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Tenth Circuit Affirms Dismissal of Antitrust Tying and Bundling Claims

The Court of Appeals for the Tenth Circuit recently affirmed the dismissal of claims by a medical products distributor that two of its competitors violated the antitrust laws by using tying and bundling contracts. *Suture Express, Inc.* v. *Owens & Minor Distribution, Inc.*, No. 16-3065 (10th Cir. Mar. 14, 2017). The Court of Appeals upheld the district court's grant of summary judgment for defendants, and in doing so rejected the opinions of plaintiff's expert, Professor Einer Elhauge, that defendants' contracts harmed competition. The court's opinion underscores that proof of harm to a single competitor is not sufficient to establish a claim under the antitrust laws, and that bundled discounts can have procompetitive, as well as anticompetitive, effects depending on how and in what context they are used.[1]

The Parties

Medical-surgical ("med-surg") products are single-use, disposable products used by hospitals and other healthcare providers. Plaintiff, Suture Express, Inc. ("Suture Express") is a distributor of two categories of med-surg products: sutures and endomechanical ("endo") products. Suture Express competes with defendants, Owens & Minor Distribution, Inc. ("O&M") and Cardinal Health 200, LLC ("Cardinal"), each of which distributes a full line of med-surg products, including suture and endo products, as well as other med-surg products in about 30 categories. Another full line distributor of med-surg products is Medline Industries, Inc. ("Medline"), which was not a party in this case but held a significant share of the market for med-surg products.

Suture Express's Allegations

Suture Express sued O&M and Cardinal in December of 2012, alleging that they had caused Suture Express to lose significant business by entering into allegedly anticompetitive contracts with customers. Under these 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 on a standalone basis than Cardinal or O&M charged. Cardinal and O&M described these contracts as offering bundled "discounts"; Suture Express and its expert labeled them "penalties." Suture Express claimed it had lost customers as a result of such "penalty" contracts. It also claimed that the

[1] Paul, Weiss previously issued a Client Memorandum discussing the district court's decision, on April 12, 2016. https://www.paulweiss.com/media/3487799/12apr16antitrust.pdf.

contracts harmed hospitals that lost access to Suture Express's distribution services and products, which Suture Express claimed were superior.

On a motion to dismiss, the district court rejected Suture Express's per se tying claim and monopolization claims, but left for summary judgment the question of whether Suture Express's tying claim could withstand the rule of reason. Under the rule of reason, the plaintiff must show that the defendant "unreasonably restrained competition." *Id.*, slip op. at 13 (quoting *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2 (1984), abrogated on other grounds by *Ill. Tool Works Inc.* v. *Indep. Ink, Inc.*, 547 U.S. 28, 31 (2006)).

The Relevant Market

Although the district court defined the relevant market as the national distribution of med-surg products to acute care providers, both the district court and the Court of Appeals took notice of the parties' shares of sutures and endo ("suture-endo") sales, which comprise about 10% of the overall med-surg market. During the time period of 2007-2012, Suture Express captured between 8% and 10% of suture-endo sales. During the same time period, O&M's share of suture-endo sales increased from 40% to 42%, and Cardinal's share declined from 30% to 26%. The court also noted that, in the same time period, O&M's share of sales of other med-surg products increased from 33% to 38%, and Cardinal's share decreased from 31% to 27%. O&M's and Cardinal's profit margins have declined since 2008, as their average "markups," or fixed percentage distribution fees, have decreased.

Meanwhile, Medline doubled its revenue and other regional full line distributors managed to increase their market shares over the 2008-2012 period, though the court noted that the evidence was not clear as to the extent of the increase.

The District Court's Summary Judgment Opinion

The parties filed cross motions for summary judgment. In its motion, Suture Express relied heavily on the opinions of its expert, Professor Elhauge, who opined that, based on the results of empirical analyses, defendants had sufficient power in the "tying" product market (the market for other med-surg products) to restrain trade in the "tied" product market (the market for suture-endo products). The district court rejected Professor Elhauge's analysis and Suture Express's arguments, holding that the failure to prove that either defendant had sufficient market power in the tying market defeated Suture Express's tying claim. *Suture Express, Inc.* v. *Owens & Minor Distrib., Inc.*, No. 12-2760-DDC-KGS, 2016 WL 1377342 (D. Kan. Apr. 7, 2016). The district court additionally held that Suture Express could not establish antitrust injury—*i.e.*, injury to competition, rather than a single competitor—and that O&M and Cardinal had provided sufficient procompetitive justifications for their bundling contracts to overcome any anticompetitive effects. *Id.*

Appeal to the Tenth Circuit

On appeal, Suture Express argued that the district court had erred in its market power analysis, that reasonable jurors could find antitrust injury, and that the bundling contracts were not procompetitive. The Court of Appeals rejected these arguments, and affirmed the district court's decision.

Market Power

As to market power, the Court of Appeals acknowledged a circuit split on the question of whether a showing of market power in the tying market is required in a rule of reason tying case. Because all parties assumed, however, that a showing of market power was required and presented evidence on the issue, the court assumed, without deciding, that Suture Express was required to establish that defendants had market power in the tying market.

Suture Express's primary argument was that market power could be inferred from the effects of the defendants' bundling contracts in the market. The court observed that evidence of market effects in the tied market "can be appropriate evidence of tying market power in a rule of reason case," but cautioned that such evidence cannot be dispositive. *Suture Express*, No. 16-3065, slip op. at 19. Here, the evidence showed that "neither [of the defendants] could exclude competition in the tying market since there was evidence the opposite was occurring, with regional and national competitors growing and expanding." *Id.* at 22. The defendants were not excluding competition in the tied market either, where competitors such as Medline were succeeding with bundled discounts of their own. The court explained that competition was not excluded, "it simply took the form of bundle-to-bundle competition." *Id.* Further, Suture Express had not proven that defendants had the ability to control price, because the evidence showed that the defendants suffered from declining profit margins in the market for other med-surg products besides suture-endo products. The court concluded that these factors constituted "persuasive evidence of a lack of market power." *Id.* at 23.

Suture Express's expert, Professor Elhauge, offered various analyses to try to show anticompetitive market effects—all of which the court rejected. Professor Elhauge opined, for example, that defendants' bundles had a coercive effect, because 56-64% of the suture-endo market accepted the bundled packages from defendants and were thus unable to buy suture-endo products from Suture Express, even if Suture Express's prices were lower and service and products were superior. Quoting the Supreme Court case *Fortner Enters., Inc.* v. *U.S. Steel Corp.*, 394 U.S. 495, 618 n.10 (1969), the court pointed out the obvious: that there could be "'other explanations for the willingness of buyers to purchase the package.'" *Id.* at 25. Here, the court found, "other explanations abound—such as the fact that many of the acute care purchasers simply preferred consolidating their purchases and having fewer distributors to deal with." *Id.* Professor Elhauge failed to account for these explanations.

Professor Elhauge also performed a "discount attribution test." Under this test, "the full amount of the discounts given by the defendant on the bundle [is] allocated to the competitive product." *Cascade Health Solutions* v. *PeaceHealth*, 515 F.3d 883, 906 (9th Cir. 2007).[2] The court then determines whether the "resulting price of the competitive product or products is below the defendant's incremental costs to produce them." *Id.* Professor Elhauge concluded that 77% of Cardinal and O&M customers with bundled contracts had incremental prices on suture and endo products that were below cost. *Suture Express*, No. 16-3065, slip op. at 25. The Court of Appeals, however, rejected the use of the discount attribution test to demonstrate market power. Rather, the court noted that the test applies to the element of conditioning—*i.e.*, whether defendant conditioned the sale of one product on the purchase of another. And even then, the discount attribution test typically only comes into play where there is proof that the defendant is a monopolist. The court noted that it could "find no support in the caselaw" for the proposition that "the test can properly be used to show coercion by a non-monopolist." *Id.* at 26–27.

Finally, the court addressed Suture Express's argument that it should have survived summary judgment based on defendants' market shares (38% and 31% for O&M and Cardinal, respectively, at their peak), which, Suture Express contended, were high enough to make a claim under the rule of reason. The Court of Appeals disagreed, holding that not only is "market share alone . . . insufficient to establish market power," but also, "it is . . . insufficient to counteract the other market realities present here that point to increased competition and lower prices." *Id.* at 24. In sum, none of Suture Express's arguments or any of its expert's opinions convinced the court that a reasonable jury could conclude that either defendant possessed sufficient market power to coerce customers. *Id.* at 27.

Antitrust Injury

The Court of Appeals also affirmed on the ground that Suture Express had not established antitrust injury—*i.e.*, injury to competition as a whole, as opposed to a single competitor. Again, the court rejected the opinions of Professor Elhauge, who had calculated market foreclosure rates of 38-42% for O&M and 18-22% for Cardinal. *Id.* at 28. Together, he concluded, defendants had restrained 56-64% of the suture-endo market from purchasing suture-endo products from Suture Express, even though Suture Express's prices were lower. Suture Express had relied on this analysis to argue that, in the absence of defendants' bundling, hospitals would have purchased suture-endo products from Suture Express. The court pointed out, however, that less than half of the "unrestrained" customers, which together made up almost half of the market, purchased suture-endo products from Suture Express at its lower price. Therefore, the court

[2] Paul, Weiss Counsel Daniel A. Crane, also the Frederick Paul Furth Sr. Professor of Law at the University of Michigan Law School, has published extensively on the treatment of bundled discounts and other forms of discounting under the antitrust laws. Crane's academic work and amicus curiae brief played a prominent role in *Cascade Health Solutions*, the landmark decision on bundled discounting by the United States Court of Appeals for the Ninth Circuit.

concluded, Professor Elhauge's calculation of foreclosure could not alone conclusively show injury to competition instead of to one competitor. *Id.* at 29.

In reaching this conclusion, the court emphasized that the "evidence in this case—the decrease in markups charged, the consolidation of buyer power, the growth of regional competitors, the success of Medline—reveals a med-surg market that is becoming more, not less, competitive." *Id.* at 30. Therefore, the court held, it could not make a finding of injury to competition.

Procompetitive Justifications

Because the Court of Appeals affirmed on two grounds—that Suture Express had failed to show market power sufficient to coerce customers and that competition as a whole had been harmed—the court declined to determine whether the procompetitive justifications for defendants' bundling practices outweighed any anticompetitive effects.

Conclusion

In this opinion, the Court of Appeals for the Tenth Circuit emphasized that bundling and tying claims cannot be proven without a showing of actual harm to competition, and not just competitors. Here, plaintiff, Suture Express, attempted to show antitrust injury by pointing to market shares and market foreclosure. Suture Express also argued that the court should infer market power from the fact that customers overwhelmingly chose to buy a bundled package from either of the defendants instead of buying Suture Express's less expensive suture and endo products. Plaintiff also complained that, when applying the discount attribution test, some of the bundled packages were sold below cost.

None of plaintiff's arguments could overcome the evidence of actual market conditions, however. In concluding that the bundled discounts at issue did not exclude competition, the court gave significant weight to evidence showing that even if the plaintiff had lost sales, marketwide competition remained robust. As the court summarized: "A market in which competitors are growing and margins are shrinking is inconsistent with the claim that Cardinal and O&M can exclude competition and control prices." *Id.* at 26.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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