Case Nos. 07-55960; 07-56017

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MASIMO CORPORATION, A DELAWARE CORPORATION,
Plaintiff-Appellant and Cross-Appellee,

—v.—

TYCO HEALTHCARE GROUP LP, A DELAWARE PARTNERSHIP, AND
MALLINCKRODT, INC., A DELAWARE CORPORATION,
Defendants-Appellees and Cross-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA
NO. CV 02-4770 MRP (AJWx)

BRIEF OF AMICI CURIAE CONSUMER FEDERATION OF AMERICA AND MEDICAL DEVICE MANUFACTURERS ASSOCIATION IN SUPPORT OF APPELLANT/CROSS-APPELLEE MASIMO CORPORATION

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STATEMENT PURSUANT TO FRAP 26.1

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *amici* make the following disclosures:

1. *Amicus curiae* Consumer Federation of America, Inc. states that it is a non-profit organization, has no parent corporation, and has issued no stock.

2. *Amicus curiae* Medical Device Manufacturers Association states that it is a non-profit organization, has no parent corporation, and has issued no stock.

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INTEREST OF AMICI CURIAE

With the consent of all parties, pursuant to FRAP 29(a), the following organizations respectfully submit this *amicus curiae* brief in support of Plaintiff-Appellant/Cross-Appellee Masimo Corporation:

The Consumer Federation of America ("CFA") is the nation's largest consumer advocacy group, comprised of more than 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, medical device, and high technology industries where exclusive dealing and other practices by dominant firms can raise critical competition issues.

The Medical Device Manufacturers Association ("MDMA") was founded in 1992 by a group of medical device executives who believed that the innovative and entrepreneurial sector of the industry needed a strong and independent voice in advocacy before Congress, regulators, state legislatures, and the courts. Over the past fifteen years, MDMA has sought to improve patient care, medical device competition, and the access to medical devices by encouraging the development of new medical technology, advocating against artificial barriers to competition, and fostering the availability of innovative products in the marketplace. MDMA represents more than 150 members who develop and manufacture medical devices and diagnostic products.

As representatives of the public interest and advocates for millions of consumers of medical devices, pharmaceuticals, and other health care products, *amici* have an interest in ensuring that consumers receive the price and quality benefits that result from a competitive marketplace. Exclusionary practices adopted by dominant firms have the potential to raise prices charged to the consumers, reduce quality, or diminish innovation.

The practices at issue in this case are a prime example of the harm to consumers that can arise where a dominant firm uses exclusionary practices, rather than competes on the merits. According to the record developed at trial, Tyco used a variety of contractual practices to keep a lower cost, safer, and more innovative product off the market. *See* Excerpts of Record ("ER") at 631. Indeed, according to the record developed below, once these practices ceased after Masimo brought this litigation, prices fell substantially. *Id.* at 2071-73. Although *amici* take no position on the legal sufficiency of Masimo's evidentiary presentation, it is apparent that the decision below employed an incorrect standard by which to judge the legality of defendant's conduct.

The legal standards in this case affect not only these parties but numerous companies in the medical device industry. The practices at issue in this case—bundling, exclusive dealing, sole source contracting, and market share discounts—are the subject of several ongoing cases and have been addressed in four separate hearings before the Senate Judiciary Committee.[1] The competitive concerns raised by these practices are substantial and impact several critical medical device markets. As Senator Kohl observed, the contracting practices of dominant medical device companies:

> have created a system that keeps many good products out of circulation while enabling large manufacturers to entrench their market position. Practices such as sole sourcing, high commitment levels – requiring a hospital to purchase as much as 90% of a product from one company in order to get the maximum discount – and bundling – giving hospitals extra discounts and bonuses for buying a group of products – can seriously damage the ability of doctors to choose the best products for their patients and for competitive manufacturers to survive and innovate. [These] contracting practices

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[1] *Hospital Group Purchasing: Lowering Costs at the Expense of Patient Health and Medical Innovations?: Hearing before the S. Comm. on the Judiciary, Subcomm. on Antitrust, Bus. Rights and Competition*, 107th Cong. (Apr. 30, 2002); *Hospital Group Purchasing: Has the Market Become More Open to Competition?: Hearing Before the S. Comm. on the Judiciary, Subcomm. on Antitrust, Competition Policy and Consumer Rights*, 108th Cong. (July 16, 2003); *Hospital Group Purchasing: How To Maintain Innovation and Cost Savings: Hearing Before the S. Comm. on the Judiciary, Subcomm. on Antitrust, Competition Policy And Consumer Rights*, 108th Cong. (Sept. 14, 2004); *Hospital Group Purchasing: Are the Industry's Reforms Sufficient to Ensure Competition?: Hearing Before the S. Comm. On the Judiciary, Subcomm. on Antitrust, Competition Policy and Consumer Rights*, 109th Cong. (Mar. 15, 2006).

> may reduce competition and innovation in health care and narrow the ability of physicians to choose the best treatment for their patients.[2]

This case will have a significant impact with regard to ongoing and future practices by dominant firms in the medical device marketplace. If the district court's broad rule of almost *per se* legality is affirmed, consumers in numerous medical device markets will be faced with less choice and higher prices; doctors will be unable to choose the best products to treat their patients; and innovative rivals will be kept from bringing new products to the market.

SUMMARY OF ARGUMENT

The district court held that absent evidence of tying or predatory pricing, a bundled discount cannot violate Sections 1 or 2 of the Sherman Act or Section 3 of the Clayton Act. Consequently, according to the court below, bundled discounts that effectuate exclusive dealing, rather than tying or predatory pricing, are therefore *always* lawful. *Masimo Corp. v. Tyco Health Care Group, L.P.*, 2006 WL 1236666, at *9, *13 (C.D. Cal. Mar. 22, 2006). The district court's decision substantially rewrote the law of exclusive dealing, and effectively ignores decades of clear Supreme Court jurisprudence.

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[2] *Hospital Group Purchasing: Lowering Costs at the Expense of Patient Health and Medical Innovations?: Hearing before the S. Comm. on the Judiciary, Subcommittee on Antitrust, Bus. Rights and Competition*, 107th Cong. 1 (Apr. 30, 2002) (statement of Senator Herb Kohl), *available at* http://judiciary.senate.gov/member_statement.cfm?id=236&wit_id=470.

Where the effect of a bundled discount program is to impair rivals, and consequently harm consumer welfare, such conduct violates the Sherman Act. To conclude otherwise turns a blind eye to the *effect* of an anticompetitive practice in favor of a defendant's *characterization* of that practice. Antitrust law is not about the label assigned to a practice, it is about the effect of the practice on consumer welfare. *See, e.g., Jefferson Parrish Hosp. Dist. v. Hyde,* 466 U.S. 2, 22 & n. 34 (1984) ("[T]he Sherman Act does not prohibit 'tying,' it prohibits 'contracts . . . in restraint of trade.' Thus, in a sense the question whether this case involves 'tying' is beside the point. The legality of petitioners' conduct depends on its competitive consequences, not whether it can be labeled 'tying.'"); *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 8 (1979) ("easy labels do not always supply ready answers").

This case reaches to the heart of how antitrust law should treat conduct by dominant firms. *Amici* believe that the district court's decision would cause significant consumer harm by permitting dominant firms to employ potentially exclusionary tactics, such as exclusive dealing, by labeling them as bundling. The rule adopted by the district court runs contrary to established exclusive dealing jurisprudence, including the recent decisions in *United States v. Microsoft*, 253 F.3d 34, 58 (D.C. Cir. 2001), and *United States v. Dentsply*, 399 F.3d 181, 192 (3d Cir. 2005). Unlike those decisions, the district court below failed to consider whether the practical effect of the bundled discounts was to effectuate an unlawful exclusive dealing scheme in violation of Section 2 of the Sherman Act, and whether those discounts, on balance, harmed consumer welfare. Instead, the district court decided that the discounts were not illegal simply because they were offered as part of a bundle.

Although the rule of law adopted by the court below may appear administratively attractive, it is wholly inconsistent with decades of antitrust jurisprudence that requires a careful scrutiny of the purpose and effect of a dominant firm's conduct in such circumstances. The decision below has no basis in economics or antitrust policy, would create an unwarranted safe harbor for dominant firm conduct, and should be reversed.

Finally, the district court opinion is inconsistent with the principles articulated in this Court's recent decision in *Cascade Health Solutions v. PeaceHealth*, 502 F.3d 895, 927 (9th Cir. 2007), and the report of the Congressionally-appointed Antitrust Modernization Commission. In *PeaceHealth*, this Court concluded that independent of whether the bundled discount constituted unlawful *price* competition under the newly adopted "discount attribution" standard, a bundled discount could nonetheless constitute unlawful exclusionary conduct under Section 1 of the Sherman Act. *Id.* Therefore, this Court's decision in *PeaceHealth* makes abundantly clear that bundling claims cannot be reduced solely to claims of predatory price competition under the discount attribution test. Similarly, in its recent report to Congress, the Antitrust Modernization Commission declined to limit tying and exclusive dealing claims to situations involving predatory pricing. *See* ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 114, n. 157 (Apr. 2, 2007), *available at* www.amc.gov. Indeed, application of a one-size-fits-all approach to bundling fails to recognize the potential means of harming competition through bundling arrangements. The district court's holding essentially would be one of *per se* legality in most contexts, ultimately serving to harm consumers through higher prices, less innovation, and less service. That is not the law today, and this Court should reverse the decision of the court below and reaffirm, as required by the decision in *PeaceHealth*, that traditional standards of liability apply under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act where a plaintiff alleges that a bundled discount constitutes an unlawful exclusive dealing arrangement.

ARGUMENT

I. ORDINARY EXCLUSIVE DEALING STANDARDS APPLY TO BUNDLED DISCOUNTS THAT OPERATE AS EXCLUSIVE DEALING ARRANGEMENTS

The district court concluded that "[i]f a customer has the alternative of purchasing the product separately, then barring evidence of predatory pricing or tying, offering customers the product in a package does not constitute a restraint of trade under Section 1 [of the Sherman Act] or [Section] 3" of the Clayton Act. *Masimo Corp.*, 2006 WL 1236666, at *9 (citing 15 U.S.C. § 1 *and* 15 U.S.C. § 14). In addition, the district court also held that "absent allegations of predatory pricing or tying, the practice of offering a discount on two or more bundled products is not anticompetitive under Section 2" of the Sherman Act. *Id.* at *13 (citing 15 U.S.C. § 2). In so holding, the district court ignored well-established jurisprudence holding that where the practical effect of a pricing scheme is to induce exclusive dealing, ordinary exclusive dealing standards should apply. Moreover, the trial court's decision below conflicts with the principles articulated by this Court's recent *PeaceHealth* decision. This Court held in *PeaceHealth* that bundled discounts could be found unlawful not only where they involved predatory pricing, but also as other forms of exclusionary conduct under the Sherman Act. *PeaceHealth*, 502 F.3d at 928-29. This case presents this Court with the opportunity to affirm that, where the practical effect of a bundled discount is to create an exclusive dealing arrangement, whether by contract or otherwise, normal exclusive dealing standards should apply.

A. Bundled Discounts Can Have the Same Practical Effects as Exclusive Dealing or Tying Arrangements

Courts have recognized for decades that the application of the antitrust laws requires an analysis of the practical impact of particular conduct—not the label ascribed to the behavior. Indeed, the jurisprudence of exclusive dealing makes that clear. Antitrust law provides that price discounts can be used to effectuate exclusive dealing arrangements, even where the contractual arrangement does not explicitly require exclusivity. For example, in *Tampa Electric v. Nashville Coal Co.*, the Supreme Court condemned an exclusive dealing arrangement even though the contract provision did not "expressly" require exclusive dealing, since the pricing arrangements in that case "had the same practical effect" as exclusive dealing. 365 U.S. 320, 326 (1961); *see United Shoe Mach. Corp. v. United States*, 258 U.S. 451 (1922) ("While the clauses enjoined do not contain specific agreements not to use the machinery of a competitor of the lessor, the practical effect of these drastic provisions is to prevent such use."); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1058 (8th Cir. 2000) ("Section 1 claims that allege only de facto exclusive dealing may be viable."); s*ee* X PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1758b, at 325-28 (3d ed. 2007 & 2006 Supp.) (hereinafter "AREEDA & HOVENKAMP").

As the Areeda and Hovenkamp antitrust treatise makes clear:

> A discount conditioned on exclusivity should generally be treated as no different from an orthodox exclusive-dealing arrangement. Section 3 of the Clayton Act expressly makes it unlawful to offer a 'discount . . . or rebate . . . on the condition, agreement, or understanding that the . . . purchaser . . . shall not use or deal in the goods . . . of a competitor' where the required threat to competition occurs. Further, as the Supreme Court made clear in *Tampa Electric*, § 3 of the Clayton Act condemns not merely express exclusive-dealing contracts but also contracts that have the 'practical effect' of inducing exclusive dealing. Thus, antitrust policy should not differentiate between the manufacturer of widgets that explicitly imposes exclusive dealing on its dealers and the manufacturer that gives such dealers a discount or rebate for dealing exclusively in the manufacturer's widgets.

X AREEDA & HOVENKAMP, ¶ 1807b, at 127-28 (citations omitted); *see also United States v. Microsoft Corp.*, 253 F.3d 34, 87 (D.C. Cir. 2001) ("Direct competition on the merits of the tied product is foreclosed when the tying product either is sold only in a bundle with the tied product or, though offered separately, is sold at a bundled price, so that the buyer pays the same price whether he takes the tied product or not.").

Early exclusive dealing cases, in fact, were predominantly ones in which exclusive dealing was induced through heavy discounting. *See, e.g.*, *Whitwell v. Continental Tobacco Co.*, 125 F. 454 (8th Cir. 1903). Section 3 of the Clayton Act was designed to prohibit those arrangements, provided there was proof that exclusive dealing would lessen competition substantially. *See, e.g.,* H.R. REP. NO. 627, PT. 1, 63 CONG., 2D SESS. 13 (1914); 51 CONG. REC. 9161-62 (1914) (Rep.

Floyd). The statutory language of Section 3, in fact, applies expressly to exclusive dealing arrangements achieved by the "fix[ing of a] . . . discount." 15 U.S.C. § 14. It is abundantly clear, therefore, that *de facto* exclusive dealing can be illegal, and that such *de facto* exclusive dealing arrangements should be reviewed under the same standards used to evaluate express and contractual exclusive dealing arrangements.

Similarly, under certain circumstances, bundled discounts can be used to effectuate a tying arrangement. And, again, the specific language of Section 3 of the Clayton Act, which applies to tying as well as exclusive dealing, contemplates tying arrangements achieved by means of discounting, including bundled discounts. *Id.; see* X AREEDA & HOVENKAMP, ¶ 1758b, at 325-28.

In practice, this would mean that if the plaintiff meets its burden to prove that the defendant's bundled discounts lead to exclusive or quasi-exclusive arrangements covering an appropriately large portion of the relevant market, the plaintiff can present the case as one of exclusive dealing, applying the standards articulated by this Court in cases such as *Omega Environmental, Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997). *See Tampa Elec.*, 365 U.S. at 327; *Twin City Sportservice v. Charles O. Finley & Co.*, 676 F.2d 1291, 1298 (9th Cir. 1982) (24% market foreclosure sufficient). Similarly, if the defendant has significant market power in the market for one product and its contractual arrangements are such that customers have no practical choice but to take a distinct second product from the defendant as a condition of getting the first, the arrangement is appropriately regarded as tying and normal tying rules should apply. *See* X AREEDA & HOVENKAMP, ¶ 1758b, at 325-38.

B. Sound Economic Principles and Public Policy Support the Application of Exclusive Dealing Standards to Bundled Discounts

Treating pricing cases as pricing cases, and treating exclusive dealing and tying separately, makes economic sense and is consistent with sound competition policy and antitrust jurisprudence. Each offense involves a distinct type of behavior and a distinct harm. As numerous courts have held, reducing prices should only be condemned in limited circumstances because lower prices benefit customers and often are a sign of a competitive marketplace. *See, e.g., Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). On the other hand, tying and exclusive dealing can have a substantially different economic effect, for example, by raising rivals' costs through the denial of access to critical forms of distribution. *See, e.g.,* Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 315-18 (2006) (hereinafter "Salop"). For example, where a bundled discount results in *de facto* tying or exclusive dealing, the harm to competition is that rivals' costs, and thus the prices to consumers, are raised, as rivals are excluded from selling their products in the relevant market—either because the exclusive arrangement has locked up potential customers or because potential customers are "tied" to the rival's product. *See Omega Envtl.*, 127 F.3d at 1162 ("The main antitrust objection to exclusive dealing is its tendency to 'foreclose' existing competitors or new entrants from competition in the covered portion of the relevant market during the term of the agreement."); *see also Northern Pac. Ry. v. United States*, 356 U.S. 1, 6 (1958) ("[Tying arrangements] deny competitors free access to the market for the tied product not because the party imposing the tying requirements has a better product or a lower price, but because of his power or leverage in another market."). In each case, the competitive harm is not necessarily that rivals cannot match the discount itself, but that the result of the bundle is that rivals are excluded from competing in the relevant market—and that prices increase and innovation diminishes as a result.

From a competition policy perspective, discounts are very different than exclusive dealing or tying arrangements. Even where a party offers a bundled discount, the arrangement does not compel consumers to purchase the entire bundle; consumers still retain the choice to buy separately. On the other hand, tying and exclusive dealing both require a customer to make a choice it otherwise may not: through exclusive dealing or tying, consumers are "forced" to purchase a product that they would prefer not to purchase, or would prefer to purchase on other terms. *See Northern Pac. Ry.*, 356 U.S. at 6. It is this denial of consumer choice that is at the core of the competition concerns, since "buyers are forced to forego their free choice between competing products." *Id.*

It is this fundamental concern that the district court effectively wrote out of the antitrust laws with the decision below. It does so by making the sole focus of the analysis whether the bundled arrangement is below cost. But that inquiry of the dominant firm's cost structure is misleading, or, at best, irrelevant in the context of exclusive dealing. Exclusive dealing is problematic because the dominant firm can deny rivals critical forms of distribution, or relegate the rivals to inferior more costly forms of distribution. Importantly, this harm arises independently of the dominant firm's cost structure. As with tying, the competitive harm from exclusive dealing arises not from the low price itself but by making that low price contingent upon the consumer purchasing the entire or a substantial portion of its requirements from the dominant firm. *See* Richard A. Posner, *Vertical Restraints and Antitrust Policy*, 72 U. CHI. L. REV. 229, 234 (2005). In an exclusive dealing case, the consumer essentially pays a "penalty" for buying rivals' products because doing so forces it to lose the attractive, exclusive price. In essence, the customer is required to purchase competitive products from the monopolist that it otherwise may not, if alternative choices were practically available. *See* Herbert Hovenkamp, *Discounts and Exclusion*, 3 UTAH L. REV. 841, 853 (2006).

As a result, where the practical effect of a defendant's decision to bundle is to impede "competition in a substantial share of the line of commerce affected," *Tampa Elec.*, 365 U.S. at 327, demonstrating predatory pricing or tying should not be the only means by which a plaintiff can mount a challenge. To hold otherwise threatens to legalize conduct that serves to harm consumers by eliminating nascent competition, which otherwise would represent viable competition to dominant firms.

II. THE DISTRICT COURT'S DECISION ALLOWS DOMINANT FIRMS TO EMPLOY EXCLUSIONARY TACTICS SIMPLY BY LABELING THEM AS PRICE COMPETITION

The district court's analysis under Section 2 of the Sherman Act is particularly troubling because it reflects an attempt to force all Section 2 claims into a pricing analysis even where the facts show that price is not the sole method of exclusion. *Masimo Corp.*, 2006 WL 1236666, at *13 ("absent allegations of predatory pricing or tying, the practice of offering a discount on two or more bundled products is not anticompetitive under Section 2" of the Sherman Act). The district court's basis for rejecting the applicability of Section 2 was its disagreement with the "reasoning" in the Third Circuit's decisions in *LePage's* and *SmithKline*. *Masimo Corp.*, 2006 WL 1236666, at *13 (discussing *LePage's Inc.*

v. 3M, 324 F.3d 141 (3d Cir. 2003), and *SmithKline v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978)). Although the district court's concerns regarding *LePage's* and *SmithKline* have now been resolved by this Court's *PeaceHealth* decision, those cases primarily considered bundled discounts under the rubric of *predatory pricing*, not exclusive dealing or tying. As explained, and as *PeaceHealth* itself holds, bundled discounts can result in *de facto* tying and exclusive dealing, which are harmful to competition apart from whether the bundled discount constitutes below-cost pricing under the discount attribution test. *See PeaceHealth*, 502 F.3d at 928. If the district court's analysis is accepted, then anticompetitive, *de facto* exclusive dealing would be deemed lawful unless the bundled discount is a form of predatory pricing.

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 Corp.*, 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 consistently have 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 Entm't, 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).

Courts have 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). 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* III Areeda & Hovenkamp, ¶ 651, at 71-82.

It is clear that exclusive dealing can violate Section 2, where the effect of exclusivity is to allow a monopolist to exclude rivals from having their goods or services reach consumers, or to make it more costly for rivals to do so, in a manner that reduces rival's constraints on the defendant's market power, causing prices to rise. *See Dentsply*, 399 F.3d at 193; *Microsoft*, 253 F.3d at 58; *PeaceHealth*, 502 F.3d at 928. The framework for analyzing exclusivity arrangements is clear and well-understood: the legality of such practices turns on whether the arrangement (express or *de facto*) threatens to create or enhance market power and therefore lead to an anticompetitive outcome. *See Tampa Elec.*, 365 U.S. at 327-29.

Exclusive dealing can be anticompetitive whether or not a firm is entirely excluded from the market. For example, costs may be raised enough to merely slow down rivals' market expansion. If, by excluding a rival from the most efficient distribution channels, a monopolist can prevent enough buyers from reaching its rival, the rival may no longer be able to reach or maintain the minimum efficient scale required to compete. *See, e.g., Dentsply*, 399 F.3d at 192 (noting that Dentsply's marketing strategy had a "significant effect in preserving Dentsply's monopoly," helping "keep sales of competing teeth below the critical level necessary for any rival to pose a real threat to Dentsply's market share"). When a small firm is prevented from operating at its minimum efficient scale, its costs prevent it from providing the sort of aggressive price competition that benefits consumers.

Such exclusionary strategies can also deny rivals economies of scale in recouping research investments. *See* Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 320-21 (2003) (hereinafter "Elhauge"). Exclusion of rivals also prevents consumers from purchasing new socially desirable technologies. As a result, successful innovations will have a smaller payout than expected, discouraging future research investments, which in turn leads to less future competition. *See id*. This result is especially likely in industries that already possess high barriers to entry, such as the medical device industry at issue here.

The legal standards for condemning exclusive dealing and predatory pricing are, and should be, different. Exclusionary bundling, as opposed to below cost pricing, can eliminate a rival regardless of that rival's efficiency, and therefore is more likely to result in increased prices. Because this type of exclusionary practice is thus more likely than aggressive price-cutting to be anticompetitive, it carries greater risks of false negatives than false positives. *See* Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 75-77 (2005) (noting that in exclusionary conduct cases where the defendant has market power "concern for false negatives counsels for a less permissive approach" than in predatory pricing cases); Willard K. Tom, et al., *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615, 624-27 (2000).

The common element among many exclusionary contract strategies (as in the case here) is that they raise rivals' costs. *See* Elhauge, 56 STAN. L. REV. at 320; Salop, 73 ANTITRUST L.J. 315-18. Prominent scholars have observed why exclusionary contract strategies, such as bundling discounts or exclusive dealing, should not be evaluated simply under a price test when considering whether they are anticompetitive. Unlike predatory pricing, exclusive dealing does not necessarily require a "profit sacrifice" that must be recouped at some later point. Rather "recoupment may occur simultaneously" with the exclusionary conduct. Salop, 73 ANTITRUST L.J. at 316. Second, unlike predatory pricing schemes, exclusive dealing does not require the exit of rivals. Instead, "[i]f the marginal costs of established competitors are raised, those rivals will have the incentive to raise their prices and reduce their output, even if they remain viable." *Id.* Finally, strategies such as exclusive dealing do not necessarily result in a short-term benefit to consumers, unlike predatory pricing where consumers see an immediate reduction in prices. *See id.*[3] In fact, there was evidence in the record to suggest precisely the opposite: prices fell significantly once the litigation began and the defendant abandoned many of its exclusionary practices. *See* ER at 2071-73.

As discussed above, the district court decision conflicts with cases that recognize that bundled discounts are not only used to exclude competitors

[3] There are two additional reasons not to limit exclusive dealing or other claims of exclusionary conduct to situations involving predatory pricing, both of which this Court recognized in its decision in *PeaceHealth*. First, the stringent rules for predatory pricing are appropriately strict: as this Court noted, on a cost-benefit analysis, the risk of overdeterring procompetitive conduct and the difficulty of a tribunal to control these practices warrants a rule under which pricing practices are subjected to only limited antitrust scrutiny. *PeaceHealth*, 502 F.3d at 915. The same risks do not apply in the exclusive dealing context. Moreover, this Court noted in PeaceHealth that it was fashioning new rules to apply to bundled discounts, an area where this Court acknowledged limited judicial experience. *Id.* at 918. On the other hand, this Court has far more experience with exclusive dealing standards, and there is no reason to abandon those principles in this case.

through lower prices, but they can also be used to exclude competitors through *de facto* or *de jure* exclusive dealing arrangements. Regardless of whether the bundled discount is alleged to be a violation of Sections 1 or 2 of the Sherman Act or Section 3 of the Clayton Act, the question in each instance is whether the plaintiff has met its burden to show that the practical effect of the bundle is an exclusive dealing arrangement or a tie. As explained above, if the plaintiff can meet this burden, then ordinary exclusive dealing or tying principles should apply. While *amici* take no position whether plaintiff met its burden on the facts to show that the bundled discounts created *de facto* exclusive contracts, the district court committed clear error by precluding plaintiff from making its case. The district court ignored decades of exclusive dealing law that squarely hold that the type of activity alleged by plaintiff in this case can constitute an illegal exclusionary practice, as mandated by this Court's decision in *PeaceHealth*, irrespective of its legality under price competition standards.

III. APPLICATION OF WELL-ESTABLISHED EXCLUSIVE DEALING PRINCIPLES IN THIS CASE WOULD BE CONSISTENT WITH BOTH *PEACEHEALTH* AND THE REPORT OF THE ANTITRUST MODERNIZATION COMMISSION

In *PeaceHealth*, the Ninth Circuit established the discount attribution test—a variant of the Supreme Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)—to determine when a bundled discount represented impermissible predatory pricing. *PeaceHealth*, 502 F.3d at

920. The focus of the discount attribution test is the whether the bundle allows below-cost pricing on the competitive products because "such a discount can exclude a rival [] who is equally efficient at producing the competitive product simply because the rival does not sell as many products as the bundled discounter." *Id.* Thus, when the plaintiff alleges that the price of the bundle has excluded it from competing with the defendant's bundle, the discount attribution test is the appropriate test to employ.

However, allegations that a bundled discount violates the discount attribution test do not preclude a plaintiff from also alleging that the same bundled discounts resulted in an exclusive dealing or tying arrangement, and it is entirely consistent with *PeaceHealth* for such a claim to proceed. This Court explicitly left open the possibility that bundled discounts could constitute other forms of exclusionary conduct. In *PeaceHealth*, this Court analyzed the bundled discounts at issue *both* under the attribution test *and* under the tying law of Section 1 of the Sherman Act. This Court reversed summary judgment against the tying claim because even though the defendant PeaceHealth argued that it "did not force those who wanted tertiary services [the tying product] to purchase primary and secondary services [the tied products] from PeaceHealth also," the "substantial market power PeaceHealth create[d] a possibility that PeaceHealth was able to force unwanted purchases of primary and secondary services." *Id.* at 928. Thus, this Court's decision in *PeaceHealth* holds that a bundled discount can not only constitute unlawful price competition under the discount attribution test, but can also constitute other forms of exclusionary conduct such as tying. Exclusive dealing, under *PeaceHealth*, therefore, should be subject to the same analysis. *See* III Areeda & Hovenkamp ¶ 749a, at 315 (2006 Supp.) (*Brooke Group* "does not require a cost-based test for every exclusionary practice in which pricing or discounting is an element.").

It is of no moment that this Court considered whether the bundled discount in *PeaceHealth* constituted, in effect, a tying arrangement (the bundle was not a literal tie since PeaceHealth purportedly offered the services independently, *see PeaceHealth*, 502 F.3d at 928), as opposed to considering whether the bundled discount constituted, in effect, an exclusive dealing arrangement. The significant point is that the Court did not adopt a rule that requires all bundled discounts to be analyzed under the discount attribution standard, which tests for unlawful price competition. Once it is admitted that a bundled discount can also be analyzed under Section 1 of the Sherman Act as a *de facto* tying arrangement, there is no principled distinction that would preclude consideration of the bundled discount as a *de facto* exclusive dealing arrangement.

The Congressionally-appointed Antitrust Modernization Commission, which this Court relied upon in *PeaceHealth*, clearly equated tying and exclusive dealing claims and chose not to limit those claims to situations involving price predation. *Id.* at 929, n. 30 ("The recommended three-part test is proposed here for challenges to bundled pricing practices, and its purpose, as the text explains, is to avoid deterring procompetitive price reductions. *The Commission is not recommending application of this test outside the bundled pricing context, for example in tying or exclusive dealing cases*.") (emphasis added) (quoting ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 114, n. 157 (Apr. 2, 2007), *available at* www.amc.gov).

The district court's failure to recognize that exclusive dealing can violate the Sherman Act regardless of its legality under predatory pricing standards runs afoul of this Court's decision in *PeaceHealth*, and the principles articulated by the Antitrust Modernization Commission that were central to this Court's decision in that case.

CONCLUSION

For the reasons stated, the decision of the district court regarding bundled discounts under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act should be REVERSED.

Respectfully submitted,

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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.

Dated: December 27, 2007

Respectfully submitted,

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