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DOJ Decides Not to Challenge the XM-Sirius Merger

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Erica E. Greulich specializes in empirical microeconomics. She has analyzed the antitrust implications of mergers and acquisitions in a variety of industries.

The Department of Justice's (DOJ's) recent decision to close its investigation of the proposed XM-Sirius merger centered on issues of market definition and efficiencies. XM and Sirius are the only two companies licensed by the Federal Communications Commission (FCC) to provide satellite radio services in the United States. Nonetheless, DOJ found the merger, which is still pending before the FCC, is unlikely to lessen competition.

Critics describe the transaction as a merger to monopoly in the market for satellite radio providers. They argue that satellite radio's extensive programming, national scale, superior sound, and freedom from commercials place it in its own market. Merger proponents argue that satellite radio competes with other music delivery services, such as terrestrial radio, MP3 players, podcasts and music-to-cell phone providers. DOJ agreed that these services would continue to restrain satellite radio prices to competitive levels and thus rejected the critics' narrow definition of the market.

Some critics believe that DOJ should have blocked the XM-Sirius merger based on a unilateral effects theory. Such a theory would argue that XM and Sirius products are each other's closest substitutes; hence the merger would eliminate competition and enable the firm to raise prices post-merger. The Federal Trade Commission (FTC) lost a recent challenge, based on a unilateral effects theory and a narrow market definition, to the Whole Foods-Wild Oats merger. Critics suggest that the Whole Foods decision made DOJ reluctant to argue a unilateral effects theory in the XM-Sirius merger and may continue to make DOJ wary of such theories in future mergers.

DOJ's statement, however, implies a belief that a viable unilateral effects theory did not apply to this merger. XM and Sirius programs are not the closest substitutes for enough customers to make a post-merger price increase profitable. For example, for a customer interested in baseball games on XM, the closest substitute would likely be baseball games on terrestrial radio, not Sirius, which does not have baseball. DOJ also found that the merger likely would lead to significant efficiencies, and that the likelihood of significant technological change in the near future made anticompetitive effects from the merger even less likely.

Also In This Issue

Digital Television May Stimulate Video Competition

This coming February, television broadcasters must switch from analog to digital television (DTV). Scott J. Wallsten points out that the DTV transition may have significant competitive effects. The transition could make over-the-air broadcast a closer competitor to subscription services. As a result, pay service providers may face additional competitive pressure to restrain prices and to innovate. Moreover, over-the-air broadcasters may take the opportunity to develop new types of programming and business models. Evidence from the United Kingdom, which has already begun its DTV Transition, shows the potential for the transition to reshape the market. DTV may not realize its full competitive potential, however, if regulators restrict broadcasters' use of spectrum.

Granting Preliminary Injunctions to Branded Pharmaceutical Suppliers to Stop Generic Entry

Robert D. Stoner discusses the economic arguments for granting a preliminary injunction to a branded pharmaceutical supplier that wants to block the entry of a generic competitor. The FDA often approves the marketing of a generic before the issue of patent infringement has been settled. In those circumstances, the branded supplier has several strategic options, including applying to the courts for a preliminary injunction against the sale of the generic. Economic analysis suggests that branded suppliers will often be able to show the significant likelihood of irreparable harm that is usually required for an injunction. Other options that the branded supplier has, particularly a settlement in which it pays the generic not to enter, have been questioned on antitrust grounds. The arguments against those options will be undercut if courts are not willing to grant preliminary injunctions in the appropriate circumstances.

Digital Television May Stimulate Video Competition

Scott J. Wallsten

On February 17, 2009, television broadcasters must switch from analog to digital transmission. Because digital broadcast uses spectrum more efficiently than analog broadcast, the transition allowed the Federal Communications Commission (FCC) to auction 108 MHz from channels 52-69 for higher-value uses. That auction concluded in March 2008 and raised $19 billion. Channels 2-51 remain dedicated to broadcasters for digital over-the-air broadcast.

To date, the primary policy concern with the DTV Transition, as it is called, has been ensuring that viewers can continue to watch television on older analog sets. That concern is understandable from a political perspective. Americans average 4.5 hours a day watching television, and politicians will be inundated with complaints from constituents if their televisions suddenly cease functioning.

Little attention, however, has focused on the competitive implications of the transition. Analog over-the-air television is a fairly poor substitute for subscription services (cable and satellite) because of its frequently poor picture quality and the relatively small number of channels. By contrast, over-the-air digital broadcast can offer video quality equivalent to cable and satellite—including high-definition broadcast—and allows broadcasters to offer multiple channels in the amount of spectrum a single analog channel required. Thus, the transition could make over-the-air broadcast a more robust multichannel video distribution platform and a closer competitor to subscription services, thereby increasing competition in the video distribution market.

The improvements in free over-the-air broadcast have numerous potential implications for market structure and competition. Consumers—especially those who subscribe to basic services primarily for purposes of better reception—may be more willing to switch to free over-the-air broadcast. Therefore, pay service providers may face additional competitive pressure to restrain prices and to innovate. Moreover, over-the-air broadcasters may generate new types of programming and business models. Finally, these changes would call for a re-thinking of many current regulations.

EI special consultant Scott J. Wallsten has worked on a large number of telecommunications matters, including cable television, broadband, and spectrum issues in the United States, the OECD, and developing countries. He also has experience in antitrust matters in a variety of industries.

Evidence from the United Kingdom (UK) shows the potential for the transition to reshape the market. Admittedly, the video distribution market in the UK differs in many important ways from the US market. The government is more heavily involved (e.g., it owns the BBC and funds it through a license fee it charges consumers who own televisions), and far fewer residents of the UK subscribe to pay video services than in the US. As a result, the US market is unlikely to develop the same way. Nevertheless, the radical remaking of the UK video distribution market highlights the profound effects the transition can have.

Most notably, to prepare for the transition, a consortium of companies and the government created the "Freeview" service. To receive Freeview, consumers must purchase a set-top box, which ranges in price from £20 – £70 (about $39 to $138). Consumers can then receive up to 40 digital channels for no additional fee.

In 2005 Ofcom, the British communications regulator, noted that Freeview was already "changing the dynamics of the TV market" as programmers rushed to offer broadcasts over the platform. Freeview has evolved from a platform solely for free over-the-air broadcast to one that competes more directly with more traditional subscription services. Today, as with cable, consumers can also choose to subscribe to additional services offered over the air on Freeview, including pay-per-view, sports, and other pay channels.

Other competitors in the video distribution market have responded to Freeview's evolution. One satellite company now offers a free tier of service, which requires only that the subscriber purchase a dish, and another satellite provider is poised to follow suit. The DTV transition has allowed terrestrial over-the-air to become more like cable

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Granting Preliminary Injunctions to Branded Pharmaceutical Suppliers to Stop Generic Entry

Robert D. Stoner

When a prospective generic entrant challenges the patent of a branded pharmaceutical supplier, the branded supplier can ask the courts for a preliminary injunction (PI) to prevent the entry. PI requests usually follow the expiration of the Hatch-Waxman (H-W) Act's initial restrictions on entry. Courts grant a PI when (a) there is substantial likelihood of success on the merits of the patent claim; (b) there is significant likelihood of irreparable harm if the injunction is not granted; and (c) the balance of harms weights in favor of the injunction. The economic analysis of the likelihood of irreparable harm must consider the H-W Act's provisions to encourage entry, and the other strategic responses that branded suppliers have to the threat of entry.

The H-W Act gives entrants the right to challenge a patent with a Paragraph IV "abbreviated new drug application" (ANDA) filing. In such a filing, the generic drug applicant claims that relevant patents are either invalid or non-infringed by the proposed generic entry. To encourage such filings, the entrant is given a period of 180 days in which other generic suppliers will not be allowed to enter. H-W, however, also provides protections for the branded product. Upon the initial ANDA filing, the branded producer may sue for infringement, which triggers a 30-month stay period during which entry is not allowed. In a sense, the 30-month stay under the H-W Act is an injunction that takes effect immediately on the filing of a patent infringement case without requiring the brand name manufacturer to show that it is entitled to a PI.

At the end of the 30-month period the firms have several strategic alternatives. At this juncture, the Food and Drug Administration (FDA) will likely have granted approval to market the generic, but the patent infringement suit is often still pending. Accordingly, the Paragraph IV filer may decide to enter "at risk" of losing the infringement suit and incurring liability for damages. If the generic supplier enters, the branded firm may pursue one or more options. The branded firm can file for a PI to try to prevent entry, or it can try to forestall generic entry by reaching an agreement (sometimes with a reverse payment) with the potential entrant. The branded firm also may

Robert D. Stoner has expertise related to intellectual property, particularly as it relates to pharmaceuticals. He has worked on a number of cases that involve potential generic entry and strategic reactions by the established brand to such entry.

introduce an authorized generic to recapture some of the profits lost from generic entry, or establish some alternative form of its branded drug that would not be susceptible to immediate generic challenge.

Each of the branded firm's options is controversial. The FTC has repeatedly attacked payments by branded firms to forestall entry as anticompetitive, with some early success. The appellate courts have recently not upheld the FTC's position, holding that the patent laws immunize these payments from antitrust scrutiny, but the tactic nevertheless remains potentially suspect.

Similarly, opinions differ on the competitive effects of authorized generics. Some emphasize the short-term gain because authorized generics increase the number of competitors. Others emphasize possible long-term costs because authorized generics may discourage independent generic competition. The FTC is currently studying the circumstances under which authorized generics should be considered anti-competitive.

If the branded firm files for a PI, it may have a strong case for showing irreparable harm because of the manner in which branded drugs are marketed, and the effect of generic entry on branded profits. Branded drugs are usually heavily promoted during their period of exclusivity. That promotion, which supports extremely high profit margins, often ends quickly after generic entry. The first generic competitor typically enters the market at a price that is perhaps 70 percent or less of its brand-name counterpart, and it rapidly gains substantial share. The branded supplier may suffer a dramatic fall in market share, and it typically responds to this loss of share by ending promotional support of the product. Further generic entry occurring after the 180-day exclusive period typically exacerbates these effects. A return

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EI News and Notes

Pittsburgh Hospital Merger

David A. Argue, with the assistance of Laura A. Malowane, provided economic analysis for the parties in UPMC's recent acquisition of Mercy Hospital Pittsburgh. The FTC allowed the transaction after a Second Request investigation that considered issues such as geographic market, the constraints already imposed on UPMC by West Penn Allegheny Health System, and reductions in the level of Mercy's tertiary services. Jones Day and Drinker Biddle represented UPMC. Buchanan Ingersoll represented Mercy.

Economic Study of the Entertainment Software Industry

Stephen E. Siwek recently completed a study that quantifies the economic contributions of the US entertainment software industry. The industry added $3.8 billion to US Gross Domestic Product and directly employed over 24,000 people. The industry's real annual growth rate was over 17%. The study, "Video Games in the 21st Century: Economic Contributions of the US Entertainment Software Industry," was released by the Entertainment Software Association.

Circuit Court Upholds Denial of Class Certification

The Third Circuit Court of Appeals upheld the District Court's denial of class certification in *American Seed Company, Inc. v. Monsanto Company*. The Circuit Court agreed that the testimony of plaintiffs' economic expert was insufficient to establish the existence of the class. At the District Court level, William C. Myslinski had submitted extensive expert analysis in opposition to class certification on behalf of defendant Monsanto. The court accepted Dr. Myslinski's arguments that the market for seed is highly individualized and that the plaintiffs had not explained how differences among types of purchasers were insubstantial with respect to commonality and typicality. Kent W Mikkelsen and Allison M. Holt assisted Dr. Myslinski. Howrey LLP represented Monsanto.

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and has induced subscription satellite to become more likfree over-the-air services.

To be sure, in the United States over-the-air DTV must overcome some real obstacles if it is to become a robust competitor to cable and satellite. First, the number of people who rely on free over-the-air broadcast is small. According to the FCC, 86 percent of all households with televisions already subscribe to a pay service. Second, no single broadcaster has enough spectrum to be a competitive multichannel distribution platform on its own. Finally, regulations may restrict the types of services broadcasters can offer over their spectrum.

DTV may not realize its full competitive potential if regulators restrict broadcasters' use of spectrum. The United States already missed the opportunity to use the digital broadcast spectrum most efficiently. The best approach, from an efficiency point of view, would probably have been to reclaim all the broadcast spectrum and auction it so it can be employed in its highest-value use. Additional regulations restricting the use of this spectrum would only further reduce its value.

The use of broadcast spectrum should not be constrained. Broadcasters should be allowed to use this spectrum to provide the highest value services. That might mean selling it, offering interactive television or information services, or even aggregating spectrum in order to build a competitive video distribution platform.

It is not possible to know how the video distribution market will develop. Terrestrial over-the-air broadcast may have trouble winning over consumers, but that doesn't mean it is impossible to do so. Cable had trouble competing with free over-the-air broadcast in its early days and had to innovate by investing in new programming, such as HBO, in order to attract consumers. Broadcasters likely will also innovate, given the opportunity.

Many obstacles stand in the way of over-the-air broadcast becoming a competitive video distribution platform in the US. Public policies, however, should not be among them.

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to the status quo ante is virtually impossible once this process is unleashed.

The possibility of irreparable harm is increased because the generic will earn less from entry than the branded firm will lose. The monopoly profit of the branded producer exceeds the combined profit of two firms in a more competitive industry. Therefore, both firms may be better off if the branded firm keeps its monopoly and shares the monopoly profits with the potential entrant (e.g., through a settlement postponing entry). In addition, were the generic to enter and subsequently lose the patent infringement suit, the amount required to compensate the branded firm for lost profits would exceed the profits that the generic had made from the infringing sales. As a result, a PI may well be warranted, as long as there is a strong likelihood of success on the merits of the patent suit.

The case for an injunction under these circumstances may be particularly strong given the antitrust issues surrounding other strategic options in the H-W environment. For example, the antitrust agencies have opposed settlements involving cash payments that delay entry. But the antitrust agency arguments against those settlements depend in part on the court's willingness to protect patent pioneers. If the courts won't grant a PI to protect a firm with a strong patent from irreparable harm by a generic, then the FTC is on weaker ground when it argues against settlements that postpone generic entry to any time that is not after patent expiration.

The FTC has recognized as much in its Amicus Curiae Brief to the Federal Circuit Court in the Ciprofloxacin case. In this brief, the FTC argues to reverse the US District Court decision that found that certain payments to delay generic entry could not be challenged on antitrust grounds because they were within the nominal scope of the patent. The FTC argued, "Thus, when a patentee asserts its patent and threatens a lawsuit with the goal of excluding a competitor from the market, the patentee can hope that the strength of its patent will either convince the infringer to accede or convince the court to issue an injunction." This argument implies that a pioneering patent holder can rely on certain rights, which assumes that those rights are properly upheld in deserving circumstances. If that is true, then it is more tenable for the FTC to argue that conduct that bypasses or goes beyond these rights, such as reverse payments, is anticompetitive.

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