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Editor's Report

As antitrust lawyers converge on Washington for the Antitrust Section's Annual Spring Meeting, we are pleased to offer a new edition of the *Chronicle*. This edition features three articles, including an economic perspective of competitive issues left unresolved in the Seventh Circuit's *Omnicare* decision, the implications of Cephalon's motion to compel patent litigation settlement data underlying FTC studies relied on in the Provigil antitrust litigation, and a summary of the 2010 Horizontal Merger Guidelines and potential implications for mergers in the health care industry.

In our lead article, David Argue, John Gale, and Kent Mikkelson of Economists, Inc., provide an economic perspective of the Seventh Circuit's decision in the *Omnicare v. UnitedHealth Group* case. The authors posit the argument that even assuming the alleged pre-merger conspiracy between UnitedHealth and PacifiCare had existed, the alleged conduct could not have harmed competition or resulted in antitrust injury.

The second article, by Gorav Jindal and Brian Savage of Dechert LLP, analyzes the potential implications of Cephalon's recent motion to compel production of underlying patent litigation settlements relied on by the FTC in its lawsuit challenging the Provigil reverse-payment patent settlement.

The third article, by Amy Kaufman, provides an overview of the 2010 Horizontal Merger Guidelines and analyzes the potential implications for mergers in the health care industry.

We are always interested in hearing from our committee members. If there is a topic that you would like to see covered in an article or a committee program, please contact Seth Silber (ssilber@wsgr.com) or Christi Braun (cjbraun@ober.com). If you are interested in writing an article for the *Chronicle*, please email us at tweir@bakerdonelson.com or jeff.white@weil.com.

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What's Inside

What Was Left Unsaid in *Omnicare* About Harm to Competition

By David A. Argue, John M. Gale, and Kent W Mikkelsen[1]
Economists, Inc.



The Seventh Circuit recently affirmed a lower court decision granting summary judgment to defendants in *Omnicare, Inc. v. UnitedHealth Group.* Among other things, plaintiff alleged a complex "gun-jumping" conspiracy by UnitedHealth Group ("United") and PacifiCare Health Systems ("PacifiCare") to extract below-competitive rates from Omnicare for the provision of institutional pharmacy services.[2] Although the matter also presented the question of whether the alleged behavior could have constituted antitrust injury, both courts focused on the likelihood of a conspiracy and made no findings about competitive effects.[3] Ultimately, both courts found that PacifiCare's behavior was consistent with economically rational unilateral action and that Omnicare presented insufficient evidence to infer an agreement between United and PacifiCare. A review of the courts' findings about the alleged conspiracy is interesting in itself, but understanding why competition would not have been harmed even if the defendants had acted as alleged is important as well.

Background

Omnicare's allegations arose in the context of a June 2005 agreement between health insurers United and PacifiCare to merge, a transaction that was ultimately completed in December 2005.[4] In the intervening months, both firms were preparing to offer insurance under the Medicare Part D prescription drug program, which would commence in January 2006. To obtain government approval to offer Part D insurance, United and PacifiCare were both required to assemble a network of pharmacies from which their enrollees could obtain prescriptions. The networks needed to include institutional pharmacies like Omnicare that deliver drugs to patients in long-term care ("LTC") facilities. United brought Omnicare into its network through a contract with payment rates favorable to Omnicare. PacifiCare and Omnicare, however, failed to reach an agreement. Subsequently, PacifiCare obtained government approval of its pharmacy network without including Omnicare.[5]

[1] David A. Argue is a Principal at Economists Incorporated in Washington, D.C. He submitted expert reports and provided deposition testimony on behalf of defendants. Senior Vice President Kent W Mikkelsen and Vice President John M. Gale assisted with the analysis.

[2] Omnicare, Inc. v. UnitedHealth Group, 629 F.3d 697 (7th Cir. 2011).

[3] Omnicare asserted that its allegations amounted to a per se violation of the Sherman Act which, if accepted by the courts, would have rendered moot an analysis of competitive effects.

[4] The background and facts in this article are all taken from the Seventh Circuit opinion in which the court construed all inferences in favor of the non-moving party, Omnicare.

[5] *Omnicare,* 629 F.3d at 699-700.

In October 2005, Omnicare interpreted an email from United to mean that after the merger, PacifiCare would maintain its own pharmacy network, which would include Omnicare only if a separate PacifiCare-Omnicare contract were signed. As a result, Omnicare contacted PacifiCare in early November 2005 and asked for its "best offer." PacifiCare sent back its standard first-offer contract, which Omnicare signed without any counteroffer or amendment.[6] Importantly, a provision of the contract permitted PacifiCare to invite any other insurer to join the contract and pay the same rate as PacifiCare.[7] After the merger, United learned about the PacifiCare-Omnicare contract, which was more favorable than the United-Omnicare contract. United then informed Omnicare that United would join the PacifiCare-Omnicare contract. Omnicare filed suit, alleging fraud and various antitrust violations.[8]

Alleged Conspiracy

Among Omnicare's antitrust allegations was the claim that, prior to consummation of the merger, United and PacifiCare conspired to pay below-competitive rates to Omnicare.[9] Omnicare had scant, if any, direct evidence, but it argued that a conspiracy could be inferred from the actions of PacifiCare and United. Omnicare's inference might have been sustained if it were able to show that PacifiCare's behavior was inconsistent with economically rational unilateral action.[10] According to Omnicare, PacifiCare and United agreed prior to the merger that PacifiCare would refuse to negotiate with Omnicare for any rate other than the relatively low rate contained in PacifiCare's standard first-offer contract. Omnicare argued that this supposed no-compromise position was not in PacifiCare's unilateral interests because PacifiCare allegedly incurred enormous risks by adhering to that position and proceeding without Omnicare in its network.[11]

The risks alleged by Omnicare were three-fold. First, Omnicare claimed that, PacifiCare might not obtain government approval to offer Part D insurance without Omnicare in its network. Second, Omnicare also claimed that PacifiCare's Part D business might be severely damaged when PacifiCare enrollees in LTC facilities served exclusively by Omnicare were unable to get their medications. Third, Omnicare alleged that United might respond to either of these events by canceling the merger or renegotiating the merger on terms less favorable to PacifiCare than if PacifiCare had a successful Part D business.[12] Omnicare argued that PacifiCare would not have tolerated these risks if it were acting independently, but under the alleged conspiracy with United it would have a "safety net" to sustain its alleged inflexible bargaining position.[13] This safety net allegedly enabled United to bring Omnicare into the PacifiCare network through the United-Omnicare contract if no PacifiCare-Omnicare agreement were reached. United allegedly furthered the conspiracy through a deceptive email that caused Omnicare to sign the PacifiCare contract.[14] Omnicare alleged that the

[6] *Id.* at 702.

[7] *Id.* at 702-03.

[8] *Id.* at 703.

[9] *Id.* at 704, 707; First Supplemental and Amended Complaint, Omnicare, Inc. v. UnitedHealth Group, (U.S.D.C. E.D. Ken.) (Civil Action No. 06-103-WOB) at ¶¶ 6, 72, 75.

[10] *Omnicare*, 629 F.3d at 707, 714.

[11] *Id.* at 714-15, 720-21.

[12] Omnicare, Inc. v. UnitedHealth Group, 594 F. Supp. 2d 945, 965 (U.S.D.C. N.D. Ill. 2009).

[13] *Omnicare*, 629 F.3d at 714-15.

[14] *Id.* at 715-16; First Supplemental and Amended Complaint at ¶¶ 87-91.

conspiracy resulted in Omnicare's receiving rates from United and PacifiCare that were ostensibly below-competitive levels and lower than rates paid by any other major insurer.[15]

To avoid summary judgment, Omnicare had to produce evidence that "tend[ed] to exclude the possibility that the alleged conspirators acted independently rather than in concert."[16] Neither court agreed with Omnicare's arguments. Both concluded, among other things, that PacifiCare could reasonably have been following a tough negotiating strategy on its own, not in coordination with United. Ultimately, Omnicare simply signed the PacifiCare contract without attempting to negotiate a higher payment rate. The rationality of PacifiCare's actions did not depend on the existence of a conspiracy-induced safety net. Indeed, the Appeals Court determined PacifiCare did not need a safety net at all since, if necessary, it could simply have signed with Omnicare after Medicare Part D started.[17] Nor did the supposed safety net of the United contract protect PacifiCare if it did not get a contract with Omnicare. The court determined that PacifiCare could not rely on United's contract with Omnicare because the United-Omnicare contract required Omnicare's consent to add PacifiCare.[18] Furthermore, if PacifiCare's negotiating strategy had damaged its Part D business, an illegal PacifiCare-United conspiracy would not have prevented United from backing out of or renegotiating the merger agreement. Moreover, the mere existence of a low payment rate does not imply that it was necessarily a below-competitive rate achieved by a conspiracy. Omnicare had other contracts with lower rates for which no allegations of conspiracy were raised. In addition, PacifiCare's low rate can readily be explained by Omnicare's failure to negotiate for a higher one.[19]

How Competition Might Be (But Wasn't) Harmed

Omnicare claimed that the alleged conspiracy between United and PacifiCare harmed competition in the purchase of institutional pharmacy services, but closer consideration reveals that there was no risk of such harm. It is true that absent the merger, United and PacifiCare would have competed as prescription drug plans to sell Medicare Part D insurance to enrollees, and they would have competed to purchase institutional pharmacy services on enrollees' behalf. The competition between them, however, is incidental, not essential, to Omnicare's complaint. The same effects that are central to Omnicare's antitrust arguments could have occurred if the firms had not been competitors in output or input markets. Even if one assumes that the alleged agreement existed and the allegedly improper information sharing took place, no competitive issues are raised by Omnicare's allegations.

An important feature of the market for institutional pharmacy services is that those pharmacies often simultaneously serve multiple prescription drug plans and may do so at different rates. Since prescription drug plans do not necessarily need to match the prices offered by other plans, and since a plan can invite an institutional pharmacy into its network even if the pharmacy already is in another plan's network, it may be hard to discern that prescription drug plans compete at all as

[15] *Omnicare*, 629 F.3d at 717.

[16] *Id.* at 707 (citing Miles Distribs. v. Specialty Constr. Brands, 476 F.3d 442, 449 (7th Cir. 2007)).

[17] *Id.* at 714.

[18] *Id.* at 715.

[19] *Id.* at 717-18.

purchasers of institutional pharmacy services. In fact, plans compete indirectly as purchasers of institutional pharmacy services through plans' competition for enrollees in the output market.

The basis of competition among prescription drug plans to attract enrollees is the price (premium and co-payment) and quality of the service they offer to enrollees. Included among the quality features are the menu of approved pharmaceuticals as well as the breadth of the network of retail pharmacies and of the network of institutional pharmacies that provide medications to enrollees in LTC facilities. A broader network of institutional pharmacies enables an enrollee to be more confident that she will be able to choose an LTC facility without worrying about whether she will have to change Part D insurance to get prescriptions. If a prescription drug plan offers rates too low to attract a particular institutional pharmacy into the plan's network, the plan risks losing some potential enrollees who will instead obtain coverage from a rival plan that does include that institutional pharmacy in its network. Prescription drug plans with which the pharmacy reaches agreement will tend to add enrollees while plans with which it does not reach agreement will tend to lose enrollees, all else equal. Thus, competition among plans to attract enrollees provides a competitive check on the rates that plans offer to institutional pharmacies.

To understand why the agreement alleged by Omnicare, even if proven true, would have had no competitive effects, it is helpful to consider different scenarios in which an agreement between two prescription drug plans *might* harm competition. Suppose a single prescription drug plan with a relatively small share of enrollees decides not to pay institutional pharmacies more than a very low rate. As a consequence, few pharmacies join the plan's network, and the networks of other plans become comparatively more attractive to enrollees. The prescription drug plan loses enrollees in this example, making the decision to pay no more than the low rate unprofitable. Presumably the prescription drug plan will relent and offer higher rates if it has not already been forced to exit the market.

Now consider if the prescription drug plan were to collude with a competing prescription drug plan and agree that both plans would refuse to offer higher reimbursement rates. Since the second prescription drug plan will also be excluding any institutional pharmacy that will not sign at the low rate, the breadth of the pharmacy network of the second plan is reduced.[20] For this reason, the first plan suffers a smaller loss of enrollees than it would have suffered if the second plan had not entered the agreement.[21] In this case, the collusion between the prescription drug plans may enable them to enlist some pharmacies that would otherwise have been unwilling to participate in their networks at the low rate, but other pharmacies may nevertheless decline to participate. Consumers might be harmed in this illustration because the collusion restricts the number of prescription drug plans that offer the broad networks that were achievable by offering higher reimbursement rates.[22] When this

[20] The collusive agreement about input rates can be considered as analogous to an agreement in the output market not to offer a broader network than can be obtained offering the low rate.

[21] It is possible that the prescription drug plan options available to enrollees other than the two plans are unattractive, so much so that few enrollees will move from the two plans to the other plans even if the two have restricted networks.

[22] If sufficient alternative prescription drug plans remain available outside of the collusive group, competition would remain unharmed.

restriction occurs, it becomes more profitable for prescription drug plans participating in the collusion to offer only the low rate. When two plans participate in the restriction, each loses fewer enrollees to rival plans offering broader institutional pharmacy networks. In other words, the collusion can create market power.

The alleged agreement between United and PacifiCare is markedly different from the (potentially) anticompetitive collusion between two prescription drug plans just described. Omnicare alleged that United and PacifiCare entered an agreement under which United assured PacifiCare that PacifiCare could use the United-Omnicare contract as a backstop to give PacifiCare enrollees access to Omnicare in the event that PacifiCare did not sign a contract with Omnicare. Unlike in the hypothetical example, United already had a contract with Omnicare. Hence, the alleged agreement between United and PacifiCare did not involve United refusing to reimburse Omnicare except at a low rate. Furthermore, United did not agree that it would offer a network without Omnicare, which might have made it more possible for PacifiCare to offer a non-Omnicare network without losing too many enrollees.

An argument might be raised that for United to switch enrollees from the higher-price United-Omnicare contract to the lower-price PacifiCare-Omnicare contract after Medicare Part D was launched in January 2006 was itself an exercise of monopsony power. In fact, this switching had nothing to do with monopsony power. It neither required nor created monopsony power. The only conditions necessary for the switching to succeed were for United and PacifiCare to have contracts with Omnicare and to merge, regardless of their size individually or jointly. Of course, the lower-cost contract (PacifiCare's) must allow United to switch its enrollees to that contract without Omnicare's consent, but this contract feature also did not result from market power.

It becomes even more apparent that the alleged agreement was not anticompetitive when one realizes that any effect the alleged agreement might have had did not depend on United and PacifiCare being competitors. To see that this is the case, consider a further hypothetical case of two prescription drug plans, North Plan and South Plan. Suppose, as the names suggest, North Plan operates only in the North and has government certification only in that region, while South Plan is similarly restricted to operate only in the South. Since they are not seen as alternatives by any enrollees, these two prescription drug plans do not compete in their respective output markets selling Part D prescription drug coverage. Because they do not compete in sales to enrollees, the composition of their pharmacy networks is not relevant for competition between them. Suppose further that North Plan has already contracted with Omnicare for institutional pharmacy services. During this contract period, Omnicare does not have the option to expand its sales to North Plan as a way to resist price demands by South Plan. Hence, the two plans are not competing in purchasing institutional pharmacy services.

Now suppose that, except for the firms' geographic areas of operation, the facts and allegations related to United and PacifiCare are applied to North Plan and South Plan, respectively. Though North Plan and South Plan would not be competitors in this example, the rest of the effects of the alleged agreement would not be altered. North Plan and South Plan could still contemplate and then complete a merger. Although it would not compete with South Plan, North Plan would be no less able to offer South Plan the alleged safety net by which, post-merger, South Plan's enrollees would have

access to Omnicare through a contract with North Plan (at North Plan's existing prices) in the event that South Plan did not sign a contract with Omnicare. The presence or absence of competition makes no difference to the effects of the alleged agreement. But if North Plan and South Plan are not competitors in output or input markets, then the alleged agreement between them could not be anticompetitive.

Another scenario that might be posited indicates that because two competing prescription drug plans were planning to merge, an agreement between them regarding the purchase of institutional pharmacy services could be anticompetitive even though one of those prescription drug plans had already contracted for pharmacy services. In this classic unilateral effects scenario, two prescription drug plans agree that one plan would offer only a low reimbursement rate to institutional pharmacies and assemble a lower-quality institutional pharmacy network. Even though the other plan had already signed contracts with the relevant institutional pharmacies (and therefore could not pledge to offer no more than the low rate), this agreement could still be anticompetitive. The first prescription drug plan would recognize that some of the enrollees it would lose as a result of offering a lower-quality network would be diverted to the second plan. Due to the impending merger, enrollees that turn from the first plan to the second are not really lost, since they are retained by the merged firm. Therefore, it would be more profitable for the first plan to reduce its institutional pharmacy reimbursement rates and offer a lower-quality network than if the two firms were not to merge.

This sort of unilateral effects mechanism is, however, entirely different from the mechanism alleged by Omnicare. In this hypothetical scenario, a merger between two competing prescription drug plans potentially has anticompetitive effects because some enrollees from one plan, who view the other plan as their best alternative, will move to the other after the exercise of market power. Unlike that scenario, the agreement alleged by Omnicare does not depend on subscribers switching from one prescription drug plan to another because of differences in networks. To the contrary, the logic of Omnicare's theory is that United had no concerns that PacifiCare would lose any subscribers since all United and PacifiCare subscribers would have access to Omnicare regardless of whether Omnicare signed PacifiCare's contract.

Conclusion

The *Omnicare* appeals decision comports with well-established precedent on proof of a conspiracy. Omnicare's arguments failed to persuade either court that PacifiCare's actions were economically rational only in the context of a conspiracy with United. Thus, the courts granted the defense summary judgment on the conspiracy allegations. Nevertheless, some interesting antitrust issues as to whether the alleged behavior could have even constituted antitrust injury were not addressed. The nature of competition among prescription drug plans is such that competition in the purchase of institutional pharmacy services is a by-product of competition for enrollees. The conspiracy alleged by Omnicare simply did not fit the facts necessary for harm to competition to occur.