The “Aggregation Theory”:
A Recent Series of Decisions in Bundled Discounting Cases Threatens to Expand Section One into Uncharted Territory

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Since the Third Circuit’s en banc decision in LePage’s v. 3M, exclusive dealing cases have been back in vogue. While LePage’s blessed a theory of Section 2 liability based on exclusionary pricing behavior, it provided little analysis or guidance for future cases. As a result, the likely competitive effects of “bundled discounts” or related practices, and even the proper antitrust analysis to evaluate them, remain hotly contested.

A recent series of “de facto” exclusive dealing cases in the medical device industry has focused on a variety of alleged exclusionary pricing practices under Sections 1 and 2, and sometimes Section 3, of the Clayton Act. Plaintiffs, usually smaller medical device suppliers, have challenged the relationships between large suppliers and group purchasing organizations (GPOs), firms that negotiate supply contracts on behalf of their member hospitals or other health care providers. These plaintiffs generally argue that certain manufacturer-GPO contract terms—such as bundled rebates and market share discounts—unreasonably exclude them and, in some cases, allow large suppliers to monopolize the markets for the products at issue. Several of these cases have resulted in large verdicts or settlements.

However, one recent development in the medical supply cases has gone relatively unnoticed despite its potential far-reaching implications for antitrust practitioners and their clients. Two decisions from the Eastern District of Texas, and one from the Central District of California, have held that a competitor with an indisputably small market share (and no alleged market power) can nevertheless be held liable under Section 1 of the Sherman Act for an allegedly exclusive contract, based on “aggregating” its small market share (and thus potential market foreclosure) with that of its competitors who may have entered similar contracts, even with no allegation of any agreement—express, tacit, or otherwise—between (or among) them.

The evolution of this “aggregation theory,” which is ungrounded in Section 1 precedent and sets unsound antitrust policy, is explored below, and some suggestions are offered on how firms can try to stay out of the aggregation theory trap.

1 324 F.3d 141 (3d Cir. 2003).
2 Masimo Corp. v. Tyco Health Care Group, L.P., No. 02-4770 (C.D. Cal. filed May 22, 2002) (a $140 million pre-trebling jury verdict against Tyco Healthcare). The verdict was partially vacated on post-trial motions and the damages case was recently re-tried. See Masimo, 2006 WL 1236666 (C.D. Cal. Mar. 22, 2006). Other cases have also ended with nine-figure verdicts or settlements. See, e.g., Retractable Techs., Inc v. Becton Dickinson., No. 5:01-cv-00036-DF (E.D. Tex. filed Jan. 29, 2001) ($100 million settlement); Spartanburg Reg. Health Servs. v. Hillenbrand Indus., No. 7:03-cv-02141-HFF (D.S.C. filed June 30, 2003) ($337.5 million settlement).
3 See Genico, Inc. v. Ethicon, No. 5:04-CV-229-DJF (E.D. Tex. filed Oct. 15, 2004), discussed in this article.
Professor Elhauge’s Statement Before the DOJ-FTC Hearings on GPOs

This new twist on Section 1 liability appears to have its origins in a paper presented to the Department of Justice (DOJ) and Federal Trade Commission (FTC) on behalf of medical device manufacturers by Professor Einer Elhauge, who has also represented some manufacturer-plaintiffs in courts and in Congress. Professor Elhauge argued that the competitive effects of GPO agreements “do not depend on all the foreclosure being accomplished by one agreement, one type of agreement, or even by agreements with one dominant firm.” Rather, he contended, anti-competitive effects arise when a number of exclusionary agreements “cumulatively” cause sufficient marketwide foreclosure.

Professor Elhauge offered an example of two manufacturers with multiple exclusive agreements with buyers that “in aggregate” foreclose enough of the market to preclude rivals from achieving minimum efficient scale. In such circumstances, he suggested that the aggregate effect of all of the independent contracts should give rise to Section 1 liability against both manufacturers, regardless of the foreclosure achieved by either, and even in the absence of any horizontal conspiracy between them, or their respective contracting partners, or anyone. Professor Elhauge cited “many” Supreme Court decisions that hold “the foreclosure produced by exclusionary agreements must be aggregated among even more than two manufacturers.”

Notably, Professor Elhauge did not address whether this aggregation theory, or the Supreme Court cases that he claimed support it, should be extended to create Section 1 liability for small, independent buyers that merely happened to contract with one or both manufacturers. However, three recent district court decisions, relying on the same purported authority, have extended Professor Elhauge’s aggregation theory to reach this result.

Applied Medical, Genicon, and Daniels

The first court to adopt this novel Section 1 aggregation theory was the Central District of California, in Applied Medical. The Genicon and Daniels decisions, which followed similar reasoning, were both issued from the same judge in the Eastern District of Texas. All three cases involve many of the same parties, experts, and lawyers. In each, a small manufacturer of medical devices brought an antitrust action against one or more competing manufacturers (only one of which an alleged monopolist) and several GPOs (with varying alleged market shares). The only alleged Section 1 conspiracies were the various independent vertical supply agreements, each between one manufacturer and one GPO.

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6 Id. at 13.
7 Id.
8 Id.
9 Id. at 15.
10 The plaintiff in Applied Medical, a manufacturer of endo-mechanical surgery devices, sued competitor Johnson & Johnson (J&J) and GPO Novation. The plaintiff in Genicon, another endo-mechanical device manufacturer, sued competitors J&J and Tyco, and GPOs Novation, Premier, Broadlane, and Healthtrust Purchasing Group. The plaintiff in Daniels, a manufacturer of reusable containers for bio-hazardous medical materials, sued competitors Tyco and Becton Dickinson, and GPOs Novation, Premier and Consorta.
11 Specifically, the Genicon and Daniels plaintiffs brought Sherman Act § 2 and Clayton Act § 3 claims against the alleged monopolist-manufacturers, and Sherman Act § 1 claims against all the defendants. The Clayton Act claims against at least some of the GPOs were dismissed or abandoned. In Applied Medical, the plaintiff asserted § 2 claims against J&J and a § 1 claim against J&J and Novation.
The plaintiffs in all of these cases thus alleged a “rimless wheel” Section 1 conspiracy. Widely recognized in criminal cases, a “rimless wheel” involves a “hub” (in these cases, large medical suppliers) entering into a series of agreements with unrelated “spokes” (in these cases, GPOs purchasing on behalf of their member hospitals). Where the hub has facilitated a horizontal agreement (or “rim”) among the spokes, the hub and all of the spokes may be jointly liable for the overarching “hub-and-spoke” conspiracy. In contrast, as the Fourth Circuit has observed, “[a] rimless wheel conspiracy is one in which various defendants enter into separate agreements with a common defendant, but where the defendants have no connection with one another, other than the common defendant’s involvement in each transaction.”

In *Genicon*, the smaller manufacturer-defendant and the two small GPO-defendants moved to dismiss. They argued that the plaintiff failed to state cognizable Section 1 claims against them, in light of the plaintiff’s allegations that their individual contracts did not foreclose a legally significant share of the relevant market. Similarly, in *Daniels*, the smaller manufacturer-defendant moved to dismiss the Section 1 claim against it, on the grounds that its alleged market share was legally insufficient to state a claim.

Judge Folsom of the Eastern District of Texas denied all of the motions to dismiss. The Court accepted the respective plaintiffs’ aggregation theories that, despite the absence of any horizontal agreement, they could nonetheless prove that all of the defendants’ agreements collectively foreclosed the relevant markets, thus subjecting each defendant to joint and several liability based on every other defendant’s independent contracts.

In *Applied Medical*, decided before *Genicon* and *Daniels*, GPO Novation moved to dismiss the Section 1 claim because the plaintiff failed to plead sufficient market foreclosure resulting from its individual contract with Johnson & Johnson (J&J). As in *Genicon* and *Daniels*, the court denied the motion to dismiss:

[J&J’s] contracts with the two largest GPOs, Novation and Premier, foreclose 65% of the relevant markets for trocars and clip appliers. The court finds that aggregating the foreclosure produced by these agreements between [J&J] and multiple buyers is appropriate, in spite of Novation’s assertions to the contrary.

Thus, as with *Genicon*, the *Applied Medical* court concluded that an individual spoke-defendant in a rimless wheel could be liable for the separate agreements of other spokes.

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12 See, e.g., United States v. Chandler, 388 F.3d 796, 807 (11th Cir. 2004); United States v. Levine, 546 F.2d 658, 663 (5th Cir. 1977), overruled on other grounds by United States v. Lane, 474 U.S. 438 (1986).

13 See, e.g., Toys ‘R’ Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000); *In re Microsoft Corp. Antitrust Litig.*, 127 F. Supp. 2d 728, 733 (D. Md. 2001).

14 Dickson v. Microsoft Corp., 309 F.3d 193, 203 (4th Cir. 2002).


16 The *Applied Medical* complaint alleged that Novation controlled 35% of the hospitals in the relevant market. Arguably, the court could have found that foreclosure sufficient to defeat a motion to dismiss, because most courts acknowledge a minimum market foreclosure threshold of 30–40%. See infra note 35.


18 The *Applied Medical* plaintiff dismissed its claims against Novation on October 6, 2004, pursuant to a settlement. The claims against J&J went to trial in July and August 2006. The jury returned a verdict in favor of J&J, and judgment was entered in J&J’s favor on September 26, 2006. See *Applied Medical*, No. 8:03-cv-1329-JVS (C.D. Cal.) (judgment dated Sept. 26, 2006).
The Upshot: Unsound Policy and Precedent

These decisions set unsound, indeed anticompetitive, precedent. The aggregation theory is a hub-and-spoke conspiracy without the rim, and thus erases the fundamental “contract, combination, and conspiracy” requirement from Section 1. It is also unprincipled and limitless, because aggregating shares always has the potential to reach 100 percent.19

The decisions also impose significant transaction costs on firms and subject them to potential liability (or at least very expensive litigation) with little ability to be counseled or protect themselves ex ante. Because a firm could be held liable for the agreements entered into by its competitors, it must attempt to monitor the activities of others in the marketplace and adjust its own competitive activities in light of them. That obligation is (a) impractical at best; (b) impossible in many instances, for example where other contracts are entered later; (c) chilling of legitimate competitive conduct, including exclusive (or quasi-exclusive) contracting; and (d) itself potentially a facilitating practice under Section 1.

But for defendants sued under the “aggregation theory,” the recent developments are even more troubling. As articulated by plaintiffs and adopted by these courts, one need only allege the theory to survive a challenge based upon insufficient market share or market foreclosure. As the Genicon court stated: “Because Plaintiff employs an aggregation theory, however, Defendants’ challenge fails.”20 Although articulated in the context of Rule 12, the court’s reasoning does not appear to stop there, and begs a number of important questions as to the further development of such a “bundled discounting” case. So long as several similar, albeit unrelated, vertical contracts exist, how would a small party to one of them defeat an aggregation theory at trial, much less on summary judgment? On the other hand, how can a theory raise “material issues of fact” for trial when it does not appear to depend on any facts, beyond the bare existence of similar contracts?

Is the aggregation theory a newly discovered route to per se Section 1 liability?

Although that seems unlikely to be the effect, or even the intent, of these opinions, their reasoning imposes a heavy, if not impossible, burden on small Section 1 defendants confronted with the aggregation theory. The error appears to stem from a misreading of early Supreme Court authority.

The Supreme Court Cases that Purportedly Support the Theory

The Genicon, Daniels, and Applied Medical orders, and Professor Elhauge’s statement to the DOJ/FTC, rely principally on three old Supreme Court cases: Standard Fashion Co. v. Magrane-Houston Co.,21 Standard Oil Co. v. United States,22 and FTC v. Motion Picture Advertising Service Co.23 As a starting point, these cases were not decided under the Sherman Act, but rather under broader “incipiency” statutes, the Clayton and FTC Acts.24

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19 The question of whether a defendant can be held liable under §§ 1 or 2, or both, for the cumulative effect of its own similar agreements is beyond the scope of this article. Suffice it to say that combining the foreclosure resulting from a single party’s agreements to evaluate that party’s potential liability is quite different from exposing an indisputably small competitor with no market power to liability based on the alleged cumulative effect of contracts it did not enter and had nothing to do with.


21 258 U.S. 346 (1922).

22 337 U.S. 293 (1949).


24 Standard Fashion, 258 U.S. at 357 (Clayton Act); Standard Oil, 337 U.S. at 297, 314 (Clayton Act); Motion Picture, 344 U.S. at 394 (FTC Act).
In any event, those cases did not hold or suggest that an individual spoke in an alleged rimless wheel could be liable for the aggregate effect of the hub’s agreements with other, unrelated spokes. At most, they suggest that a single hub-defendant may be liable based on the combined foreclosure of its own contracts. Thus, Genicon, Daniels, and Applied Medical ignore critical distinctions in market position. Under the aggregation theory endorsed by those decisions, each of the 20,000 retail stores in Standard Fashion would have been jointly liable for the manufacturer’s 19,999 other contracts. No case, including this Supreme Court trilogy, has ever made such a holding. Indeed, Justice Frankfurter, the author of Standard Oil, made clear in his dissent in Motion Picture that “this Court has never decided that [exclusive contracts] may, in the absence of conspiracy, be aggregated to support a charge of Sherman Act violation.”

Even putting this debate aside, the wisdom of drawing a new antitrust liability theory from these cases is dubious given that they emerged from the early years of antitrust, which also produced such since-discredited opinions as International Salt, Schwinn, and Albrecht (and perhaps soon, Dr. Miles). That is not to say the authors of these opinions were not capable, even brilliant, jurists—they were—but a person with perfect vision would stumble in an unfamiliar, dark room. The Court’s attempt to come to grips with the legal and economic underpinnings of the Clayton Act in Standard Fashion, for example, is almost painful to read. The plaintiff, a Boston retail store, entered an exclusive contract to sell the defendants’ patterns. The defendant had similar contracts with some 20,000 stores around the nation. The Court reached its holding that the defendant had threatened competition in Boston by considering the exclusive contracts with other stores in other parts of the country and concluding that it must have a monopoly “in hundreds, perhaps in thousands, of small communities,” but not necessarily Boston. These cases should be allowed to continue gathering dust, not revived and extended to areas they never addressed in the first place.

Apart from resting on questionable interpretation of questionable precedent, Genicon, Daniels, and Applied Medical undermine the very foundation of Section 1 liability. It is, and always has been, fundamental antitrust law that a Section 1 defendant may be liable only for an agreement it enters, and cannot be liable for an agreement it does not. Before these decisions, as the Seventh Circuit noted in Paddock Publications, Inc. v. Chicago Tribune Co., no case had ever held otherwise. Nonetheless, under the aggregation theory espoused in these new decisions, every defendant, regardless of its minimal market share or lack of market power, may be held accountable under Section 1 based on the share or market power of another, unrelated defendant, or perhaps several of them put together. That cannot and should not be the law and, actually, it is not.

Modern Authority’s Rejection of the Aggregation Theory

In Paddock, the Seventh Circuit refused to aggregate the foreclosure of exclusive agreements held by the two largest newspapers in Chicago. The court considered the same Supreme Court authority that the plaintiffs (and courts) relied on Genicon, Daniels, and Applied Medical, but concluded

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25 See Standard Oil, 337 U.S. at 295, 297, 314–15 (finding against single oil company, not individual gas stations); Motion Picture, 344 U.S. at 393–96 (finding against single advertising distributor, not individual theaters).

26 Motion Picture, 344 U.S. at 400 (Frankfurter, J., dissenting) (emphasis added).


28 Standard Fashion, 258 U.S. at 357.

29 103 F.3d 42 (7th Cir. 1996).
the cases do not establish that exclusive contracts independently entered by two competitors can be aggregated to hold either liable for the other’s agreement: “[N]o subsequent case has read Motion Picture Advertising Service to abolish the requirement of concerted action under § 1 of the Sherman Act.”

The Fourth Circuit reached the same conclusion in *Dickson v. Microsoft Corporation*. In *Dickson*, a class of plaintiff-consumers alleged a rimless wheel scenario between Microsoft and two computer manufacturers (OEMs), Compaq and Dell. The complaint alleged that Microsoft and the OEMs violated Sherman Act Sections 1 and 2 by entering into separate licensing agreements that ensured Microsoft’s applications would be installed on new computers. The OEMs moved to dismiss the Section 1 claim on the grounds that their individual agreements with Microsoft could not, as a matter of law, foreclose a sufficient share of the relevant market. The district court granted the OEMs’ motions, and the Fourth Circuit affirmed. According to the Fourth Circuit, “a wheel without a rim is not a single conspiracy,” and thus the agreements must be evaluated individually.

The *Dickson* plaintiffs argued that Microsoft, as the dominant hub, had sufficient market power to state a claim arising from each spoke agreement. However, the Fourth Circuit held that was not enough. “[A]bsent an allegation regarding Compaq’s or Dell’s power or share in the PC market, there is no basis in [plaintiffs’] complaint for concluding that either of the two licensing agreements at issue, when considered individually, are likely to foreclose a significant share of the relevant software markets.” The court reasoned as follows: “The relevant focus of the § 1 inquiry, however, is the anticompetitive effects of the conspiracy qua conspiracy; therefore the plaintiff must demonstrate that the conspiratorial agreement itself affected competition in ways that would not have obtained absent the agreement.”

Thus, *Paddock* and *Dickson* confirm the principle that the *Genicon*, Daniels and *Applied Medical* courts ignored (or misunderstood)—Section 1 reaches only as far as the agreement actually entered.

**A Potential Dilemma for Antitrust Practitioners and Their Clients**

Still, *Genicon*, Daniels, and *Applied Medical* remain on the books, and the aggregation theory they approve is poised to wrongly entangle small defendants in large antitrust cases, especially if they find themselves in the wrong court. Before their appearance, practitioners could safely advise their clients that rule of reason cases generally require a 30–40 percent market share (or foreclosure) for a Section 1 violation as a matter of law. Thus, companies that enter agreements with large—

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30 *Paddock*, 103 F.3d at 46.
31 309 F.3d 193, 200 (4th Cir. 2002).
32 *Dickson*, 309 F.3d at 203–04.
33 Id. at 209 (citing *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 327 (1961)).
34 Id. at 210 (emphasis added) (citation omitted); accord *Spectators’ Comm’n Network Inc. v. Colonial Country Club*, 253 F.3d 1433, 1436–37 (5th Cir. 1984) (contracts entered separately between powerful buyer and competing sellers not horizontal combination without evidence of agreement among sellers).
35 See, e.g., *Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I.*, 373 F.3d 57, 68 (1st Cir. 2004) (30–40% minimum foreclosure rate required for violation; “low numbers make dismissal easy”); *United States v. Microsoft Corp.*, 253 F.3d 34, 70 (D.C. Cir. 2001) (40–50% required); *Minnesota Mining & Mfg. Co. v. Appleton Papers, Inc.*, 35 F. Supp. 2d 1138, 1143 (D. Minn. 1999) (“at least 30 percent to 40 percent” required). Of course, these thresholds are not bright lines, and they vary somewhat case to case based on other factual or economic circumstances. However, any comfort they provide, particularly for companies well below them, is eliminated by the aggregation theory.
even monopolistic—suppliers could, for the most part, avoid the reach of Section 1 so long as the agreement does not constitute a per se violation, or create actual harm to competition.

The aggregation theory endorsed (actually, created) by the Applied Medical, Genicon, and Daniels orders dramatically increases uncertainty in the law of Section 1. Taken literally, it could expose to antitrust liability every company that operates in vertical relationships with one (or more) suppliers that could be said to have some foreclosure effect, where other such contracts may also exist.

So how can practitioners and their clients protect themselves? With difficulty, though a few options may be available. First, companies should carefully evaluate their current and prospective vertical supply agreements to (1) identify potential issues, such as bundled, market share, or loyalty discounts; (2) determine their likely exclusionary effect, if any; and (3) weigh any exclusionary effect against likely procompetitive effects. This process is especially important (although evidently not essential under the theory) if the supplier has a significant market share and thus is likely to present a bigger litigation target. If the risk of such contract terms appears to outweigh the contract’s business advantages, several devices may help soften any “foreclosure” effect, including the use of termination clauses, shorter term contracts, and “carve out” provisions to allow the buyer to deal with smaller market participants without forgoing contract incentives. Second, if a company is aware of an industry-wide contracting practice—particularly in a concentrated market, as many medical device markets are claimed to be—it should exercise caution before “falling in line” with that practice.36 Finally, companies can vigorously defend themselves if attacked under the aggregation theory, and attempt to create better precedent by taking any adverse decision up for appeal.

36 Companies that are told by a supplier in negotiations that others have entered similar contracts so they should “fall in line” should spill their proverbial drink and leave the room, because this could lead to the inference of a “rim” that makes the aggregation theory unnecessary. See supra note 13. See, e.g., Interstate Circuit v. United States, 306 U.S. 208, 222 (1939) (inferring horizontal conspiracy from the nature of the proposals made to the defendants, the manner in which they were made, and the unanimity of action taken); Toys R Us, 221 F.3d at 935 (inferring horizontal conspiracy where toy companies agreed to distributor’s demand on the condition that its competitors “were doing the same thing”).