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A BRIEF ANALYSIS OF POLICY AND LITIGATION

Second Circuit Affirms Dismissal of Adderall Pay-For-Delay Suit

Robert D. Stoner

EI Principal Robert D. Stoner has consulted in a number of instances about matters concerning branded vs. generic competition in pharmaceuticals.

The Second Circuit recently upheld the dismissal of a suit challenging an alleged anticompetitive refusal to deal involving a branded pharmaceutical. Plaintiffs, a class of indirect purchasers, argued that a 2006 settlement of patent infringement litigation required Shire LLC (Shire) to provide Adderall XR, which is used to treat attention deficit disorder, to authorized generic marketers Teva and Impax. Shire allegedly provided significantly lower quantities of Adderall than the settlement required. Plaintiffs contended that Shire's delivering insufficient quantities was an antitrust violation.

The court found that "the complaint does little more than attach antitrust 'labels and conclusions' to what is, at most, an ordinary contract dispute." Moreover, the Plaintiffs were drug wholesalers, not parties to the agreement. Those parties had separately settled their dispute over quantities supplied. Plaintiffs argued that the original patent settlement agreement created a "duty to deal" under Aspen Skiing. The court, however, cited several factors that distinguished this case from Aspen Skiing. In particular, there was no unilateral termination of a voluntary, and presumably profitable, prior course of dealing that would suggest sacrifice of short-term profits for long-term monopoly gain.

Plaintiffs could have argued that the Adderall patent settlement combined with the follow-on contract settlement was anticompetitive based on the Supreme Court's recent decision in *Actavis*. That decision, which came out after the complaint was filed in the *Adderall* case but before the Second Circuit ruling, dealt with settlements of patent litigation under the Hatch-Waxman Act, which applied to *Adderall*. The *Actavis* decision established that reverse payments in those settlements could be anticompetitive and should be subjected to a rule of reason analysis. The settlement allowed for only limited entry, and plaintiffs might have argued that the patent and later contract settlement involved an anticompetitive restriction on entry that was similar to the anticompetitive "pay for delay" that the *Actavis* decision recognized as a possibility.

Plaintiffs, however, explicitly told the court that their appeal did not rely on the *Actavis* decision, even though Shire argued that it did. Moreover, plaintiffs did not allege that the *Adderall* patent settlement was anticompetitive. (Plaintiffs might have been influenced by the FTC's decision not to challenge that settlement.) In fact, Plaintiffs contended that the settlement, by allowing for future entry, was procompetitive, but they alleged that the procompetitive potential of the settlement had not been attained because Shire had not abided by its terms. It was that allegation that the court found was a contract, not an antitrust issue.

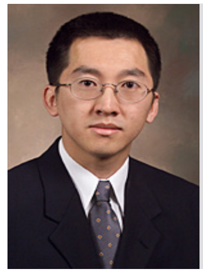
Also In This Issue

Conditional Pricing: The Next Frontier of Antitrust Enforcement?
Su Sun discusses the competitive analysis of conditional pricing, which was the subject of a recent workshop run by the Federal Trade Commission and the Antitrust Division of the Department of Justice. Conditional pricing includes two types of pricing discounts: (1) discounts or rebates offered on a bundle of multiple products but not available on separate purchases of products in the bundle; and (2) loyalty discounts or rebates given on single product purchases that exceed a specified share or volume. Conditional pricing is a common business practice that often results in lower prices for customers but that in some circumstances may exclude competitors and protect or extend market power. There appears to be no bright-line test that would distinguish between competitive conditional pricing and anticompetitive discounts. Currently, the most frequently cited test is the price-cost test.

Assessment of Merger-Related Efficiencies Challenged
Allison I. Holt discusses FTC Commissioner Wright's recent criticism of the Commission's method of assessing merger-related efficiencies. The criticisms came in his dissent concerning the Commission's review of the Ardagh Group's proposed acquisition of Saint-Gobain Containers. Commissioner Wright argued that the burden of proof required of the parties in establishing efficiencies should be the same as the burden of proof required of the agencies in establishing anticompetitive effects. Requiring that efficiencies "be proven," while accepting "probabilistic predictions" of harms, could harm consumer welfare. The Commission majority, in response to Wright's dissent, disagreed with his concerns that it engaged in an asymmetric treatment of efficiencies. It contended that it often gives great weight to efficiencies in merger investigations.

Conditional Pricing: The Next Frontier of Antitrust Enforcement?

Su Sun



Su Sun has worked on merger, pricing fixing and abuse of dominance cases, including those involving conditional pricing. He has expertise in China's antitrust issues and has made presentations before China's Ministry of Commerce (MOFCOM).

Conditional pricing includes two types of pricing discounts: (1) discounts or rebates offered on a bundle of multiple products but not available on separate purchases of products in the bundle; and (2) loyalty discounts or rebates given on single product purchases that exceed a specified share or volume. Conditional pricing is a common business practice, but it is controversial, and different U.S. courts have used different criteria in judging its legality. Recently, the Federal Trade Commission and the Antitrust Division of the Department of Justice held a one-day public workshop to explore the economics and legal policy implications of conditional pricing.

There is no consensus in analyzing bundled or loyalty discounts in U.S. case law. In *LePage's, Inc. v. 3M* (2003), 3M had a dominant share in the market for transparent tapes, but private label products were emerging as a competitive threat. 3M responded by making its own private label tapes. Since 3M also made other office products, including its branded Scotch tapes, it offered discounts to stores that purchased bundles that included its private label tape. LePage's could not match that strategy due to its limited product variety. The 3rd Circuit found that 3M's bundled pricing strategy was to exclude LePage's from the transparent tape market by leveraging 3M's monopoly power in other products. The 3rd Circuit ruled against 3M on the basis of exclusion, not predation.

> "There appears to be no bright-line test that would distinguish between competitive conditional pricing and anticompetitive discounts."

This exclusion-based standard adopted by the 3rd Circuit was much criticized. In 2007, the Antitrust Modernization Commission (AMC) suggested a different test that focused more on predation than exclusion. The AMC's test required a plaintiff to show three things. First, the defendant sold the competitive product below its incremental cost after all discounts and rebates attributable to the bundle of products were allocated to the competitive product. Second, the defendant likely would recoup the losses from the below-cost pricing. Third, the bundled discounts likely would harm competition.

The AMC's price-cost test was adopted in the 9th Circuit's decision in *Cascade Health Solutions v. PeaceHealth* (2007). McKenzie and PeaceHealth were the only providers of hospital care in Lane County, Oregon. Both offered primary and secondary care, but only PeaceHealth offered tertiary care. McKenzie claimed that it was more efficient in providing primary and secondary care and it could not compete because PeaceHealth offered discounts on tertiary care to insurers only if they made PeaceHealth their sole preferred provider for all three services. The 9th Circuit adopted the first prong of the AMC's three-pronged test to allocate total discounts to the competitive product. The 9th Circuit's requirement of a showing of below cost pricing in this case is consistent with the Supreme Court's decision in *Brooke Group v. Brown & Williamson Tobacco Corp*. (1993) that a plaintiff must show that a rival's discounted price falls below an appropriate measure of its costs.

Loyalty discounts are given to single product purchasers that satisfy specified share or volume requirements. In *ZF Meritor, LCC v. Eaton Corp*. (2012), Eaton had long-term agreements involving loyalty discounts with all the customers in the heavy-duty "Class 8" truck transmissions market. The 3rd Circuit considered these arrangements to be exclusive dealing and thus exclusionary. The 3rd Circuit rejected a price-cost test proposed by Eaton. In contrast, in *Eisai Inc. v. Sanofi Aventis U.S. LLC* (2014), the district court found the practices that the plaintiff alleged were exclusionary all came down to price, and a price-cost test was appropriate.

U.S. antitrust authorities are not the only ones scrutinizing conditional pricing. For example, the EU General Court affirmed the European Commission's (EC) decision against Intel's practice of offering rebates to PC manufacturers and to a PC retailer that were conditional on buying all or almost all of their microprocessors from Intel. While

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Assessment of Merger-Related Efficiencies Challenged

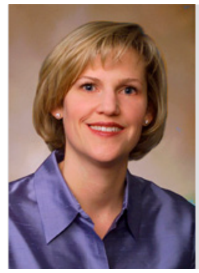
Allison I. Holt

FTC Commissioner Joshua D. Wright recently criticized the Commission's method of assessing merger-related efficiencies. The criticisms came in his expansive dissenting opinion concerning the Commission's review of the Ardagh Group's (Ardagh) proposed acquisition of Saint-Gobain Containers (Saint-Gobain). In his dissent, Commissioner Wright criticized the general methodology used by the Commission in weighing a merger's potential efficiencies against its potential harms. He explained that there is no economic reason why the burden of proof for substantiating efficiencies from a merger should be greater than the burden for substantiating harms.

In its decision, the Commission determined that the merger between Ardagh and Saint-Gobain would result in harmful unilateral and coordinated anticompetitive effects. Specifically, the Commission found that the merger would increase concentration in an already highly concentrated market that was "vulnerable to post-acquisition coordination." The Commission also considered "evidence from the parties of verifiable, merger-specific efficiencies that could offset this harm." Nonetheless, it concluded that these efficiencies "were not merger-specific and could have been achieved absent the acquisition." Further, the Commission found the parties' evidence was insufficient to show "that the level of synergies that could be substantiated and verified would outweigh the clear evidence of consumer harm." Because the Commission voted to issue a Complaint, the merging parties agreed to create a third competitor in the relevant market by divesting six of the nine glass container plants as well as other assets of the newly merged firm to a single buyer within six months.

Commissioner Wright dissented from the decision because he found insufficient evidence that the merger would substantially lessen competition in the market. He argued that "any potential anticompetitive effect arising from the proposed merger is outweighed significantly by the benefits to consumers ... [from the] expected cognizable efficiencies." Commissioner Wright further explained the broader issues that he believed to be problematic in how the Commission generally goes about analyzing efficiency claims.

Prior to the 1997 Merger Guidelines revision, the efficiency defense was considered if the efficiencies were "significant" and the evidence supporting them was "clear and convincing." The 1997 revision more precisely defined the efficiency defense. In the revision, efficiencies would be considered "cognizable" if they were merger-specific, verifiable, and did "not arise from anticompetitive reductions in output or service." These changes were made so that mergers with a net pro-competitive effect could go through. Even with this revision, the merging parties still bore the burden of proof of efficiencies, while the agencies bore the burden of proving harms. The 2010 Merger Guidelines did not significantly change the language on efficiencies and continued to suggest that the merging parties would bear the burden of proof of efficiencies.



EI Senior Economist Allison I. Holt, an empirical microeconomist, specializes in quantitative analysis and assessment of damages in antitrust and class action matters.

In his dissent, Commissioner Wright argued that the burden of proof should be the same for both efficiencies and harms. He wrote that there is no sound economic theory to justify requiring that the burden of proof required of the parties in establishing the existence of efficiencies be higher than the burden of proof required of the agencies in establishing anticompetitive effects. Any asymmetry, such as requiring that efficiencies "be proven," while accepting "probabilistic predictions" of harms, could harm consumer welfare. The Commissioner wrote that the language of the 2010 Merger Guidelines does not require this asymmetry in determining cases, but it does "allow for this [asymmetrical] outcome in practice." The fact that the Guidelines require verifiability "could be interpreted to impose [a] stricter burden of proof than the agency is willing to accept when it comes to predictions, estimates, presumptions, or simulations of anticompetitive effects."

Commissioner Wright argued that "symmetrical treatment in both theory and practice of evidence proffered to discharge the respective burdens of proof facing the agencies and merging parties is necessary for consumer-welfare based merger policy." He concluded that "standard micro-

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Conditional Pricing

the EC performed a rule of reason analysis of Intel's pricing practice, the General Court went further to find loyalty rebates by a dominant firm, like Intel, a per se violation.

Chinese antitrust authorities are also dealing with conditional pricing. One of the three Chinese antitrust agencies, the State Administration of Industry and Commerce (SAIC), has been investigating Tetra Pak's bundled pricing of its packaging machines, packaging materials and service. Another Chinese antitrust agency, the National Development and Reform Commission (NDRC), has recently investigated Qualcomm's patent licensing practices. Part of the investigation focuses on Qualcomm's bundled pricing of its chips and patent licenses. (The Korean Fair Trade Commission (KFTC) fined Qualcomm in 2009 for bundled pricing.) The third Chinese antitrust agency, the Ministry of Commerce (MOFCOM), has imposed conditions on a recent merger prohibiting post-merger cross bundling of the merging parties' products.

Economists recognize that the use of conditional pricing as a competitive strategy often results in lower prices for customers, especially when firms adopting that pricing strategy do not possess market power. Economists also recognize that in some circumstances when firms have market power, such pricing may exclude competitors, even when competitors are more efficient, and may strengthen a firm's market dominance or extend market power from one market to another.

There appears to be no bright-line test that would distinguish between competitive conditional pricing and anticompetitive discounts. Currently, the most frequently cited test is the price-cost test. The main benefits of the price-cost test include the underlying principle that only discounts that do not allow equally efficient rivals to compete may be considered a violation of the antitrust law. However, skeptics say price is not the only dimension for competition, especially in a differentiated product market. Firms may also compete through marketing and quality. Some critics of this test argue that even less efficient competitors help lower prices for consumers, so that excluding them may be anticompetitive.

From a practical perspective, because the price-cost test is relatively straightforward, it is easier for businesses to comply with and for courts to rely on in adjudicating such disputes. Still, application of such a test may be difficult. For example, a large number of products may be included in the bundle, the pricing schemes of different bundles may be very complex, and rivals may form their own bundles in response to a dominant firm's bundling. For single product loyalty discounts, it is often difficult to determine the level of purchases the customer would have to buy from the defendant, i.e., its incontestable demand.

In general, there is a need to balance all these considerations in finding a proper test for analyzing conditional pricing. Such a test needs to be based on sound economics, and it should also be clear and administrable.

Merger-Related Efficiencies

economic analysis" should be used as a guide and that the interpretations of the Guidelines that lead to asymmetric burdens of proof "do not make economic sense and are inconsistent with a merger policy designed to promote consumer welfare." As it now stands, the high burden of proof of efficiencies essentially overwhelms the efficiency defense. While efficiencies may be part of the reasons for a merger, firms often do not get credit for these efficiencies because the burden of proof is too high. Commissioner Wright cited papers and studies arguing that "the government is accorded greater evidentiary leniency in proving anticompetitive effects than the merging parties are in proving offsetting efficiencies," and that "the efficiency defense faces an impossibly high burden."

The Commission majority, in response to Wright's dissent, disagreed with his concerns that it engaged in an asymmetric treatment of efficiencies that was ultimately harmful to consumer welfare. It contended that it often gives great weight to efficiencies in merger investigations. Determining both competitive effects and efficiencies requires a certain amount of estimation. The Commission majority argued, however, that efficiencies are harder to verify and quantify because while competitive effects data can come from a variety of sources, data on efficiencies come "almost entirely from the merging parties." The concern of the majority was that without "independent verification of this party data," this one-sided possession of information would lead to the efficiency defense dominating Section 7 enforcement. Thus, efficiencies need to be substantiated and verifiable to be cognizable. Therefore, the majority contended that the actions it ordered in the Ardagh case are consistent with the 2010 Merger Guidelines and beneficial to consumers.

EI News and Notes

Effect on Telecom Industry of Change in Local Number Portability Administrator

A report by EI Principal Hal J. Singer finds that transitioning to a new U.S. local number portability (LNP) administrator would impose costs of approximately $719 million on telecommunications firms. The change would also seriously reduce the quality of customer service. The report was commissioned by Neustar Inc., a provider of real-time information and analytics as well as clearinghouse and directory services to the telecommunications industry. Dr. Singer was assisted by EI economists Anna X. Koyfman and Kevin W. Caves.

AK Steel Acquires Assets of Severstal

The Department of Justice Antitrust Division allowed AK Steel's acquisition of certain assets of Severstal North America to proceed without a second request. The assets acquired included Severstal's Dearborn Michigan steel mill, which like AK produces a variety of flat-rolled steel products. EI Principal Joseph W. McAnneny assisted attorneys from Weil Gotshal in preparing an antitrust defense of the acquisition. EI Vice President Henry B. McFarland also assisted in preparing the defense.

Conferences on Antitrust and Intellectual Property in Asia

EI Vice President Su Sun recently spoke at the ABA Section of Intellectual Property Law's Spring Conference. At that conference, he discussed the increasing role of economic analysis in patent infringement litigation and antitrust countersuits in China. Dr. Sun also recently spoke about careers in antitrust at a conference on "Antitrust in Asia." That conference was sponsored by the ABA Antitrust Section and the Expert Advisory Committee of the Anti-Monopoly Commission of China's State Council.

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