

HEALTHCARE ANTITRUST,
SETTLEMENTS, AND THE FEDERAL
TRADE COMMISSION

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HEALTHCARE ANTITRUST, SETTLEMENTS, AND THE FEDERAL TRADE COMMISSION

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INTRODUCTION

This volume of *Research in Law and Economics* contains chapters that address important legal and economic developments in the areas of healthcare, intellectual property and labor settlements, competitive effects, cartel overcharges, and the US Federal Trade Commission (FTC). Four of the chapters were initially presented at a conference on healthcare competition in Washington, DC, which was sponsored by the American Antitrust Institute, this journal, and Navigant Economics. These chapters explore practices that are under challenge in pharmaceuticals, where the FTC has been extremely active, as well as issues involving hospital and health insurance mergers. They are followed by a detailed discussion of the current and historic role of economists and economic analysis at the FTC. The next two chapters analyze different aspects of the French economy, pretrial labor settlements and the impact of e-commerce on franchisees. The volume ends with three technical economics chapters – one on “upward pricing pressure,” one on estimating price increases in cartel cases, and one critiquing a “meta-analysis” of research on the effectiveness of US merger regulation. Taken together, these chapters raise questions about appropriate competition policy, how to evaluate settlements and other firm behaviors, and where economics and competition policy are headed.

The first chapter is by Deborah L. Feinstein, former Director of the FTC’s Bureau of Competition and Partner at Arnold & Porter Kaye Scholar. As the title “To Know Where You’re Going, Look at Where You’ve Been” suggests, the chapter discusses how the FTC’s actions have shaped the evolution of healthcare competition. The chapter discusses a wide variety of FTC practices and actions in healthcare, including hospital mergers, general competition reviews of pharmaceutical transactions, the Hatch–Waxman Act and abuses relating to “reverse payment” settlements, the improper listing of patents in the FDA’s “Orange Book,” and non-compete agreements outside of patent settlements. Feinstein gives historical accounts of each area, describing recent legal and policy developments. For example, Feinstein follows the record of FTC enforcement actions against “reverse payment” settlements beginning with the 2000 Hytrin matter, through the milestone *FTC v. Actavis*, and up to the more recent *FTC v. Cephalon, Inc.* and *FTC v. Allergan plc* cases. Even taking into account the various unusual regulatory and competitive aspects of the healthcare industry in the US, she concludes there is no need for special rules in healthcare markets.

In “*Actavis*, Authorized Generics, and the Future of Antitrust Law,” Marc G. Schildkraut, Partner and lead antitrust Attorney at Cooley LLP, discusses the possible effects of the US Supreme Court’s decision in *Federal Trade Commission v. Actavis, Inc.* on not only the future of antitrust litigation in the pharmaceutical industry, but also its implications for settlements in other industries. Foreseeing the possibility of *Actavis* logic being applied beyond the scope of “reverse” payment settlements in pharmaceuticals, Schildkraut analyzes *Actavis*’ ability to upend conventional analysis of antitrust litigation regarding intellectual property – and antitrust litigation in general. Schildkraut explains how *Actavis* does not provide a basis for determining whether a settlement is pro- or anti-competitive. Using the standard probabilistic entry model, he shows that any settlement could be found anticompetitive if efficiencies from the settlement are not fully weighed under a “rule of reason” analysis, with or without a “reverse payment.” He also shows that there are a number of circumstances where “reverse payments” can increase consumer welfare. As such, applying the logic of *Actavis* can result in the prosecution of practices for which there is little chance of anticompetitive effects, and at the same time misses potentially anticompetitive practices. He argues that the *Actavis* logic implies the end of merits analysis, the end of plaintiffs needing to establish anticompetitive effects directly or through structural analysis, and the weakening of the preponderance of evidence standard in civil litigation. Schildkraut then extends his analysis to include how *Actavis* could create new problems regarding standing analysis, damages calculations, and the balancing of efficiencies against anticompetitive effects.

Michael A. Carrier, distinguished Rutgers University professor, and Steve D. Shadowen, cofounder of Hilliard & Shadowen LLP, offer a framework courts and government enforcers could employ when analyzing the merits of “product hopping” cases in “Solving the Product-Hopping Conundrum through Safe Harbors and a No-Economic-Sense Test.” Product hopping is when the manufacturer of a patented drug stops promoting or selling one version of its patented drug, and sells and promotes another version with an additional patent claim. These switches can be “hard,” where the branded drug is no longer sold and thereby prevents a generic version from being sold. Alternatively, a switch can be “soft,” where the older drug is still sold but the branded manufacturer stops promoting the old version and heavily promotes the new version. To aid in the differentiation between benign and offensive product hopping, Carrier and Shadowen’s framework first examines whether brand manufacturers both (1) reformulate a product such that its generic is nonsubstitutable and (2) encourage doctors to prescribe their reformulation in place of the original. Assuming both conditions are met, the reformulation is assumed to be a product hop. Step 2 of the framework checks if the action either does not fit into the safe harbors of (1) reformulation long before generic approval or (2) introduction of the reformulation after market entry of the generic apply to the product. If the reformulation is both considered a product

hop and neither safe harbor applies, then they would apply a “No-Economic-Sense” test, which compares the net gains to the alleged monopolistic conduct, excluding gains from eliminating competition. If these net gains are negative, then the authors argue the conduct makes “no economic sense except for the impairment of competition.” Carrier and Shadowen use their framework to analyze five litigated product hopping cases, and conclude that the outcome in two of the cases should be reversed based on their test.

In “A Market All Its Own: Medicare Advantage as a Separate Product Market in the DOJ’s Case against the *Aetna-Humana* Merger,” Douglas Ross and David Maas, respectively Partner and Associate at Davis Wright Tremaine LLP, discuss the US Department of Justice’s (DOJ’s) narrative when successfully challenging the two proposed “megamergers” of Anthem with Cigna and Aetna with Humana. These attempted mergers spanned hundreds of potential geographic markets and many potential product markets, making analyses of market definition and competitive effects potentially very complex. However, the DOJ adopted a simple narrative regarding the reasonable interchangeability of Medicare Advantage with “Original Medicare” in the *Aetna-Humana* Merger. After reviewing the general framework for horizontal merger challenges, the legacy of the US Supreme Court’s 1962 case *Brown Shoe Co. v. U.S.*, and the 155-page opinion of the presiding Judge Bates, Ross and Maas argue the application of basic economics and common sense using traditional market definition still triumphs over the use of sophisticated econometric tools when reviewing the competitive effects of a merger.

“A History of the FTC’s Bureau of Economics” by former FTC Deputy Director Paul A. Pautler reviews the Bureau of Economics’ changing function in the Commission as the size, scope, and importance of data in investigations and litigations have increased. Beginning in the 1960s, the Bureau was primarily a policy research and development shop. Today, it carries the additional roles as an unbiased advisor to the Commission and advocate for market competition. Pautler discusses in detail the challenges faced by the Bureau over time, ranging from changing legal requirements, situational pressures, and limitations imposed by key FTC decision-makers. For example, with regard to the influence of economists on consumer protection matters, Pautler states:

As on the antitrust side of the agency, any influence economists have had in the consumer protection area has occurred due to the persuasiveness of arguments, rather than positioning in the chain of command. There was never any time when economists in the Bureau of Economics had final decision-making power regarding consumer protection matters.

Although the chapter is largely a retrospective of the Bureau’s accomplishments, it also anticipates the future role of the Bureau. Internal decision-making at the FTC and litigatory proceedings have become increasingly dependent on data analysis and economic modeling. This trend has led lawyers and economists at the FTC to become increasingly dependent on one another, and Pautler believes this trend will continue.

Despite concerns over settlements raised in the “reverse payments” cases discussed by Feinstein and Schildkraut in this volume, there has been much published regarding the potential welfare-enhancement attained from settling disputes via court settlement, rather than taking disputes to trial. This research has led the French to reform their labor courts. Jean-Christian Tisserand analyzes the progress of this reform effort in “Labor Disputes and Pretrial Settlements: The French Case.” He finds French labor courts are currently trailing other countries in pretrial settlements. He analyzes the causes for the courts’ lag relative to other countries using a novel dataset consisting of 539 closed cases registered at the Cesancon labor court in France. He estimates the likelihood of pretrial settlement and the determining factors that aid in the success or failure of settlements in these cases, and finds current lawyer remuneration and French law’s plaintiff’s restitution ceiling as likely explanations of France’s low settlement rate.

In “Franchisees Facing Online Sales in a European Legal Context,” Guy Basset, Rozenn Perrigot, and Gerard Cliquet analyze how French franchisees in retail and service industries perceive the impact of online sales on their franchisee network. They survey 46 franchisees, asking questions such as “Are online sales viewed as complementary or competing sales for physical stores?” Basset, Perrigot, and Cliquet outline the concerns that franchisees carry as e-commerce becomes more prevalent in their network. Such concerns include, but are not limited to, the need to keep up with competitors using e-commerce, the loss of in-person sales, and the inability to sell products online due to their franchisee contracts. Basset, Perrigot, and Cliquet conclude that the spread of e-commerce within franchisee networks cannot be stopped, but instead will need to be carefully integrated in the development strategies of franchisee networks. Such integration will not come without its challenges as franchisor development of e-commerce within their networks may be perceived as undermining many of the contractual safeguards classically held by franchisees, such as territorial exclusivity.

In “Mandatory Upstream Inputs and Upward Pricing Pressure: Implications for Competition Policy,” Dr. Dennis L. Weisman, Emeritus Professor of Economics at Kansas State University, and Dr. Timothy J. Tardiff, Principal at Advanced Analytics Consulting Group, Inc., review the relationship between vertically integrated providers (VIPs) and their downstream competitors. Building on previous analyses by Weisman, Tardiff and Weisman, the authors, compare the effect that various regulatory price, input, and merger controls would have on consumer and producer welfare when a VIP could supply mandatory (must have) inputs to a downstream rival. Ultimately, this analysis shows how some seemingly beneficial regulatory decisions regarding the pricing and availability of mandatory inputs may lead to increased rivalry between a VIP and its downstream competitors – but at the same time decrease consumer welfare. For example, mandatory sharing of a VIP’s inputs may reduce dynamic and allocative efficiencies by discouraging competitor

investment and innovation, causing upward pricing pressure on retail prices and forgoing merger efficiencies from the elimination of double marginalization. With several vertical mergers being investigated or challenged, such as ATT and Time-Warner, these insights could have important policy implications.

The “Kennedy Correction” is an econometric technique to correct estimation bias in collusion dummy variables when using regressions with semi-logarithmic functional forms to calculate overcharge percentages in cartel matters. In their chapter “When is the ‘Kennedy Correction’ Appropriate in Estimating Overcharges,” Wenqing Li, Director at Epsilon Economics, and James F. Nieberding, Principle and founder of North Coast Economics, discuss the possible misuse of the “Kennedy correction” and the empirical implications of doing so. Specifically, Li and Nieberding show that estimating an increase in the price of items due to collusive behavior with the “Kennedy correction” can lead to overestimation of overcharge rates when estimated as a percentage of actual prices. The percentage difference between an estimate incorrectly using the “Kennedy correction” and its non-“Kennedy corrected” counterpart may be a few tenths of a percentage. However, Li and Nieberding show those tenths of percentage points equate to tens of millions of dollars when the volume of effected commerce is in the billions of dollars, as often occurs in major cartel cases.

Michael Vita of the US Federal Trade Commission provides a critique of Professor John Kwoka’s meta-analysis of “retrospective” academic studies of consummated mergers and other horizontal arrangements in the US. Based on this analysis, Kwoka claims the agencies permit far too many anticompetitive mergers to go unchallenged, and are far too willing to accept remedies that fail to prevent a significant loss of competition. Vita argues there are serious flaws in the construction of Kwoka’s sample and in his statistical analysis, which Kwoka has not corrected.

This volume illustrates the many issues raised by the intersection of law and economics. These chapters address a wide variety of topics, including competition policy in healthcare, settlements of labor disputes, franchisee contracts in a changing world, economic modeling of vertically related firms, econometric estimation of damages in cartel cases, and empirical research on the effectiveness of merger regulation.