundling arena, and its other recommendations are likely to influence policy both in Congress and the federal agencies involved in antitrust enforcement.⁸⁶ It’s still too early to tell, but many experts in the

⁷⁸ AMC REPORT, *supra* note 51, at vi.

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.* at 15.

⁸² *Id.* at 435.

⁸³ AMC REPORT, *supra* note 51, at 334.

⁸⁴ *Id.* at 342.

⁸⁵ Freed, *supra* note 47, at 8.

⁸⁶ *Id.*

antitrust field say the report's \$4 million price tag was still worth the price.⁸⁷

⁸⁷ *Id.*
