SHOULD THE EXEMPTION FROM THE ROBINSON-PATMAN ACT APPLY TO PHARMACEUTICAL PURCHASES BY NONPROFIT HMOS?

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INTRODUCTION

In 1994, a group of retail druggists filed a number of coordinated lawsuits against 25 major pharmaceutical manufacturers.[1] The druggists alleged that the manufacturers violated antitrust laws by selling prescription brand name drugs to the retailers at significantly higher prices than those charged to favored purchasers, such as nonprofit Health Maintenance Organizations (HMOs) and mail-order pharmacies, through the use of a "'charge-back' or rebate system."[2] The

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[1] See In re Brand Name Prescription Drugs Antitrust Litig., No. 94-C897, 1994 WL 240537, at *1 (N.D. Ill. May 27, 1994) (giving background on consolidated actions) [hereinafter *Prescription Drugs I*]. The litigation is actually an amalgamation of a number of separate lawsuits consolidated by the Judicial Panel on Multidistrict Litigation in the Northern District of Illinois for pretrial proceedings. When originally consolidated, the litigation consisted of 11 separate actions by approximately 400 retail pharmacies against 25 pharmaceutical manufactures and 8 wholesalers. At that time, the actions were divided into two groups: the "Consolidated Action"—a class action alleging only Section 1 Sherman Act violations—and "Coordinated, Individual Actions"—which alleged Sherman Act and Robinson-Patman Act violations. See id. The Coordinated, Individual Actions include the pharmacies that opted out of the class action, actions by the chain drug stores Revco and Rite Aid, and actions by chain grocery stores Safeway, Kroger, Albertson's, and Von's. See Edwin McDowell, Judge Agrees to Settlement in Drug Case, N.Y. Times, June 22, 1996, at A31 (describing parties in this litigation).

Though some of the defendants settled in June 1996, the litigation continues. See id. (describing details of settlement). In the meantime, the consolidated litigation has expanded to include a few hundred separate actions, a number of which are class actions, see In re Brand Name Prescription Drugs Antitrust Litig., 123 F.3d 599, 602 (7th Cir. 1997) [hereinafter *Prescription Drugs II*], and has resulted in 57 orders and opinions from Judge Kocoras as of the time of this writing. Search of Westlaw, FED7-ALL Database (Feb. 7, 1998).

[2] *Prescription Drugs I*, 1994 WL 240537, at *3. According to the druggists, the charge-back system allowed the manufacturers to conceal the differential between the prices charged to the druggists and those charged to the HMOs. The pharmaceutical manufactur-

druggists claimed that through this rebate system, and other alleged violations, the manufacturers competitively injured the class, causing many retailers to fail because they could not compete against the recipients of the unfair discounts.[3]

As one of their affirmative defenses, some of the pharmaceutical companies claimed that discount drugs sales to one class of favored purchasers, nonprofit HMOs, were protected by a little known statute, 15 U.S.C. § 13c, which permits price discrimination for "purchases of their supplies for their own use by . . . charitable institutions not operated for profit."[4] The district court, agreeing with the defense interpretation of the statute, read section 13c to cover the pharmaceutical purchases of nonprofit HMOs, thereby protecting discounts that allegedly were large enough to allow the HMOs to resell the drugs to patient members at prices below the retail pharmacies' wholesale prices.[5] Since this reading of section 13c permitted the rebate system, the court dismissed the retailers' claims of price discrimination against these manufacturers.[6]

Section 13c, the only statutory exemption from the Robinson-Patman Antidiscrimination Act (Robinson-Patman Act or Act),[7] permits suppliers to charge different prices to certain organizations when the supplies are purchased by those organizations for their own use.[8] The list of organizations includes many traditional charities: schools, colleges, universities, public libraries, churches, and hospitals, as well as a catch-all category, "charitable institutions not operated for profit."[9] In *In re Brand Name Prescription Drugs Antitrust Litigation (Prescription Drugs)*, the court continued a tradition of reading section 13c in very broad terms;[10] the court defined "charitable institu-

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ers published price lists and sold their products through wholesalers to all accounts at the published prices. However, the druggists allege that the pharmaceutical manufacturers then secretly rebated a substantial percentage of the list price to the wholesalers when they sold the drugs to certain favored purchasers. The wholesalers then passed the rebate along to these favored customers. The alleged system's complexity is explained by the plaintiffs as an attempt to prevent arbitrage. Allegations of these practices recently survived summary judgment motions by defendants. See *Prescription Drugs II*, 123 F.3d at 615-16 (reversing grant of summary judgment to defendant DuPont Merck on theory that enough evidence exists to go to jury on allegation of conspiracy to deny discounts, a Sherman Act claim).

3 See *Prescription Drugs I*, 1994 WL 240537, at *1.

4 15 U.S.C. § 13c (1994).

5 See In re Brand Name Prescription Drugs Antitrust Litig., No. 94-C897, 1995 WL 715848, at *2-*3 (N.D. Ill. Dec. 4, 1996) [hereinafter *Prescription Drugs III*].

6 See id. at *1 (granting designated defendants' summary judgment motion).

7 15 U.S.C. §§ 13-13b, 21a (1994).

8 See 15 U.S.C. § 13c.

9 Id.

10 See infra Part II.B.

tions not operated for profit" to include the nonprofit HMOs and their mail-order pharmacies and defined "supplies for their own use" to include pharmaceuticals purchased by HMOs for resale to customers at a profit.[11]

This Note criticizes the conclusion reached in *Prescription Drugs* and argues that the interpretation of section 13c offered by the court misconstrued the statute, inappropriately expanding both the group of purchasers and the products to which the statute should apply. This Note also criticizes previous interpretations of the statute, arguing that courts subtly have changed and updated the statute with each successive reading. Finally, this Note argues that the misinterpretation of section 13c is simply one example of a broader problem—the lack of an interpretative theory to guide the reading of obsolete statutes.[12] In response, this Note proposes a novel theory of interpretation: the changed circumstances theory.

This Note begins with the background of section 13c, surveying the history of price discrimination legislation and the legislative history of the exemption. Part II.A. explores the nonprofit sector of the economy, the intended beneficiary of section 13c, surveying some significant changes that have created a disjunction between the exemption and its intended target. Part II.B. then reviews three judicial interpretations of section 13c, exploring how courts have updated the statute to adjust to the changed circumstances of the nonprofit sector. Part III argues that such updating is inappropriate and proposes the changed circumstances theory as an alternative mode of interpretation. Part III.C. applies this theory to generate an interpretation of section 13c that accommodates the changed circumstances and signals to the legislature that the statute no longer reflects majority preferences.

I
HISTORICAL BACKGROUND ON THE EXEMPTION FROM THE ROBINSON-PATMAN ACT

The historical events leading to the passage of section 13c, the exemption from the Robinson-Patman Act, are closely tied to the history of the Act itself. Therefore, to facilitate an evaluation of the exemption, Part I provides a general history of price discrimination and of the Act before turning to the exemption's purpose and operation.

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[11] See *Prescription Drugs III*, 1995 WL 715848, at *2-*3.

[12] Obsolete statutes are those enactments that do no reflect the views of a current majority on what preferences in treatment are warranted by present conditions. See Guido Calabresi, A Common Law for the Age of Statutes 1, 5-6 (1982).

A. *The History of the Robinson-Patman Act*

The elimination of price discrimination has long been a goal of the federal government.[13] The first federal law prohibiting price discrimination, the Interstate Commerce Commission Act,[14] was passed in 1887 and addressed price discrimination in interstate railroad shipping.[15] Since then, Congress has repeatedly legislated against price discrimination, most often as part of specific regulatory schemes.[16]

Congress also has attempted to prohibit price discrimination generally on two occasions. The first attempt came in 1914 in section 2 of the Clayton Act,[17] which proscribed direct or indirect "discrimination in price between different purchasers of commodities."[18] However, since the Act permitted "discrimination in price . . . on account of differences in the grade, quality, or quantity of the commodity sold,"[19] it was interpreted to allow quantity discounts "without regard to the amount of the seller's *actual* savings in cost attributable to quantity sales or quantity deliveries."[20] That is, sellers could charge different customers significantly different prices for the same product, as long

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[13] Price discrimination is the practice of charging similarly situated customers "different prices on different sales of the same product despite identical costs." Phillip Areeda & Donald F. Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697, 724 (1975).

[14] An Act to Regulate Commerce, ch. 104, § 2, 24 Stat. 379, 379 (1887) (repealed 1978).

[15] The Interstate Commerce Commission Act created the Interstate Commerce Commission and empowered it to set railroad rates to stop the railroads from charging large shippers per car prices significantly lower than those charged to small shippers. Congress believed that elimination of such shipping rate disparities would allow small, independent businesses to compete with larger merchants and prevent the development of monopolies. See 80 Cong. Rec. 8112 (1936) (describing, during debate of Robinson-Patman Act, motivation for Interstate Commerce Commission Act).

[16] See, e.g., Federal Power Act § 205, 16 U.S.C. § 824d(b) (1994):

> No public utility shall, with respect to [rates] (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service;

Communications Act of 1934 § 202, 47 U.S.C. § 202(a) (1994):

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, . . . for or in connection with like communication service, . . . or to make or give any undue or unreasonable preference or advantage to any particular person . . . or to subject any particular person . . . to any undue or unreasonable prejudice or disadvantage;

see also James C. Bonbright, Principles of Public Utility Rates 372-78 (1961) (describing "price discrimination" and discussing application to public utilities).

[17] Act of Oct. 15, 1914, ch. 323, § 2, 38 Stat. 730, 730 (codified as amended at 15 U.S.C. § 13 (1994)).

[18] 15 U.S.C. § 13 (1934) (amended 1936).

[19] Id.

[20] FTC v. Morton Salt Co., 334 U.S. 37, 43 (1948) (emphasis added).

as they *attributed* the price differential to quantity discounts. Therefore, in most cases the Clayton Act prohibitions could easily be avoided and price discrimination could continue unabated.

Though Congress cited disappointment with judicial interpretation of the Clayton Act as the inspiration for further legislative action against price discrimination,[21] commentators agree that strong antichain-store sentiment among small business owners formed the impetus for Congress's second attempt to prohibit price discrimination generally.[22] In the years following World War I the country witnessed tremendous growth of national resalers, and by the 1930s independent small merchants began to lobby against these stores at the national level. The small business lobby argued that the size of the chain-stores evidenced unfair competition that if unchecked would lead to industry concentration in retail sales and, eventually, monopolies.[23] Concern was so great that Congress ordered a Federal Trade Commission (FTC) investigation of "the chain-store method."[24]

The FTC studied chain-stores in two fields: groceries and drug products. The FTC found that chain-stores were successful because they were able to buy products at lower prices from their suppliers[25] and hence charge lower prices than independent merchants.[26] The FTC also concluded that the lower prices stemmed from a number of factors related to the chain-stores' size. One of the most important seemed to be purchasing volume, which allowed the chain-stores to negotiate pricing with many of their suppliers.[27] Their bargaining power was great enough that chains could often profitably sell items at

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21 See H.R. Rep. No. 74-2287, at 7 (1936) (calling price discrimination language of Clayton Act "inadequate, if not a nullity" during debate on need for Robinson-Patman Act).

22 See John Seneca McGee, The Robinson-Patman Act and Effective Competition 60-62 (Arno Press 1979) (1952) (describing hostility toward chain-stores in 1930s from independent business owners, their suppliers, and public generally); Richard A. Posner, The Robinson-Patman Act: Federal Regulation of Price Differences 26 (1976) (citing passage of Robinson-Patman Act as "high water-mark of the anti-chain-store movement"); Harry L. Shniderman & Bingham B. Leverich, Price Discrimination in Perspective 5 (2d ed. 1987) (noting that "political atmosphere . . . was highly charged" as result of fierce competition facing small businesses from newly successful chains, mail-order houses, and other mass merchandisers).

23 See U.S. Dep't of Justice, Report on the Robinson-Patman Act 102-05 (1977) (describing growth of chain-stores and fear of monopolization).

24 Wright Patman, The Robinson-Patman Act 238 (1938).

25 See McGee, supra note 22, at 26 (discussing FTC Report).

26 See Federal Trade Comm'n, Chain-stores: Final Report on the Chain-Store Investigation, S. Doc. No. 74-4, at 53 (1935) [hereinafter Final Report] (stating that "lower selling prices are a very substantial, if not the chief, factor in the growth of chain-store merchandising").

27 See id. at 24; see also McGee, supra note 22, at 26-29 (describing chain-store buying methods).

a price below an independent merchant's cost for the same product.[28] Based on the practices in these two fields, the FTC reported that "monopolistic tendencies and the unfair use of large-volume purchasing power"[29] were both present in the chain-store market. Based on this report and the pressure applied by a strong small business lobby, Congress enacted the Robinson-Patman Act.[30]

The Robinson-Patman Act was designed to prevent large retailers from receiving lower prices than independent merchants by correcting the judicial interpretation of section 2 of the Clayton Act.[31] While the Clayton Act had been read to allow price discrimination as long as the sellers attributed the difference to quantity discounts,[32] the Robinson-Patman Act limited "the use of quantity price differentials to the sphere of *actual* cost differences."[33] This new constraint was intended to limit the discounts given to chain-stores, and other large purchasers, to the exact amount that a seller actually saved due to the reduced transaction costs or increased efficiency of production incident to selling in bulk.[34]

To achieve this goal, the Robinson-Patman Act forbids suppliers from "discriminat[ing] in price between different purchasers of commodities of like grade and quality"[35] when the effect of such discrimination would be "substantially to lessen competition."[36] However, in the Robinson-Patman Act, unlike other antitrust statutes, behavior that lessens competition is defined as that which lessens the number of competitors.[37] And the drafters made no attempt to disguise this

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[28] See McGee, supra note 22, at 26 & n.24.

[29] Patman, supra note 24, at 238; see also H.R. Rep. No. 74-2287, at 8-17 (1936) (reporting on chain-store unfair trade practices); S. Conf. Rep. No. 74-267, at 2-3 (1936) (same); Final Report, supra note 26, at 23-28 (describing anticompetitive nature of chain-store purchasing practices).

[30] Pub. L. No. 692, 49 Stat. 1526 (1936) (codified as amended at 15 U.S.C. §§ 13-13b, 21a (1994)).

[31] See supra text accompanying note 21.

[32] See FTC v. Morton Salt Co., 334 U.S. 37, 43 (1948) (describing reasons for amendment of Clayton Act with Robinson-Patman Act).

[33] H.R. Rep. No. 74-2287, at 9 (1936) (emphasis added).

[34] See Thurlow M. Gordon, The Robinson-Patman Anti-Discrimination Act, in Business and the Robinson-Patman Law 39, 44-47 (Benjamin Werne ed., 1938) (discussing legal bases for discrimination and practical impossibility of measuring savings from reduced transaction costs or increased efficiencies).

[35] 15 U.S.C. § 13(a) (1994).

[36] Id.

[37] Judge Richard Posner has argued that the definition of price discrimination used in the Robinson-Patman Act is one of the main problems with the Act. Posner explains that the economic definition of price discrimination is "making two (or more) sales at prices that are not in the same proportion to the marginal cost of each sale." Richard A. Posner, supra note 22, at 3 (1976). Therefore, using "price discrimination" to mean any price differential converts "price discrimination" into a legal term of art, rather than an economic

change in usage. Instead, they explained that the purpose of the Act is "to protect the independent merchant, the public whom he serves, and the manufacturer from whom he buys, from exploitation by unfair competitors."[38]

Because the Act tries to protect merchants, the public, and manufacturers by "prevent[ing] discrimination between competing customers of a seller,"[39] its main focus is the pricing practices of suppliers as between their retailer customers, called "secondary-line discrimination."[40] Ironically, the chain-stores that caused such anxiety and motivated the passage of the Act were rarely the focus of FTC enforcement actions.[41] Instead, the pricing practices of their suppliers were subject to scrutiny, causing many manufacturers to eliminate price lists, withdraw advertising allowances, and engage in covert pricing policies,[42] such as the "charge-back" system allegedly used by pharmaceutical manufacturers.[43] The behavior of chain-stores, based on their continued economic success, appears to have been unaffected.

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standard. See id. at 2-17 (discussing economic understanding of price discrimination and potential objections).

38 Patman, supra note 24, at 3 (quoting preamble to bill that would become Robinson-Patman Act).

39 Id. at 5.

40 Secondary-line discrimination affects competition on the buyer's level, rather than in the seller's market. In secondary-line discrimination, the seller discriminates between purchasers, typically singling out one purchaser or group for preferential treatment, usually lower prices, and thereby giving that buyer a competitive advantage as compared to other customers of the price discriminator. Usually this kind of discrimination results from pressure by the buyer on the seller. See J. Furman Lewis and Richard L. Horstman, Competitive Injury—Secondary/Tertiary Line, 53 Antitrust L.J. 891, 894 n.9 (1984).

Though the Act was aimed primarily at secondary-line discrimination, it was interpreted to reach primary-line discrimination in Utah Pie Co. v. Continental Baking Co., 386 U.S. 685, 697-98 (1967). However, the influential analysis of predatory pricing by Areeda and Turner has convinced most academics and courts that primary-line discrimination under the Act should be governed by the same standard as predatory pricing under section 2 of the Sherman Act. See Areeda & Turner, supra note 13, at 727 (arguing that "[t]he basic substantive issues raised by the Robinson-Patman Act's concern with primary-line injury to competition and by the Sherman Act's concern with predatory pricing are identical").

41 See Shniderman & Leverich, supra note 22, at 5 (noting that suppliers have been primary targets of enforcement, despite fact that suppliers are often characterized as "unwilling accomplices" of chain-stores).

42 See Patman, supra note 24, at iii (describing confusion following passage of Act).

43 See Prescription Drugs I, No. 94-C897, 1994 WL 240537, at *3 (N.D. Ill. May 27, 1994) (describing alleged pricing practices of pharmaceutical manufacturers).

B. *The Exemption from the Robinson-Patman Act*

In 1938, the 75th Congress amended the Robinson-Patman Act to create its only statutory exemption, section 13c.[44] Though the Act speaks in terms of the seller of products at discriminatory prices, the exemption, like the FTC investigation that inspired the Act,[45] focuses on the behavior of purchasers. The exemption functions by creating a small class of buyers, "schools, colleges, universities, public libraries, churches, hospitals, and charitable institutions not operated for profit,"[46] (named institutions or named nonprofits) who are released from the Act's price prohibitions for purchases by the organizations of "their supplies for their own use."[47]

The exemption was meant to restore discounts that suppliers apparently had offered to the named institutions in furtherance of their charitable work, but which were withdrawn after enactment of the Robinson-Patman Act.[48] Although sales of differently priced products to the named institutions arguably would not have run afoul of the Act,[49] the broad sweep of the Robinson-Patman Act had engendered confusion about its application.[50] As a result, suppliers of the named institutions probably discontinued charitable discounts in an attempt to comply with the Act's provisions.[51] Because these institutions subsisted on donations, the loss of discounts severely impacted their ability to function and survive.[52] Therefore, an immediate remedy was required, and Congress responded with section 13c.

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[44] See Act of May 26, 1938, ch. 283, 52 Stat. 446, 446 (codified at 15 U.S.C. § 13c (1994)). The full text reads: "Nothing in the Act approved June 19, 1936, known as the Robinson-Patman Antidiscrimination Act, shall apply to purchases of their supplies for their own use by schools, colleges, universities, public libraries, churches, hospitals, and charitable institutions not operated for profit." 15 U.S.C. § 13c (1994).

[45] See supra text accompanying notes 24-30.

[46] 15 U.S.C. § 13c.

[47] Id.

[48] See H.R. Rep. No. 75-2161, at 2 (1938) (relating reasons for adoption of exemption); S. Rep. No. 75-1769, at 1-2 (1938) (same).

[49] See infra note 54 (arguing that organizations not competing in market are not subject to Act).

[50] See Patman, supra note 24, at iii (explaining that Patman wrote book in response to thousands of requests to clarify application of Act).

[51] See H.R. Rep. No. 75-2161, at 2 (detailing predicament of charity hospitals after passage of Act and suggesting that other charities faced similar supply problems); S. Rep. No. 75-1769, at 1-2 (same); Earl W. Kintner & Joseph P. Bauer, 3 Federal Antitrust Law § 25.9, at 464-65 (1983) (noting that "concern was expressed that the [Robinson-Patman Act] might prevent the offering of price concessions to educational and other non-profit institutions").

[52] See H.R. Rep. No. 75-2161, at 2 (suggesting that if pre-Act discounts were not restored, charity hospitals might be forced to close); S. Rep. No. 75-1769, at 1-2 (same).

II
CHANGED CIRCUMSTANCES

When section 13c was enacted, Congress had before it a nonprofit sector[53] of limited scope and variation that could be distinguished easily from private industry. The seemingly clear division between competitive industry and charitable enterprises allowed a law like section 13c to pass relatively unnoticed—since it would not affect anyone outside the nonprofit sector, its impact on Congress's greater pricing scheme was expected to be minimal at most.[54]

However, within a decade of the exemption's enactment, the nonprofit sector began to transform in dramatic and unexpected ways. Part II.A. explores some of the major shifts in the composition of the nonprofit sector, explaining how these changes affected the assumptions underlying the exemption. Part II.B. then examines how the courts dealt with the growing schism between the world in which section 13c was expected to operate and the reality of the nonprofit sector.

A. Changes in the Nonprofit Sector

In 1938, when section 13c was proposed and enacted, the institutions named in section 13c were all what later would be called "traditional charities."[55] These organizations subsisted on donations, rarely received any financial reward for their efforts, and provided "services that had the character of a public good,"[56] generally serving the poor and needy. Though the named institutions[57] made up a significant

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53 The "nonprofit sector" is the term most frequently used to describe the group of organizations that incorporate under state nonprofit corporation statutes and are exempt from federal income taxes. For examples of state nonprofit corporation statutes under which the section 13c institutions could organize, see, e.g., Ala. Code § 10-3A-4 (1975) (permitting nonprofit incorporation for purposes including charitable, benevolent, eleemosynary, educational, religious, and literary); 805 Ill. Comp. Stat. Ann. 105/103.05 (West 1993) (same); Kan. Stat. Ann. § 17-1701 (1995) (same); Ky. Rev. Stat. Ann. § 273.167 (Michie 1989) (same); see also Fla. Stat. ch. 617.0301 (1993) (allowing incorporation for any lawful purpose). Federal tax exemption for the nonprofits listed in section 13c would come from the federal tax code, I.R.C. § 501(c)(3) (1994) (exempting organizations operated for purposes including religious, charitable, scientific, literary, and educational).

54 See S. Rep. No. 75-1769, at 1:

> The purpose of the Robinson-Patman Act, to prohibit price discrimination between purchasers in interstate commerce where competition would thereby be lessened, does not seem to apply as to eleemosynary institutions as they are not operated for profit. The act does forbid such favors as might now be granted by sellers to such institutions.

55 See Henry Hansmann, The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?, 39 Case W. Res. L. Rev. 807, 812 (1988-89).

56 Id.

57 See supra text accompanying note 46 (listing named institutions).

part of the nonprofit sector, the sector was relatively small, and the organizations themselves were modest establishments.[58]

However, in the 1950s, the nonprofit sector began a major transformation. For the first time, the sector became populated by "'commercial' nonprofits"[59]—organizations that sold their services instead of receiving donative or membership support.[60] Nonprofits began to compete with for-profit firms, inspiring the passage of the unrelated business income tax (UBIT)[61] in an attempt to stem the unfair advantage that nonprofit businesses received from their income tax exemption. At the same time, the sector began to grow at an unprecedented rate, both absolutely and as a share of the gross national product (GNP).[62]

These trends have continued into the present, creating a modern nonprofit sector that would be unrecognizable to a 1938 legislator. For the last 20 years, the nonprofit sector has grown four times as fast as the rest of the economy. There are at least 1.2 million nonprofit organizations, excluding churches, that make up 6% of the nation's GNP and employ nearly 7 million people.[63] Support from contributions and dues has dropped from 43% of income to 25%, while "other" income, including income from commercial activities, has increased to 75% of nonprofit income.[64] And, increasingly, nonprofits

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[58] See Hansmann, supra note 55, at 812 ("[T]he nonprofit sector and most of the organizations within it were small.").

[59] Id. at 813.

[60] Membership organizations, such as labor unions, trade and professional associations, fraternal lodges, and cooperatives constitute the other major type of nonprofit organization besides charitable organizations. Membership organizations, also called mutual benefit organizations, generally are operated to provide goods and services to members at cost. They receive federal tax exemption, see I.R.C. § 501(c)(5)-(25) (1994), and are authorized to incorporate as nonprofits under the same statutes that allow charitable organizations to so incorporate, see, e.g., Ala. Code § 10-3A-4 (1975) (permitting nonprofit incorporation for social and fraternal purposes, as well as charitable, educational, and religious purposes); 805 Ill. Comp. Stat. Ann. 105/103.05 (West 1993) (same); Kan. Stat. Ann. § 17-1701 (1995) (same); Ky. Rev. Stat. Ann. § 273.167 (Michie 1989) (same).

[61] See Revenue Act of 1950, ch. 994, § 301, 64 Stat. 906, 947-53 (codified as amended at I.R.C. § 511 (1994)). For a discussion of the motivations for passage of UBIT, see Harvey P. Dale, About the UBIT . . ., New York University, 18th Conference on Tax Planning for 501(c)(3) Organizations § 9.02 (1990), reprinted in James J. Fishman & Stephen Schwarz, Nonprofit Organizations 726-28 (1995).

[62] See Hansmann, supra note 55, at 814 (attributing expansion to growth of service sector of economy).

[63] See Gilbert M. Gaul & Neill A. Borowski, Free Ride: The Tax-Exempt Economy (1993), reprinted in Fishman & Schwarz, supra note 61, at 9-10.

[64] See Unrelated Business Income Tax: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 100th Cong. 218 (1988) (statement of Joseph O'Neil, Chairman, Business Coalition for Fair Competition).

earn this "other" income in businesses that compete with for-profit businesses.[65]

These changes have left section 13c in sharp contrast to the current nonprofit sector—few of these organizations would inspire charity giving by their suppliers, as they no longer operate as traditional charities. Further, their fee for service form of financial support eliminates the need for section 13c price protections. As nonprofit hospitals and universities have shown, when the organizations' costs increase, the price charged to their customers increases as well.[66] In response to this change in circumstances, courts interpreting section 13c have chosen to update the statute to apply to the modern nonprofit sector.

B. Judicial Interpretations of Section 13c

Judicial interpretations of section 13c have transformed the exemption from a benevolent protector of charities into a boon for nonprofit businesses. This Part reviews three judicial interpretations of section 13c, all involving the health care arena,[67] and explores how the courts misread section 13c in order to apply it to circumstances that it was not equipped to handle. As a result, section 13c began to operate in exactly the opposite manner than was intended—protecting price differentials that discriminate among competitors and giving certain businesses unfair advantages over their rivals. However, instead of

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[65] UBIT only applies to commercial activities "not substantially related" to the organization's exempt purpose. I.R.C. § 513(a) (1994). The "substantially related" test is applied very broadly, allowing most nonprofits to engage in significant commercial activities. For example, the Educational Testing Service, a nonprofit organization and the creator and administrator of the Scholastic Aptitude Test, is not subject to UBIT for profits on the sale of study materials for the test because this activity furthers its "educational" purpose. The income from sales of study material prepared by the for-profit Princeton Review, however, is subject to income tax.

[66] Nonprofits, like for-profits, may go out of business when costs exceed revenues. However, nonprofits have the option of seeking increased donations when the cost of providing services increases. Universities engage in both kinds of fund raising—capital drives and increased tuition—to cover rising costs. See Henry B. Hansmann, Reforming Nonprofit Corporations Law, 129 U. Pa. L. Rev. 497, 503 (1981) (pointing to universities as examples of combined donative and commercial nonprofit).

[67] The cases discussed represent half of the case law interpreting section 13c since its enactment. The other "major" decisions construing section 13c are Logan Lanes, Inc. v. Brunswick Corp., 378 F.2d 212 (9th Cir. 1967) (holding that sale of bowling alley equipment to university qualifies for exemption); Students Book Co. v. Washington Law Book Co., 232 F.2d 49 (D.C. Cir. 1955) (arguing that sales to college bookstore does not qualify for exemption); Burge v. Bryant Pub. Sch. Dist., 520 F. Supp. 328 (E.D. Ark. 1980) (holding that school district requirement that photographers pay 10% "commission" as part of bid to take student photographs does not violate Robinson-Patman Act because purchase of photographs by school is covered by section 13c), aff'd, 658 F.2d 611 (8th Cir. 1981).

chain-stores receiving the benefit of this price discrimination, section 13c extended unfair advantages to nonprofit organizations.

1. Abbott Laboratories v. Portland Retail Druggists Ass'n

The first judicial application of section 13c to the health care sector came in *Abbott Laboratories v. Portland Retail Druggists Ass'n*,[68] a price discrimination action against twelve pharmaceutical manufacturers. The plaintiffs, sixty retail pharmacies, alleged that the defendant pharmaceutical companies violated the Robinson-Patman Act by charging favored purchasers, nonprofit hospitals, lower prices than were charged to the druggists for pharmaceutical products. As an affirmative defense, the manufacturers claimed that section 13c exempted pharmaceutical purchases by the nonprofit hospitals from price discrimination prohibitions.[69]

After the plaintiffs prevailed at the court of appeals,[70] the Supreme Court granted certiorari, citing the "obvious need for a definitive construction of [the] language"[71] of section 13c.[72] At issue were two interpretative questions: (1) whether modern nonprofit hospitals qualified for the exemption, and (2) whether the hospitals' resale of pharmaceuticals fell within the hospitals' "own use."

Debate over whether hospitals qualified for the exemption might seem odd, since hospitals are one of the organizations specifically named in section 13c for receipt of its protections.[73] However, the changes in the nonprofit sector detailed above have been most dramatic in the health care market.[74] While in the early part of the 20th

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[68] 425 U.S. 1 (1976).

[69] See id. at 5.

[70] See Portland Retail Druggists Ass'n v. Abbott Lab., 510 F.2d 486, 489-90 (9th Cir. 1974) (holding that purchases were not for hospitals' own use), vacated, 425 U.S. 1 (1976).

[71] *Abbott Lab.*, 425 U.S. at 6.

[72] In addition to defining some of the terms of the exemption, the Court also coined a potentially misleading name for the exemption, calling section 13c the "Nonprofit Institutions Act." See id. at 4. Until then, the statute was referred to by its statute at large number or its U.S.C. code and section number. See Act of May 26, 1938, ch. 283, 52 Stat. 446, 446 (calling statute "An Act" without providing official or popular name); 15 U.S.C. § 13c (1940) (labeling statute as "Exemption of non-profit institutions from price discrimination provisions"); *Students Book Co.*, 232 F.2d at 50 n.5 (referring to exemption by its code and section number, "15 U.S.C. § 13c," and as "[t]he exemption provision"); *Logan Lanes*, 378 F.2d at 214-15 (referring to exemption by year of its adoption, "the 1938 statute," by its code and section number, "15 U.S.C. § 13c," and by its statute at large number, "52 Stat. 446," but never by any name).

[73] See 15 U.S.C. § 13c (1994) ("Nothing in the Act approved June 19, 1936, known as the Robinson-Patman Antidiscrimination Act, shall apply to purchases of their supplies for their own use by . . . hospitals . . . not operated for profit.").

[74] In the early part of the 20th century, hospitals were all nonprofits and served primarily as almshouses for the poor. Volunteer hospitals were the quintessential charity—staffed by volunteers, supported by donations, and focused on serving the needy. However, by the

century hospitals were used only by the poor and very sick,[75] by the late 1960s, as a result of the enactment of Medicaid and Medicare and the increasing availability of employer-provided private insurance, nonprofit hospitals received payment from almost all of their clients, "increasingly tak[ing] on the appearance of business enterprises . . . striving to generate as much surplus revenue as possible through commercial transactions."[76] This dramatic shift in nonprofit hospitals' role and operation led the plaintiffs to challenge the hospitals' right to the section 13c exemption.

While the plaintiffs argued that the exemption should apply only to hospitals that continued to fill their traditional role as almshouses for the poor,[77] the defendants claimed that the exemption was intended "'to assist a wide range of nonprofit institutions to operate at the lowest possible cost.'"[78] To choose between these competing claims, the Court turned to the brief legislative history of section 13c.[79]

The Court reported that the bill that became section 13c originally contained language that would have restricted the exemption to "sales to nonprofit institutions 'supported in whole or in part by public subscriptions.'"[80] From this proposed and rejected language, the Court concluded that the drafters did not intend to limit the exemption, as the retail druggists had suggested, only to hospitals that exclu-

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1950s, because of advances in technology, hospitals began to generate more of their income in the form of fees, instead of donations. See Mark A. Hall & John D. Colombo, The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption, 66 Wash. L. Rev. 307, 319 (1991) ("[D]evelopments in anesthesia, surgical technique and other aspects of medical science . . . suddenly transformed hospitals from the dumping ground of humanity to the pinnacle establishment of the health care delivery system."). For a list of sources providing in depth analysis of the changes within the health care industry, see id. at 319 n.35.

[75] See Bruce R. Hopkins, The Law of Tax-Exempt Organizations § 7.6, at 137 (6th ed. 1992) (describing charitable hospitals of early 20th century as almshouses).

[76] Hall & Colombo, supra note 74, at 319; see id. at 317-21 (arguing that nonprofit organizations should earn their exemption by receipt of at least 30% of their income in donations and concluding that most hospitals would no longer qualify for tax exempt status under proposed criteria); Henry B. Hansmann, The Role of Nonprofit Enterprise, 89 Yale L.J. 835, 840-41 (1980) (giving hospitals as example of "commercial" nonprofit—one that receives bulk of its income from fees for service).

[77] See Abbott Lab. v. Portland Retail Druggists Ass'n, 425 U.S. 1, 12 (1976).

[78] Id. at 13 (quoting Brief for Petitioners at 17).

[79] The exemption inspired very little legislative history, each house filing only a two page report on the exemption's purpose, with a lobbyist's letter comprising the majority of both committees' reports. See H.R. Rep. No. 75-2161 (1938) (briefly explaining motivation for exemption and reprinting letter from John H. Hayes, President of the Hospital Bureau of Standards and Supplies); S. Rep. No. 75-1769 (1938) (same).

[80] *Abbott Lab.*, 425 U.S. at 13 (quoting 83 Cong. Rec. 6065 (1938)).

sively served the poor.[81] Then, relying only on the fact that the statute was enacted in a form that the Court believed to be less restrictive than it could have been, the Court concluded that applicability of section 13c did not depend on hospitals remaining in their traditional role.[82] Despite the fact that nonprofit hospitals function in ways almost identical to their for-profit counterparts, the exemption still applied.

After reading the statute to encompass the modern institution, the Court immediately pointed out that qualifying as an institution was only the first half of the inquiry under section 13c.[83] Explaining the second half of the analysis, the Court said, "the test is the obvious one inherent in the language of the statute, namely, 'purchases of their supplies for their own use.'"[84] However, despite repeated claims that the exemption should be read narrowly, the Court interpreted "for their own use" as any use by the hospital that "is a part of and promotes the hospital's intended institutional operation."[85] This focused the inquiry on the relationship between the purchase and the function of the institution. The Court concluded that section 13c applied to most of the hospitals' purchases—including most of the pharmaceuticals purchased exclusively for resale.[86]

The Court's holding in *Abbott Laboratories* is open to much criticism. First, the Court offered no explanation for how it developed its interpretation of "for their own use." It is possible that the Court was analogizing to the limitations placed on nonprofits by the UBIT,[87] which limits the commercial activities of nonprofits by imposing an income tax on their businesses that are "not substantially related" to the organization's exempt purpose.[88] Under this standard, a nonprofit hospital pharmacy is not subject to the UBIT because the pharmacy furthers the exempt purpose of the hospital by promoting health. The Court seemed to be drawing on the UBIT standard when it interpreted "for their own use" to mean any use by the hospital that "is a

81 See id.

82 See id.

83 See id.

84 Id. at 14 (quoting 15 U.S.C. § 13c).

85 Id.

86 Four types of resale were found to exceed the exemption's boundaries: refills, dispensations to employees for their dependents' use, dispensations to physicians for re-resale to private patients, and any prescriptions from walk-in clients. All prescriptions filled for inpatients, emergency room patients, outpatients on the premises, inpatients upon discharge, outpatients for use away from the premises, hospital employees, medical students, and doctors and their dependents were found to be within the statute. See id. at 14-18.

87 See supra notes 61 and 65 and accompanying text (discussing unrelated business income tax (UBIT)).

88 I.R.C. § 513(a) (1994).

part of and promotes the hospital's intended institutional operation."[89]

However, the relationship between not taxing income earned by a related business and allowing that commercial business to buy inventory at discriminatory prices is significant. Combined, they may give an unfair competitive advantage to a commercial nonprofit of exactly the kind that Congress sought to eliminate with UBIT[90] when it became apparent that nonprofits could compete with for-profit business. Further, section 13c was enacted on the assumption that nonprofits would not compete with for-profit businesses;[91] reading the exemption to allow such competition as long as the UBIT standard is not violated assumes that the antitrust statute is modified by the later tax provision.

Second, the Court's reading of section 13c seems to ignore the statute's plain language, which allows discounts on purchases only of "supplies" for the hospital's "own use." The only way to make sense of this language is to read it in the context of the nonprofit sector that existed when the exemption was written. The organizations named in section 13c served the poor;[92] they had neither the capital with which to purchase nor the clientele for whom to purchase items other than those consumed in providing those services. In this context, the limit imposed by section 13c seems to exclude items purchased for separate resale, or at least to limit such purchases to situations that would not put the nonprofit in competition with for-profit businesses. The Court's only acknowledgment of the potentially ambiguous meaning of the word "supplies" was a long footnote at the end of the majority opinion.[93]

The Court's reading of section 13c to include modern hospitals and purchases of drugs for resale requires an underlying belief that statutes should be updated when circumstances change. The statute

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89 *Abbott Lab.*, 425 U.S. at 14.

90 See supra note 61 and accompanying text.

91 See supra notes 53-54 and accompanying text.

92 See supra notes 55-58 and accompanying text.

93 See *Abbott Lab.*, 425 U.S. at 18 n.10. Footnote 10 began with a discussion of the meaning of "supplies" as defined in Logan Lanes, Inc. v. Brunswick Corp., 378 F.2d 212 (9th Cir. 1967). The Court noted that in *Logan Lanes*, "supplies" was defined as "anything required to meet the qualified institution's needs." *Abbott Lab.*, 425 U.S. at 19 n.10. However, the Court refrained from explicitly adopting the *Logan Lanes* definition of the term. Instead, the Court expressed agreement with the decisions in *Logan Lanes* and Students Book Co. v. Washington Law Book Co., 232 F.2d 49 (D.C. Cir. 1955), and segued into a discussion of how to distinguish them. Rather than focusing on the purchases in each case, the Court explained that *Students Book Co.* failed to qualify for section 13c because the purchasing institution was not actually the university. Footnote 10 ended without discussion of resale. See *Abbott Lab.*, 425 U.S. at 18 n.10.

on its original terms would not have covered the purchases at issue; "hospital" in 1938 connoted something different than in 1976, and "supplies for their own use" is at best ambiguous as to the meaning of "supplies" and the permissibility of resale. But the Court, acting on a widely held belief that statutes should be adjusted to make sense in the present,[94] interpreted section 13c to allow something that it was never intended to allow—discriminatory pricing to the detriment of one set of a supplier's customers.

2. De Modena v. Kaiser Foundation Health Plan, Inc.

Seven years later, in *De Modena v. Kaiser Foundation Health Plan, Inc.*,[95] the Portland Retail Druggists, the plaintiff in *Abbott Laboratories*, claimed that pharmaceutical companies' sales of brand name drugs at a discount to a group of "favored purchasers" violated the Robinson-Patman Act. There were two important factual differences between the two cases: in *De Modena* the plaintiff druggists sued the purchasers, rather than the sellers[96] and the "favored purchasers" were nonprofit HMOs,[97] rather than nonprofit hospitals. However, the Ninth Circuit used the same two-pronged analysis developed in *Abbott Laboratories*: (1) whether nonprofit HMOs qualified for the exemption, and (2) whether the HMOs' resale of pharmaceuticals fell within the HMOs' "own use."

To decide whether HMOs qualify for the section 13c exemption, the court turned to the catch-all category, "charitable institution not operated for profit," since HMOs are not among the organizations specifically enumerated in the statute. Though neither section 13c, the legislative history, nor the case law offers a definition of "charitable institution," the court claimed that the House and Senate reports indicated that "the drafters of the Nonprofit Institutions Act wished to protect the same eleemosynary institutions that are given special con-

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[94] See 73 Am. Jur. 2d Statutes § 205 (1974) (discussing this "general rule of statutory construction").

[95] 743 F.2d 1388 (9th Cir. 1984).

[96] The Robinson-Patman Act creates a cause of action against both purchasers and sellers of products at discriminatory prices. See 15 U.S.C. § 13(a), (f) (1994).

[97] HMOs are allowed to organize as nonprofit corporations by most states and are eligible for federal tax exempt status under I.R.C. section 501(c)(3) as "charitable" institutions because of their "promotion of health." Their status as tax exempt organizations has been challenged in recent years and is the topic of ongoing debate. See Hopkins, supra note 75, § 7.6, at 143-45; id. at 26-27 (Supp. 1997). See generally John D. Colombo & Mark A. Hall, The Future of Tax-Exemption for Nonprofit Hospitals and Other Health Care Providers, 7 Exempt Org. Tax Rev. 395 (1993) (discussing current tax status of nonprofit healthcare providers and evaluating proposed changes in tax exemption).

sideration under the tax and charitable trusts laws."[98] Unfortunately, the reports say nothing of the kind.[99]

Based on this odd assertion, the court examined the regulations that interpret I.R.C. section 501(c)(3), the statute granting many nonprofit corporations a federal income tax exemption.[100] The court found that under I.R.C. section 501(c)(3), "charitable" is defined, in part, as furthering the "promotion of health,"[101] and that some non-

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98 *De Modena*, 743 F.2d at 1391.

99 In fact, the House Committee on the Judiciary simply reported:

> The committee does not feel that the wholesome purpose of the Robinson-Patman Act will be interfered with by the enactment of this bill to make certain that favors in price which are occasionally extended to eleemosynary institutions, because of the character of the institution, do not fall under the ban of the act.

H.R. Rep. No. 75-2161, at 1 (1938).

100 See supra note 53 (describing relationship between federal tax exempt status and nonprofit incorporation).

101 See Rev. Rul. 69-545, 1969-2 C.B. 117, 118 (modifying previous ruling that required nonprofit hospitals to provide charity care in order to qualify for tax exempt status under section 501(c)(3)); cf. Lisa Marie Starczewski, IRS National Office Procedures—Rulings, Closing Agreements, 621 Tax Management Portfolio, at A-29 (1996) (explaining precedential value of revenue rulings).

The "promotion of health" definition of charitable is a result of the changes in nonprofit hospital operation detailed above. See supra notes 74-76 and accompanying text. In the 1960s many commentators believed that nonprofit hospitals would no longer need to provide charity care, as those patients who previously had received such care now had access to Medicaid or Medicare. See Colombo & Hall, supra note 97, at 399 & n.10. This development required a change in the tax treatment of nonprofit hospitals. Instead of requiring nonprofit hospitals to treat indigent patients "to the extent of [their] financial ability," Rev. Rul. 56-185, 1956-1 C.B. 202, 203, in order to maintain their tax exempt status, the IRS instead declared all "promotion of health" to be *per se* charitable and for the benefit of the community, leaving hospitals with the same favorable tax treatment, without requiring them to engage in any charity care. See Rev. Rul. 69-545, 1969-2 C.B. 117, 118. Thus, because of the IRS classification, nonprofit hospitals and HMOs are considered "charitable," even though they are not obligated to treat indigent patients and in most cases operate in a manner indistinguishable from their for-profit competitors.

In fact, nonprofit hospitals now donate only 6% of total expenditures to care for those who cannot pay. See Gaul & Borowski, supra note 63, at 11. Unfortunately, claims that Medicaid and Medicare would eliminate the need for the charity care requirement have proved premature. See Colombo & Hall, supra note 97, at 404-05. However, the ability of nonprofit hospitals to offer charity care has been severely restricted by private insurance companies, which prevent the hospitals from cross subsidizing—charging private patients an amount in excess of their "real" bill in order to cover the cost of care to those without insurance or government reimbursement. See Hall & Colombo, supra note 74, at 319. Even so, commentators have argued that nonprofit hospitals are anachronistic and opportunistic. See Hansmann, supra note 55, at 813.

The appropriateness of the entire "promotion of health" category within the tax law definition of "charitable" has been questioned by some scholars. See, e.g., Hall & Colombo, supra note 74, 332-45 (arguing that tax exemption of health care organizations is now inappropriately governed by trust law meaning of "charitable" and proposing alternative donative theory); Hansmann, supra note 66, at 516 n.40 (noting "unthinking recent extension of [the definition of 'charitable'] to include hospitals organized strictly as com-

profit HMOs qualify for tax exemption under this classification.[102] Therefore, since nonprofit HMOs can qualify as "charitable" under federal tax law, the court concluded that nonprofit HMOs must also satisfy the charitable institution category of the Robinson-Patman Act exemption.

This interpretation of "charitable" in section 13c is subject to easy criticism. One of the least controversial rules of statutory construction is that interpreters should use the common speech meaning of terms, unless guided by clear evidence that some other definition was intended.[103] Despite some changes in the tax law definition, the colloquial usage of "charitable" has remained quite narrow,[104] referring to the traditional notion of charity as aid to the needy or suffering. The court's explanation for deviating from the colloquial definition, that "the drafters of the Nonprofit Institutions Act wished to protect the same eleemosynary institutions that are given special consideration under the tax and charitable trusts laws,"[105] finds no support in the legislative history. Therefore, the narrow colloquial meaning should have been used.

Further, the tax and trust laws definition of charity to which the court referred offers little support for its interpretation of "charitable." As the history discussed above indicates,[106] when section 13c was drafted, the term "charitable" only referred to traditional charities, as all nonprofits were traditional charities at that time. The federal tax regulations issued to define "charitable" from 1924-1959 also endorsed this picture of the nonprofit sector, defining "charitable" as

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mercial nonprofits"); cf. Hopkins, supra note 75, §§ 5.2-5.3 (giving history of and discussing current tax definition of "charity"); id. § 7.6 (describing "promotion of health" category); Hansmann, supra note 55, at 823-24 (arguing that IRS should give interpretation of "charitable" coherence by contracting scope of exemption to exclude nonprofits for which subsidy is no longer appropriate, rather than stretching term to accommodate changes in organizations).

102 See Sound Health Assoc. v. Commissioner, 71 T.C. 158, 177-81 (1978) (holding that "promotion of health" test applied to nonprofit hospitals for determining section 501(c)(3) eligibility should be applied to HMOs as well, despite restricted class of beneficiaries), acq. 1981-2 C.B. 1, 2.

103 See, e.g., Will v. Michigan Dep't of State Police, 491 U.S. 58, 64 (1989) (arguing for use of "common usage" of term in statutory interpretation). See generally 73 Am. Jur. 2d Statutes § 206 (1974) (listing cases that support general rule that terms should be read using commonly accepted meanings).

104 See Webster's Third New International Dictionary, Unabridged 378 (Philip Babcock Gove ed. in chief, 1993) (defining "charitable" as "practicing or showing charity: generous in assistance to the poor . . . arising from or dictated by kindness," and defining "charity" as "the kindly and sympathetic disposition to aid the needy or suffering: liberality to the poor").

105 De Modena v. Kaiser Found. Health Plan, Inc., 743 F.2d 1388, 1391 (9th Cir. 1984); see also supra note 99.

106 See supra notes 55-58.

relief for the poor.[107] It was not until 1959 that the Internal Revenue Service (IRS) significantly expanded the tax meaning of "charitable," defining the term very broadly to encompass all activities that convey a public benefit.[108] This change reflected the dramatic transformation taking place in the nonprofit sector at that time.[109] It was not until 1969 that the IRS defined charitable to include "promotion of health."[110] Aside from the court's unsupported assertion that the drafters intended to use the same definition of "charitable" as the tax law,[111] there is no reason to assume that changes in the tax law meaning should have any effect on the interpretation of section 13c.

Having shoehorned nonprofit HMOs into the language of the exemption, the court addressed the second question: whether drugs purchased for resale to members were made for the HMOs' "own use." The court adopted the Supreme Court's interpretation of "own use" from *Abbott Laboratories* and then discussed whether the purchase and resale of pharmaceuticals was "'a part of and promote[d] the [HMO's] intended institutional operation.'"[112] The court decided that the "basic institutional function" of an HMO was "to provide a complete panoply of health care to [its] members"[113] and

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[107] See Treas. Reg. 65, Art. 517 (1924) ("Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor."). This definition remained unchanged through numerous versions of the treasury regulations. See, e.g., Treas. Reg. 69, Art. 517 (1926); Treas. Reg. 74, Art. 527 (1929), Treas. Reg. 103 § 19.101(6)-1 (1940); Treas. Reg. 111 § 29.101(6)-1 (1943); Treas. Reg. 118 § 39.101(6)-1(b) (1953). The narrow reading even persisted after the enactment of the second Internal Revenue Code in 1954, which created section 501(c)(3), the tax exemption statute currently in force. The House Committee on Ways and Means specifically stated that as to section 501, "[n]o change in substance has been made," thereby keeping previous definitions of the terms therein in force. H.R. Rep. No. 83-1337, at A-165 (1954). The language of the regulations was changed with the issuance of Treas. Reg. § 1.501(c)(3)-1. See Treas. Reg. § 1.501-(c)(3)-1(f) (as amended in 1990) (stating that new regulations apply for taxable years beginning after July 26, 1959).

[108] See Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990):

> The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense .... Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

[109] See supra notes 60-62.

[110] See Rev. Rul. 69-545, 1969-2 C.B. 117, 118; see also supra note 101.

[111] See De Modena v. Kaiser Found. Health Plan, Inc., 743 F.2d 1388, 1391 (9th Cir. 1984).

[112] Id. at 1393 (quoting Abbott Lab. v. Portland Retail Druggists Ass'n, 425 U.S. 1, 14 (1976)).

[113] Id.

that the sale of drugs to a member of an HMO could be considered a part of the basic function of the organization.[114] Therefore, the court concluded that drugs purchased by HMOs for resale to their members constituted purchases for the HMOs' own use.[115]

Unlike the Supreme Court, the *De Modena* court seemed concerned about the resale aspect of the case; in a footnote the court noted that section 13c says "nothing about sales by [exempt] institutions."[116] However, the court concluded that *Abbott Laboratories* had implicitly decided that "for their own use" could apply to resold items, and inquired no further into the issue.[117]

In *De Modena*, as in *Abbott Laboratories*, the court's reading of section 13c expanded the statute beyond what it reasonably was intended to cover. This time, the court opened the organizational qualification part of the statute to include any nonprofit that receives a federal tax exemption under I.R.C. section 501(c)(3), the charitable organizations exemption. This misreading of section 13c was probably an attempt to bring the statute in line with current conditions. However, this court too failed to explain why such a reading was appropriate.

3. In re Brand Name Prescription Drugs Antitrust Litigation

The most recent judicial interpretation in this line came during *Prescription Drugs*[118] which involves a very similar controversy to that in *De Modena*. The plaintiffs, a consolidated group of retail pharmacies, accused the defendants, a group of pharmaceutical manufacturers and wholesalers, of sales to HMOs and mail order pharmacies in violation of the Robinson-Patman Act.[119] Four of the defendants filed for summary judgment, arguing that they sold their drugs at a discount to nonprofit HMOs and were therefore protected by the exemption.[120]

In *Prescription Drugs*, the plaintiff druggists made a novel argument: they asserted that section 13c's discounts should not be available when competition would be harmed by its application.[121] The court declined to consider competitive effects, finding "no basis in

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114 See id.

115 See id.

116 Id. at 1393 n.6.

117 See id.

118 See supra note 1 (describing procedural posture of consolidated group of cases).

119 See *Prescription Drugs I*, No. 94-C897, 1994 WL 240537, at *5-6 (N.D. Ill. May 27, 1994).

120 See *Prescription Drugs III*, No. 94-C897, 1995 WL 715848, at *1 (N.D. Ill. Dec. 4, 1995).

121 See id. at *4.

either the language of the [exemption] itself, or in the case law cited"[122] for the retail druggists' argument that a competitive injury exception should be read into section 13c. Therefore, relying heavily on the *Abbott Laboratories* and *De Modena* opinions, the court repeated the conclusion that section 13c allows pharmaceutical companies to sell medications to nonprofit HMOs at discriminatorily low prices, even when these drugs are purchased for resale to the HMOs' members at a profit.[123]

Though the court was correct in stating that the statute does not refer to competitive effect, this omission was likely due to the assumption that the named nonprofits[124] would have no adverse competitive effect on their respective markets when they bought supplies at discriminatory prices since nonprofits at that time did not compete with for-profit businesses. Had the statute been read with this assumption in mind, the court likely would have concluded that the exemption was not meant to provide nonprofits with a price advantage over for-profit firms. However, the court read the statute in its updated form, which included the glosses of the *Abbott Laboratories* and *De Modena* courts, under which adverse competitive effect is irrelevant.

The courts in the above three cases did something that none of them would openly admit—they "rewrote" section 13c so that the statute made sense in circumstances that it was not meant to handle. The following Part argues that these interpretations of section 13c did more harm than good, leaving a statute that conflicts with its intended purpose and that thwarts the goals of the Robinson-Patman Act.

III
How Should the Language of Section 13c Be Understood?

This Part argues that the courts' difficulties in interpreting section 13c stem from the fact that it is an obsolete statute. To that end, this Part proposes a theory of interpretation that this Note argues better enables courts to deal with the unique problem of statutory obsolescence: the changed circumstances theory.

Part III.A. defines the term "obsolete statute" and explores why section 13c should be characterized as such. Part III.B. then reviews and criticizes "updating dynamism," a proposed method for dealing with obsolete statutes. Part III.B. ends by exploring how prior judicial interpretations of section 13c are examples of dynamic interpretation

122 Id. at *5.
123 See id.
124 See supra text accompanying note 46 (listing named nonprofits).

and pointing out how dynamic interpretation led to problematic outcomes. Finally, Part III.C. proposes a new method of interpretation for obsolete statutes and applies this method to generate a better interpretation of section 13c.

A. Statutory Obsolescence

The problem of statutory obsolescence occurs when, as described by Judge Guido Calabresi, "laws do not reflect the views of a current majority on what preferences in treatment are warranted by present conditions."[125] In other words, the statute is obsolete because the circumstances under which the statute was enacted no longer exist, leading to the presumption that a current legislature would not enact the statute. Given the enormous numbers of statutes enacted each year at every level of government, and the increased degree of specificity in legislation,[126] the problem of obsolete statutes is not trivial.

Calabresi identifies a number of factors that indicate whether a statute is obsolete. The statute should no longer fit the "legal topography"—perhaps it should even clash in an unanticipated manner.[127] Additionally, some major technological or societal change should have disconnected the statute from the circumstances of its enactment.[128] The age of the statute, academic criticism, and the fact that the statute originally responded to a crisis also argue for judicial response.[129]

The section 13c exemption seems like it could have been the prototype for Calabresi's set of obsolescence factors. The exemption was enacted under immensely different societal circumstances—the Great Depression. At no time since then have charitable organizations borne such a heavy burden, as many of the services then provided by private charities are supplied now by the government.[130] The exemption was a reaction to a crisis; the enactment of the Robinson-Patman

125 Calabresi, supra note 12, at 72.

126 See id. at 5 (calling post-New Deal statutes "specific" and "detailed").

127 See id. at 124, 129.

128 See id. at 130.

129 See id. at 132-33.

130 For example, Medicaid eliminates the need for charity health care for the very poor. Unemployment benefits, food stamps, and welfare also lessen the burden on private charities. But see Saving Our Children: The American Community Renewal Act of 1996: Joint Hearing on H.R. 3467 Before the Subcomm. on Human Resources of the House Comm. on Ways and Means and the Subcomm. on Early Childhood, Youth and Families of the House Comm. on Econ. and Educ. Opportunities, 104th Cong. 74 (1996) (statement of Sharon M. Daly, Deputy to the President for Social Policy, Catholic Charities USA) (testifying that in 1994 "[o]ver 60 percent of the cash revenues of our local agencies came from government . . .[because] our agencies are reimbursed by government agencies under contracts to provide services that government would otherwise have to provide.").

Act arguably had caused a sudden rise in the prices for supplies and severely impacted the ability of the named institutions to function.[131] As for academic criticism, section 13c is one example of the regulatory benefits accorded to nonprofit organizations that have been condemned by major commentators.[132] Most importantly, however, the exemption is obsolete because it was enacted for a completely different nonprofit sector—one comprised of traditional charities, rather than today's commercial nonprofits.[133] Therefore, section 13c is obsolete because it was meant to regulate a world that no longer exists.

In response to the problem of obsolescence, Calabresi proposes treating statutes like common law rules, allowing courts the same leeway that they have to shape the common law when it fails to comport with current values. When an obsolete statute comes before a court, Calabresi argues that the court should shift the "burden of inertia"[134] by overturning the statute, or in some other way throwing the statute's current legitimacy into doubt, thereby forcing the legislature to reenact the statute if support for it does in fact still exist.[135]

Note, however, that recent enactments that limit government assistance, such as the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 1996 U.S.S.C.A.N. (110 Stat.) 2105 (codified as amended in scattered sections of 7, 29, 42 U.S.C.A.), have been supported by some on the theory that private charities will be able to fill the gap. Compare Reforming the Present Welfare System: Hearing Before the Subcomm. on Dep't Operations, Nutrition, and Foreign Agric. of the House Agric. Comm., 104th Cong. 344, 346 (1995) (statement of Michigan Governor John Engler) (lobbying for changes in Food Stamp Program and testifying: "I trust local charities, civic groups, churches, synagogues, [and] mosques to make sure that the children and their mothers in their respective communities get the proper nutrition"), with Contract with America—Welfare Reform: Hearing Before the Subcomm. on Human Resources of the House Comm. on Ways and Means, 104th Cong. 735, 736 (1995) (statement of Rabbi David Saperstein, Director, Religious Action Center of Reform Judaism) (testifying that "those who suggest that the private charity sector . . . can fill the void of a government withdrawal from guaranteeing assistance for the poor greatly misread the realities that we face"). See also Charles Murray, Losing Ground: American Social Policy, 1950-1980 229-30 (1984) (arguing that, in event of elimination of federal government assistance programs, private charity and local government programs would be available to provide services to those who still do not enter work force).

131 See H.R. Rep. No. 75-2161, at 2 (1938) (detailing withdrawal of discounts by charity hospital suppliers after passage of Act); S. Rep. No. 75-1769, at 1-2 (1938) (same).

132 See, e.g., Hansmann, supra note 55, at 826 (concluding that "most of the regulatory exemptions that have been granted to nonprofits seem poorly founded").

133 See supra Part II.A.

134 Calabresi, supra note 12, at 141; see id. at 101-19 (explaining and defending proposal of treating statutes like common law rules).

135 See id. at 147-48; see also id. at 165 (arguing that exposing statutes to same scrutiny as common law rules would reestablish traditional balance of power between legislature and judiciary).

B. *Dynamism*

Although proposed earlier, Calabresi's prescription for obsolescence is very similar to the theory of dynamic statutory interpretation proposed by William Eskridge, Jr.,[136] and can be viewed as a specific form of dynamism. Both strategies see aggressive judicial interpretation as a method for keeping statutes in line with the current political consensus.[137]

Dynamic statutory interpretation was proposed by Eskridge as a response to originalist[138] and textualist[139] interpretation. Eskridge argues that neither of these theories is capable of describing the manner in which courts actually interpret statutes, as each of these theories advocates overly formal methods of interpretation. He proposes instead that the interpretative process used by courts more closely resembles a dynamic reading of statutory enactments in a manner paralleling human decisionmaking, which he describes as "polycentric, spiral, and inductive."[140] Rather than considering the statutory text in isolation, or focusing entirely on the enacting legislature's purpose, Eskridge argues that interpreters in fact consider all the available information, giving each piece varying degrees of weight as the specific

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136 See William N. Eskridge, Jr., Dynamic Statutory Interpretation (1994).

137 See Karen M. Gebbia-Pinetti, Statutory Interpretation, Democratic Legitimacy and Legal-System Values, 21 Seton Hall Legis. J. 233, 294 (1997).

138 Originalism is a generic term for subtler theories of interpretation: intentionalism, which focuses on discovering the drafters' understanding of the language at issue, and purposivism, which focuses on interpreting language in line with a statute's overall purpose or goal. See Eskridge, supra note 136, at 13-40. Originalism begins with the proposition that statutes derive their legitimacy to govern from their democratic enactment. This premise leads originalism to conclude that justifiable interpretations of a statute must be based on the enacting legislature's understanding of the statute, as only the perspective taken by the enactors reflects the democratic understanding for the statute. Therefore, all originalist theories seek to unearth the drafters' intent. For the purposes of this Note, the generic term originalism will be used.

139 In its simplest form, textualism advocates "plain meaning" interpretation, which proposes that statutes be read simply with ordinary meanings for the terms and the general rules of grammar and syntax. Plain meaning rejects reliance on most outside sources for interpretative guidance; some call this very limited inquiry the "four corners" approach. See Daniel A. Farber & Philip P. Frickey, Law and Public Choice 89-95 (1991) (discussing "'four corners' rule"). Concerns with separation of powers and the public choice model of legislative intent has led some textualists to argue that original legislative intent is irrelevant to the interpretative process. See Frank H. Easterbrook, The Role of Original Intent in Statutory Construction, 11 Harv. J.L. & Pub. Pol'y 59, 61 (1988) (arguing that individual intent recorded in legislative history is irrelevant to interpretation and that only "original meaning" matters); Bradley C. Karkkainen, "Plain Meaning": Justice Scalia's Jurisprudence of Strict Statutory Construction, 17 Harv. J.L. & Pub. Pol'y 401, 424-28 (1994) (explaining that Scalia's opposition to use of legislative history stems from separation of powers concern).

140 Eskridge, supra note 136, at 55.

case warrants.[141] Finally, Eskridge argues normatively that courts should construe statutes in this way to ensure that statutes continue to reflect the preferences of the current majority,[142] effectuate the goals of the statute,[143] provide individual justice and create just rules.[144]

1. *Dynamic Interpretation in Section 13c Cases*

The three cases discussed above support Eskridge's thesis that courts in fact interpret statutes dynamically. In each case, the court took section 13c and read then-current preferences into the statute, on the assumption that the exemption should evolve to meet changing conditions. *Abbott Laboratories* read "hospital" to mean "modern nonprofit hospital," though it obviously was impossible that the 1938 legislature could have meant "modern nonprofit hospital" when it only had experience with the almshouse-style hospitals of the 1930s. The Court assumed in *Abbott Laboratories*, however, that the enacting legislature used "hospital" to mean "whatever a hospital turns out to be in the future." Similarly, the *De Modena* court read "charitable institution" to mean "whatever a charitable institution turns out to be in the future (including whatever the tax and trust laws consider charitable)." And both courts assumed that "supplies for their own use" encompassed any possible activities in which these organizations would engage in the future.[145] The *Prescription Drugs* court simply applied the updated statute to another set of facts. These are quintessential dynamic interpretations.

2. *Evaluation of Dynamism and Consequences for the Section 13c Exemption*

Though Eskridge's descriptive claim about dynamism seems accurate, his conclusion that dynamism is always the best method of interpretation is less convincing, both as a matter of theory and as evidenced by the results of the courts' dynamic interpretations of section 13c. In theory, use of dynamism in all interpretive situations is unappealing because of the enormous discretion it bestows on the interpreter. Since dynamism guides the interpreter to use broad social policies in interpretation, it makes an implicit assumption that the policies identified by the judge in reinterpreting the statute will be policies shared by the litigants or society as a whole. However, at least in the federal system, the life tenure of judges ensures that many on the

141 See id. at 54-56 (arguing for interactive process model).
142 See id. at 111-40 (arguing that traditional liberal theory supports dynamism).
143 See id. at 141-73 (arguing that legal process theory supports dynamism).
144 See id. at 174-206 (arguing that "normativist" theories support dynamism).
145 See supra Part II.B.

bench will not share current preferences on a given issue. Allowing a "conservative" appointee the freedom to reread "liberal" statutes (or the converse) gives this single interpreter the same power as the entire legislature—he can change the scope, the meaning of terms, even effectively overturn the statute. Dynamism offers no theory on how to control this kind of unbridled discretion.

Further, dynamism rejects legislative supremacy without offering a strong justification for this position.[146] The separation of powers issue implicit in any argument that encourages judges to rewrite statutes seems to cause dynamism's supporters little concern. When obsolete statutes are at issue, this separation of powers concern is particularly acute. The more that circumstances have changed since the enactment of a statute, the greater the freedom of the dynamic interpreter and the greater the chance that the dynamic interpreter will imbue the statute with meaning that simply reflects her preferences, rather than the preferences of a legislative majority. Therefore, as a statute begins to become obsolete, there is a greater chance that the statute will be reread in an unpredictable manner.

In practice, dynamic interpretation of section 13c has led to negative results for both sellers of pharmaceuticals and consumers. The statute has been used by nonprofit hospitals and HMOs, both of which operate as profit-maximizing firms, to purchase and resell pharmaceuticals at prices below those at which independent and chain-store pharmacies can buy the same products.[147] As a result, drug stores have gone out of business[148]—an ironic turn of events,

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146 See Eskridge, supra note 136, at 120; Gebbia-Pinetti, supra note 137, at 336-37.

147 See Prescription Drugs I, No. 94-C897, 1994 WL 240537, at *1 (N.D. Ill. May 27, 1994) (alleging such practices); FTC is Probing Pricing Policies of Pharmaceutical Manufacturers, 70 Antitrust & Trade Reg. Rep. (BNA) No. 1756, at 370 (Apr. 4, 1996) (reporting on FTC investigation of discounts offered to bulk purchasers, such as HMOs, that are not available to independent pharmacies); Kathleen Day, Fulfilling a Promise on Prescriptions? Prices are Rising Slower Than Inflation, but . . ., Wash. Post, Aug. 13, 1996, at D1:

> Manufacturers publish list prices, which are used as a basis to sell products to wholesalers, which then sell the drugs to hospitals, drug stores, clinics and health maintenance organizations (HMOs). But the manufacturers also offer a range of rebates and discounts to those buyers. Drug companies don't publish the rebates they give, making it harder to come up with accurate [prices];

McDowell, supra note 1, at A31 (reporting that Wisconsin agency found that hospitals and other institutions paid $10.19 for 100 acetaminophen with codeine pills, while community pharmacies paid $24.60).

148 See Susan Headden, Forced Closures: The disappearing corner drugstore, U.S. News & World Rep., Sept. 1, 1997, at 74, 74 (reporting that in past six years more than 9,000 independent pharmacies—approximately one-third of nation's total—have gone out of business because they lose money on prescription drugs); Caryn Eve Murray, In Need of a Cure: Independent Pharmacies Seek Relief from Mounting Economic Pressures, Newsday, May 13, 1996, at C1 (stating that approximately 100 of estimated 2,400 independent pharmacies in New York go out of business each year).

considering that the protection of local drug stores was one impetus for the passage of the Robinson-Patman Act.[149]

Despite potentially lowering drug prices, the expanded section 13c has also been bad for consumers.[150] Besides contributing to the elimination of a class of businesses, the independent pharmacist, the expanded section 13c has helped to decrease consumer drug options.[151] Since section 13c as interpreted allows nonprofit HMOs to buy drugs at discriminatorily low prices, pharmaceutical manufactures can offer these discounts in return for exclusive contracts with these HMOs.[152] Therefore, instead of buying low price medicines from every pharmaceutical company, each HMO agrees to buy only from one or two companies in return for steep discounts.[153] The HMOs then offer a limited choice of pharmaceuticals to their patients, even though in many cases patients may have preferred noncovered brands

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149 See supra Part I.A.

150 Cf. Louis B. Schwartz, "Justice" and Other Non-Economic Goals of Antitrust, 127 U. Pa. L. Rev. 1076 (1979) (arguing that focusing entirely on price ignores other goals of antitrust law, such as consumer choice, decentralization of economy, and justice).

151 See Mark Green, Public Advocate for the City of New York, Compromising Your Drug of Choice: How HMOs are Dictating Your Next Prescription, Dec. 1996, at 3 (listing as first finding that "[p]atient and doctor drug choice is becoming very restricted"); Susan Headden, The big pill push, U.S. News & World Rep., Sept. 1, 1997, at 67, 68 (describing how HMOs limit patient drug choices by contracting with middlemen, called pharmaceutical benefit managers (PBMs)). The PBMs create lists of drugs, called formularies, from which managed care organizations' doctors are "encouraged" to prescribe medications. See Ronald Powers, Drug Makers Control Prescriptions, Consumer Group Says, Buffalo News, Aug. 14, 1997, at 6A, available in LEXIS, Regnws Library, Curnews File. Patient choice is often restricted to the drugs produced by the PBM's owner or to the pharmaceutical company that pays the PBM the most to promote its products. See Peter Keating, Why You May Be Getting the Wrong Medicine, Money, June 1997, at 142, 146 (describing how formularies restrict patient drug choices by covering as few as 100 of 10,000 FDA approved available medications for an illness); Lauran Neergaard, FDA steps in to monitor drug insurance coverage; Some companies known as "pharmacy benefits managers" are owned by drug manufacturers, Fresno Bee, Jan. 6, 1998, at C1, available in LEXIS, Regnws Library, Curnews File (reporting that Merck, Eli Lilly, and SmithKline Beecham own three of nation's largest PBMs, and that many other drug manufacturers have signed agreements with PBMs); see also Headden, supra, at 73 (noting that choice of antidepressants, allergy drugs, stomach remedies, and heart medications are frequently restricted).

152 See Headden, supra note 151, at 67 ("Drug manufacturers are feeling regulatory heat as they offer kickbacklike discounts to health plans . . . ."); Keating, supra note 151, at 144 ("When managed-care plans decide which drugs they will pay for, one of the first factors they consider is which drugmaker offers the best rebate program.").

153 See Green, supra note 151, at 5-8 (describing "[s]ecret [c]ontracts" between PBMs and HMOs, frequently favoring pharmaceutical companies that own PBMs). The fact that three of the nation's largest drug manufacturers actually own PBMs has led the FDA to propose regulating the PBMs. See Draft Guidance for Industry: Promoting Medical Products in a Changing Healthcare Environment; I. Medical Product Promotion by Healthcare Organizations or Pharmacy Benefits Management Companies (PBMs), 63 Fed. Reg. 236 (1998) (giving notice of proposed regulations, advising how copies of such can be obtained and explaining how to register comments).

of the drug.[154] The HMO's doctors are "encouraged" to prescribe only the covered drugs and patients are denied access to the products that would best satisfy their preferences.[155] Since most people do not choose which HMO to enroll in, but instead are enrolled in the plan chosen by their employer, consumers are unable to express their drug plan preferences by choosing an HMO with a comprehensive selection of pharmaceuticals.[156] Worst of all, recent studies suggest that restrictive drug lists lower drug prices only temporarily and raise overall medical costs.[157]

Dynamic interpretation of section 13c alone is not responsible for the dysfunctional market that currently controls drug pricing. As the *Prescription Drugs* lawsuit indicates, a conspiracy may be responsible for the inflation of drug prices and the concomitant limitation of pa-

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154 See Mark Green, Public Advocate for the City of New York, Pharmaceutical Payola: How Secret Commercial Deals Are Dictating Your Next Prescription and Harming Your Health, Aug. 1997, at 4-18 (describing health risks of drug switching and rising concern of doctors, pharmacists, and "[e]ven HMOs"); Milt Freudenheim, Not Quite What Doctor Ordered, N.Y. Times, Oct. 8, 1996, at D1 (describing HMO practice of switching cheaper drugs for those prescribed by patients' physicians and explaining that patients may face risky side effects from common substitute medicines that would not be present with higher priced alternatives); Headden, supra note 151, at 73-74 (describing adverse reactions of patients who were switched to alternative medicines because their health plans did not cover previously used drugs).

155 See Freudenheim, supra note 154, at D1 (reporting that critics of HMO-manufacturer deals accuse HMOs of allowing medical decisions to be made on basis of favorable drug plans); Headden, supra note 151, at 74 (reporting that doctors face reprisals from HMOs when they do not prescribe drugs from the formulary); Tonya Jameson, Pressure to switch prescriptions a rising concern, report says, Houston Chron., Aug. 14, 1997, at A2 (reporting on New York survey which found that 76% of New York doctors and 74% of New York pharmacists polled said that they believed that drug switches diminished quality of medical care, and 57% of doctors polled had patients who had experienced adverse side effects as result of being switched); Keating, supra note 151, at 144 (describing how drug companies bombard pharmacists and doctors with information, and offers of cash payments, to prescribe their drugs); cf. Roger Parloff, The HMO Foes, Am. Law., July/Aug. 1996, at 81, 82 (describing "capitation," one of chief cost containment techniques used by HMOs, in which HMOs pay doctors flat sum per patient per year, regardless of cost of care actually provided that year, giving doctors incentive to provide least expensive medical care).

156 See Parloff, supra note 155, at 85 (reporting that between 80% and 85% of Americans under 65 get their health coverage as an employee benefit). Note that people over 65 receive their health coverage from the federal government, through Medicare. See also Powers, supra note 151, at A6 (reporting that more than 50% of Americans are enrolled in PBM administered drug plans).

157 See Green, supra note 151, at 64-65 (citing data that indicated that patients of HMOs with more restrictive formularies had greater number of emergency room visits and days of hospitalization than patients of HMOs with wider range of drug choices); Headden, supra note 151, at 74-75 ("A growing body of medical literature shows that limited access to prescription drugs actually *raises*, rather than reduces, overall medical costs.").

tient choices.[158] However, the updating of section 13c may have helped conceal pricing behavior that was evidence of other anti-competitive practices,[159] and by shielding these practices, contributed to the drug pricing crisis that is now occurring. A nondynamic reading of section 13c might have helped the questionable pricing practices of the pharmaceutical industry come to light sooner.

Unfortunately, at present there is no theory to help courts decide when dynamic statutory interpretation is appropriate. Except for pure ideologues, most interpreters can see value in each of the major interpretive theories, and recognize that originalism, textualism, and dynamism can each have a role in the interpretation of an ambiguous statutory term or phrase. The following section begins the process of deciding when each interpretative method is appropriate by proposing a theory for the interpretation of obsolete statutes.

C. A Theory of Interpretation for Changed Circumstances

This Note suggests that dynamic interpretation, as proposed by Eskridge and Calabresi, should be rejected when a court faces ambiguities in an obsolete statute. Rather than offering an updated interpretation and inviting the legislature to overturn it, or overturning a statute and inviting the legislature to reenact it, this Note proposes that narrow interpretation of obsolete statutes is the best way to effect "a shift in the burden of inertia"[160] and force legislative reconsideration of statutes that may no longer have majority support because of radically changed circumstances. Narrow interpretation of obsolete statutes limits these statutes to their original scope, thereby notifying the legislature that these statutes have fallen out of step with the surrounding legal landscape. Once on notice, the legislature can adjust these statutes to meet current circumstances, or leave these statutes to fade away as the situations to which they apply disappear.

The changed circumstances theory proposes a two-step analysis. First, the interpreter must evaluate the degree to which the statute is a victim of changed circumstances. This requires consideration of the factors that Calabresi used to identify obsolete statutes.[161] If a statute shares most of the qualities that identify an obsolete statute, then the

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158 See Prescription Drugs I, No. 94-C897, 1994 WL 240537, at *1 (N.D. Ill. May 27, 1994) (summarizing allegations of plaintiffs).

159 See Stephen W. Schondelmeyer, Competition and Pricing Issues in the Pharmaceutical Market, PRIME Inst., Aug. 1994 (arguing that pharmaceutical market is not competitive and that price discrimination evidences monopoly power) (on file with the *New York University Law Review*).

160 Calabresi, supra note 12, at 141.

161 See supra text accompanying notes 127-129 (discussing factors used to identify obsolete statutes, including changed circumstances, age, and academic criticism).

interpreter should construe the statute as nearly as possible to its original meaning.[162] This Note advocates the use of a combination of originalist and textualist theory in this endeavor, allowing courts to consider the plain meaning of the terms, context, originalist sources, and history in order to resolve ambiguities. For guidance, the interpreter should also consider the meanings of terms in the most narrow body of law to which the obsolete statute belongs.[163] However, if the statute seems to be in conflict with its general body of law, ambiguities should be resolved so that the statute applies as narrowly as possible.

Changed circumstances theory advocates a combination of textualism and originalism because each of these methods alone fails to consider certain classes of information. Textualism rejects the premise that the meaning of statutory language can be illuminated by reference to legislative history.[164] This prescription seems to "throw out the baby with the bath water." Pure originalism, however, focuses almost exclusively on legislative history and other indications of "statutory intent." Criticisms from public choice theorists have demonstrated that attempts to determine statutory intent are often inconclusive, leading interpreters to create intent and purpose when none existed or can be determined.[165]

However, when used as one part of the general pool of information from which to gather interpretative suggestions, legislative history can offer some guidance as to the meaning of ambiguous terms. Instead of reading legislative history for clues as to the specific intent of the drafters or the general purpose that the legislation was intended to

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[162] See Easterbrook, supra note 139, at 61 (distinguishing "original meaning" from "original intent").

[163] Textualism plus legal context has been advocated by Justice Scalia, and termed "holistic textualism" by Eskridge. See Eskridge, supra note 136, at 42. Scalia has suggested that:

> The meaning of terms . . . ought to be determined . . . on the basis of which meaning is (1) most in accord with context and ordinary usage [at the time] . . . and (2) most compatible with the surrounding body of law into which the provision must be integrated—a compatibility which, by a benign fiction, we assume that Congress always has in mind.

Id. (quoting Green v. Bock Laundry Mach. Co., 490 U.S. 504, 528 (1989) (Scalia, J., concurring)).

[164] Scalia rejects the use of legislative history because it allows the legislature to avoid enacting controversial laws by placing the meaningful sections in committee reports with the intent that courts will discover the omitted language and read it back into the statute. This outcome would violate the separation of powers, which Scalia describes as "'more sacred than any other [principle] in the Constitution.'" Karkkainen, supra note 139, at 425 (alteration in original) (quoting Proceedings of the Administrative Law Section's 1976 Bicentennial Institute on Oversight and Review of Agency Decisionmaking, 28 Admin. L. Rev. 569, 686 (1976) (remarks of Antonin Scalia)).

[165] See Eskridge, supra note 136, at 13-47.

serve, legislative history can be used to determine how specific terms were used in the discussions of the statute or to understand the context in which the statute was proposed and enacted. Based on this information, the interpreter can generate an interpretation that accords generally with the circumstances surrounding enactment.

As was described above, the changed circumstances theory should be used only to interpret obsolete statutes. In Part III.A., this Note argued that section 13c is an obsolete statute, primarily because it is meant to regulate a world that no longer exists. Therefore, this theory can be applied to generate a narrow interpretation of section 13c that is most in line with the original meaning of the statute.

The first issue in interpreting section 13c concerns the types of organizations that qualify for the exemption. Two of the named institutions,[166] churches and public libraries, continue to fill a role quite similar to that which they held when the statute was written. Therefore, they should continue to qualify for section 13c's benefits. Colleges, universities, and schools operate in a different manner than they did 60 years ago. Private nonprofit colleges and elementary schools compete with public schools for students. However, none of these organizations compete with for-profit enterprises, leaving them in a comparable position in the economy today as they were in 1938.[167] Therefore, section 13c should apply to them as well.

Hospitals, however, should not receive section 13c's benefits automatically. They have changed too dramatically for any interpreter to be able to read the modern hospital into a statute that applied to the old institution. That kind of broad policy decision must rest with a legislature. However, individual hospitals should still be able to qualify if they can prove that they function as traditional charitable organizations. Similarly, "charitable" should not be interpreted using the current tax law definition of the term. Since there is no sign from its enactors that section 13c was intended to track tax law changes, the term "charitable" should be read in its colloquial form as "assistance of the needy."[168] Therefore, nonprofit HMOs should qualify to make

166 See supra text accompanying note 46 (listing named institutions).

167 Recent developments suggest that the education market will be the next part of the nonprofit sector to experience direct competition between for-profits and nonprofits. See James K. Glassman, Seer Ambition: You Can Pick Future Stock Stars, Wash. Post, Mar. 30, 1997, at H1 (reporting that 106 for-profit education firms already trade on public exchanges and predicting that for-profit education will be major economic force in 10 years); Tyra Lucile Mead, Napa Joins Experiment With For-Profit Schools, S.F. Chron., Jan. 20, 1998, at A1 (describing Edison Project, for-profit firm that manages public schools and that now has 25 partner schools nationwide and plans another 15 this year).

168 See supra text accompanying note 104 (discussing colloquial meaning of "charitable").

purchases under section 13c only if they can prove that they donate significant amounts of time and resources to charity care.

The second issue in interpreting section 13c concerns the reading of "supplies for their own use." The legislative history cited in *Abbott Laboratories*, which reveals that the bill contained language that would have restricted the exemption to "sales to nonprofit institutions 'supported in whole or in part by public subscriptions,'"[169] does suggest that the exemption was not meant to ban resale of products purchased under section 13c. However, it is not clear why this language was struck from the statute or what alternative sources of income were intended to be covered. It is possible that the language was struck to allow the exemption to apply to organizations that receive support from commercial activities. But it also might have been struck because it was considered redundant.

Additionally, the composition of the nonprofit sector in 1938 suggests that resale would not have been a major concern, as most of the named institutions served populations that could not pay for the institutions' services, let alone purchase items from a related commercial business.[170] Further, the legislative history suggests that section 13c was enacted on the assumption that it would not interfere with competition because the named institutions did not compete with for-profit businesses.[171] Given these expectations, it seems closest to the original meaning to allow resale, and certainly resale at a profit, only so long as for-profit firms are not engaged in the same line of business. If for-profits are in the same market, then the purchases must be consumed by the nonprofit in providing its service.

An example might help clarify this interpretation. For a public library, which would normally qualify for a section 13c exemption, books purchased at discriminatorily low prices for loan to the community would be a "supply for their own use." However, if the library decided to open a children's bookstore and sell books to support its programs, it would have to forego the exemption for such purchases. The library could still sell the books at prices below that of a for-profit book store because the library would not be subject to income tax.[172] Also, consumers might choose to purchase books at the library in order to support the programs. But the library would not be able to buy the books at prices significantly lower than those offered to a commer-

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169 Abbott Lab. v. Portland Retail Druggists Ass'n, 425 U.S. 1, 13 (1976) (quoting 83 Cong. Rec. 6065 (1938)).

170 See supra text accompanying notes 56-58.

171 See supra note 54 and accompanying text.

172 See supra notes 61 and 65 (discussing unrelated business income tax).

cial bookstore because this would unfairly disadvantage a direct for-profit competitor.

In the health care arena, a narrow reading of section 13c would not cover purchases of pharmaceuticals by nonprofit hospitals and HMOs for resale to their patients. Assuming that nonprofit hospitals or HMOs could qualify for section 13c protection, their purchases would be limited to those items that they consume in the process of providing their service, as any other discriminatorily priced purchases would give them an unfair advantage over for-profit firms in their field.

The most obvious criticism of this interpretation of section 13c is that it opens these pricing behaviors to the scrutiny of the Robinson-Patman Act, which itself is at best, obsolete, and at worst, reviled.[173] However, given the narrow constructions that the Robinson-Patman Act generally has received from the courts, the absence of the section 13c exemption does not guarantee the application of the Act to every transaction by nonprofits. Further, reading section 13c so that it remains compatible with another potentially obsolete statute serves to highlight the ill fit of the exemption statute and its need for revision or repeal. Since the changed circumstances theory seeks only to draw attention to obsolete statutes, leaving their rewriting to the legislature, interpreting statutes in a manner that camouflages their flaws would thwart the goals of this interpretative theory. Therefore, in this case, the ambiguities in the exemption should be construed in light of the Robinson-Patman Act. More generally, when faced with ambiguities in an obsolete statute, the interpreter should construe these portions of the statute to conform to the narrowest body of law to which the statute belongs. Then, the flaws of the statute will be most obvious.

CONCLUSION

This Note argued that section 13c, the exemption from the Robinson-Patman Act, is being improperly interpreted by the courts and is therefore protecting behavior that should be governed by the Act. Specifically, this Note focused on an ongoing controversy involving pharmaceutical pricing, nonprofit HMOs, and retail druggists.

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173 For lists of some of the hundreds of pieces commenting on the Act, see Kintner & Bauer, supra note 51, § 31.1, at 689 n.5; id. at 70-71 (Supp. 1998).

The most damning critique of the Act came from the Department of Justice in 1977. See U.S. Dep't of Justice, supra note 23. The report concluded that the Act encouraged the type of oligopolistic industries that the rest of antitrust law was designed to prevent. The report also condemned the Act for preventing initiation of the competitive struggle that benefits consumers with more efficient operations and lower prices. See id. at 256-57.

The Note began by examining the forces that led to the passage of the Act and then of the exemption. The Note then explained how the circumstances that had inspired adoption of the exemption have changed, so that the purpose intended to be served can no longer be accomplished. The interpretations of section 13c supplied by the courts were reviewed, and this Note concluded that, in an attempt to align the statute with current conditions, the courts had generated an interpretation of the exemption that changed the scope and effect of section 13. However, the courts gave no explanation of what justified their updating the statute, and in fact, the new interpretation of section 13c produced undesirable outcomes.

This Note then argued that these negative outcomes were the result of two factors: the statute's obsolescence and the courts' inappropriate use of dynamic interpretation. Therefore, this Note proposed a theory to help courts choose among the various theories of interpretation, called the changed circumstances theory. The changed circumstances theory identifies one situation in which dynamic theories of interpretation should be rejected—when the court is faced with statutes that no longer correspond to the circumstances upon which they act. Rather than advocating greater judicial discretion to update out-of-touch enactments, this Note proposed that textualist and originalist theories be used to interpret obsolete statutes, generating narrow interpretations of the language of such statutes in order to alert the legislature to these statutes' conflict with current norms. Finally, this Note applied the changed circumstances theory to section 13c. A narrow reading was generated which limits the exemption's benefits to traditional charities, and only for purchases for resale that do not put the nonprofits in direct competition with for-profit firms.

Ideally, the changed circumstance theory of interpretation releases any single interpreter from the burden of deciding how an obsolete statute should be rewritten to bring it in line with present circumstances. Instead, the interpreter is asked to read the statute as closely as possible to its original boundaries, inviting the legislature to expand or repeal the statute if it disagrees with the court's narrow reading. This interpretive scheme preserves legislative supremacy and offers some predictability in interpretation. It also avoids the unbridled discretion that characterizes dynamism and other theories that attempt to interpret obsolete statutes. Finally, this theory constrains obsolete statutes so that they affect as narrow a range of circumstances as possible. Therefore, even if the legislature fails to act, the class of behavior regulated by the obsolete statute is greatly diminished and the fewest actors are governed by a rule intended for circumstances that no longer exist.