Anti-competitive pricing strategies by laboratories

Many types of strategies to prevent or delay the entry of generics

- Many of them :
  - patent litigation,
  - manipulation of the length or scope of the patents,
  - Possible anticompetitive effects of patent pools…
- Others are more « classical » strategies :
  - Predatory pricing
  - Bundling of a princeps and a drug open to competition
  - …

In France, a number of recent cases in the pharmaceutical sector

- Many cases concern parallel trade or other forms of vertical restraints.
- Others concern anticompetitive practices by laboratories, for example :
  - Glaxo (2007) : predatory pricing, sanctioned by the Conseil, decision cancelled by the appeal court, now pending before the Supreme Court.
  - Sandoz (2003) : rebate on the princeps conditional on bundled purchase of a number of other products produced by Sandoz in competition with generics.

Glaxo : predatory pricing, an effects based approach

A brief history of the case :

- July 2000: Flavelab refers the case to CC, asks for interim measures
- November 2000: CC does not grant interim measures
- December 2001: Flavelab goes bankrupt
- April 2002: Flavelab acquired by Panpharma
  - *2003: Complaint withdrawn – CC proceeded ex officio*
- July 2004: Statement of objections
  - *2006: first hearing, supplementary SO, final hearing*
- March 2007: Decision on the merits, fining GSK France
- 2008 : the appeal court cancels the decision.
- Pending before the Supreme Court.

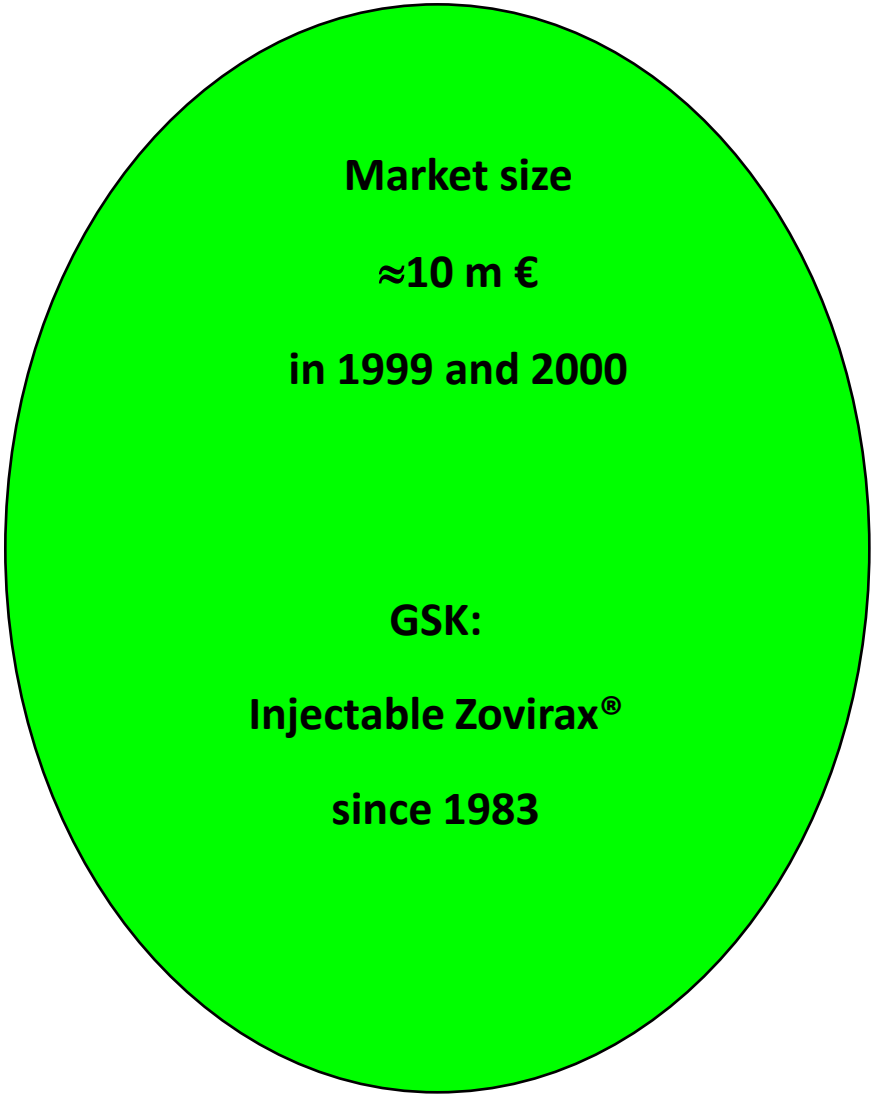
Products

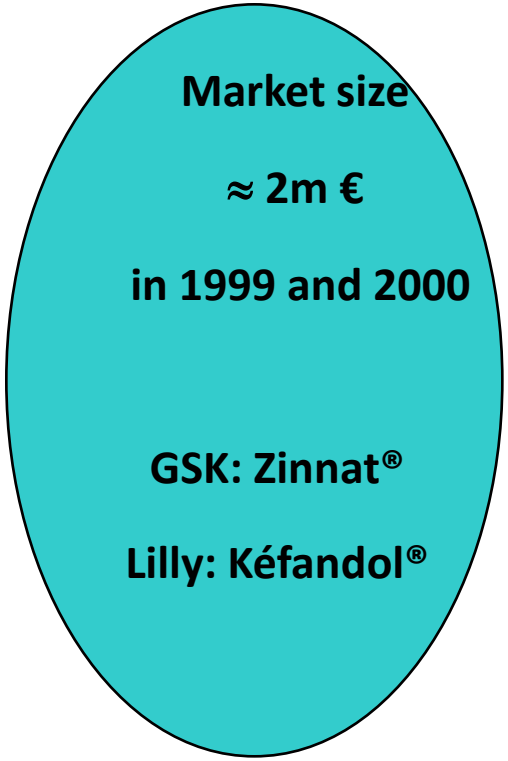
- Anti-infective drugs ("J" in the ATC = Anatomical Therapeutic Chemical classification)
- Sold (almost) only to hospitals (bidding markets)
  - Community market not involved
- Market A: Injectable Aciclovir (ATC: J05A)
  - Treatment of herpes
- Market B: Injectable cephalosporins 2nd generation
  - Prevent infections during surgical operations
  - Cefuroxime and Cefamandole (Lilly)
- Market definition : not disputed

Market A: Aciclovir

Market B:

Injectable cephalosporins





Practices

- Here : focus on economic aspects, but also interesting legal aspects

- **1999-2000: below cost pricing on market B**
  - GSK buys Zinnat® from the *Adechsa company*
  - *Retail prices < purchase prices (PP)*
  - Purchase prices computed from invoices net of all discounts and rebates.
  - 12 markets (hospitals, dosage) in 1999, 29 in 2000.
  - Selective price cuts: prices below cost when faced to generics.

Cost Test

- Price > ATC: ok (but exceptional circumstances)
- ATC > Price > AVC: burden of proof on CC
  - Multiple indicators: hard evidence, selective price cuts, supplementary practices, likely recoupment, fact-based theory of harm (e.g. vulnerable prey, etc.), understanding of the strategy followed by the firm
- AVC > Price: burden of proof on defendant
  - defendant can rebut presumption by proving either
    - recoupment ex ante impossible (low entry barriers),
    - perishable goods,
    - learning by doing,
    - switching cost...

- Need for a convincing microeconomic history

Price analysis : at which level?

- **GSK** : CC should consider average prices across all hospitals
- **CC** : exclusion occurs at the hospital level. Bids at each invitation to tender relevant, because of selective price cuts.

- **GSK**: contests selective price cuts
- **CC:**
  - This is only an indicator (discrimination makes predation less costly for the predator)
  - Large differences in the bids depending on competitive pressure (can be anticipated depending on the wording of the public market).

Bids with comp. < Bids without comp.

Link between markets A and B

- **GSK** : contests the link
- **CC :**
  - Same seller: GSK France (hospital business unit)
  - Same buyers (hospitals) buy Zinnat® et Zovirax®
  - Bundled rebates between both goods offered in 1999
  - Rationale for predation in (small) market B: deterring generic drug companies from following Merck (a generic producer) into (large) market A.
    - Same as in *Akzo:* the incumbent prices below cost in the small market to deter ECS from entering its core market.

Theories of harm (1/2)

- Threats of entry in 1999 in spite of patent's extension
  - **In 1999, 7 (3) generic drug companies had regulatory approvals to enter market A (B)**
  - Merck: small-scale entry on market A in 1999, but 1m€ in 2000.
  - GSK was uncertain about the outcome of a patent litigation, did not challenge Merck in court.
- GSK builds a reputation for toughness [Kreps and Wilson, 1982] :
  - Two types of incumbent : tough/weak, 2 markets, 2 periods
  - After an entry on market B at T=1, I has incentives to prey to avoid entry on market A at T =2 (deter entry or discipline an entrant)

Theories of harm (2/2)

- **CC** : also mentions a possible financial predation scenario leading to Flavelab's bankruptcy
- Common story: I sacrifices short-run profit to manipulate E's profit expectations, distorts entry decisions, and recoups later
  - Sacrifice is impossible to check → look for short-run losses
  - Conservative test
- **Reminder**: **Since P < AVC, CC has not the burden of establishing such a theory; the defendant has to prove that predation is obviously impossible, and to give an objective justification for the observed behavior.**

Recoupment

- **GSK**: No entry barrier after patent's expiration, recoupment impossible.
- **CC :**
  - No need to prove recoupment ex post, only ex ante when the burden of proof is on the CA.
  - But recoupment indeed occurred !
  - Losses on market B: 75 000 € in 1999-2000, very small.
  - Gains on market B in 2001-2002 = extra profit earned by pricing above the competitive price (Proxy: price of generic drugs) = 400 000 €
  - Recoupment even easier on market A, where GSK has more market power

Meeting competition defense

- **GSK:** price cuts necessary to align on Flavelab, the aggressive plaintiff.
- **CC:** GSK could have aligned without violating the predation test

GSK Bids below costs < Flavelab price

- **GSK**: Price cuts necessary to align on Kefandol® (Lilly)
- **CC**: Not true: Kefandol® price >> predatory prices of GSK.

Other arguments

- **GSK**: raised prices for fear of being found guilty of predation, following CC decision to keep the case, not for recoupment
- **CC:** The motivation of the price rise does not matter. But the fact that the price rise occurred, did not eject GSK from the market but allowed recoupement of losses shows that ... recoupment was possible.

- **GSK:** Flavelab went bankrupt because inefficient
- **CC:** Flavelab good at selling Cefamandol (in market B) and Flavelab affected by predation (concerned drug accounted for half of its sales to hospitals in 1998)

- **CC: GSK did not provide any justification for its behaviour.**

Sanctions

- **Infringement of Art. 82 (multinational firms, imports, etc.)**
- **Seriousness**
  - Exclusionary practices
  - 40 markets involved, generics' entry delayed
  - GSK: first supplier of hospitals

- **Fine: 10 m €**
  - Legal ceiling at the time: 5 % of GSK France turnover in the last accounting year: 1.6 b€
  - Fine < 1 % of the ceiling
  - Fine ≈ Size of market A
- **Publication of the decision in professional journals**

Conclusion -The Appeal court decision:

- agrees with the cost test and the cost benchmark chosen for recoupment;
- agrees to reject the arguments put forward by Glaxo to explain its behavior;
- But also rejects the decision of the Conseil on the ground that :
  - there is no hard evidence concerning the fact that Glaxo wanted to build a reputation for toughness ; no investigation, dawn raid,… showing a plan of action.
  - The connection between markets A and B is not enough demonstrated (by documents, hard evidence).