April 22, 2014

Federal Court Rules "Loyalty Discounts" Do Not Violate Antitrust Laws Unless Below-Cost

The United States District Court for the District of New Jersey recently rejected an antitrust plaintiff's challenge to "loyalty-discount" contracts, holding that such contracts are not anticompetitive, as a matter of law, as long as the prices they offer are above-cost. *Eisai Inc.* v. *Sanofi-Aventis U.S., LLC*, No. 08-4168 (MLC) (D.N.J. Mar. 28, 2014). The *Eisai* decision adopts a price-cost test for antitrust claims involving price discounts conditioned on a customer's agreement to purchase a certain volume or market-share of a single product from a supplier: unless the plaintiff can show that such discounts result in prices that are below the defendant's cost, there is no right to recovery under the antitrust laws.[1]

Eisai is an exclusive dealing and monopolization case involving two competing pharmaceutical manufacturers. The plaintiff (Eisai) alleged that the defendant (Sanofi) violated the Sherman and Clayton Acts by entering into contracts with hospital group purchasing organizations (GPOs) for the drug Lovenox®. Sanofi's contracts included loyalty discounts, whereby "[g]reater discounts were offered where customers purchased higher volumes and higher market shares of Lovenox®." (Op. at 8-9.) The highest discounts -- up to 30% off list price -- were offered to hospitals that purchased Lovenox® for 90% or more of their needs within the relevant drug class.

In addition to meeting volume and market-share thresholds, hospitals seeking to qualify for discounts also were required to provide access for Lovenox® on the hospital's formulary that was no less favorable

[1] Paul, Weiss has advocated successfully for application of the price-cost test to claims of anticompetitive discounting -- including in the United States District Court for the Southern District of New York, which dismissed federal antitrust claims brought against a major market research company by a competitor, holding that "the law in this circuit bars claims of predatory or anti-competitive pricing unless the price charged was below short-run average variable cost." *Information Resources, Inc.* v. *Dun & Bradstreet Corp.*, 359 F. Supp. 2d 307, 307 (S.D.N.Y. 2004). Paul, Weiss counsel Daniel A. Crane, who is also the Federick Paul Furth Sr. Professor of Law at the University of Michigan Law School, has published extensively on the treatment of loyalty discounts and other forms of discounting under the antitrust laws. Crane's academic work and amicus curiae brief played a prominent role in the landmark decision on "bundled discounting" by the United States Court of Appeals for the Ninth Circuit, *Cascade Health Solutions* v. *PeaceHealth*, 515 F.3d 883 (9th Cir. 2008).

© 2014 Paul, Weiss, Rifkind, Wharton & Garrison LLP. In some jurisdictions, this publication may be considered attorney advertising. Past representations are no guarantee of future outcomes.

than any other drug in the same class.[2] This formulary access clause did not require exclusivity for Lovenox®, but rather operated like a "most favored nations" provision -- requiring that no competing drug be given more favorable treatment than Lovenox® on the formulary.

Eisai argued that the market-share discounts in Sanofi's GPO contracts, together with the formulary access clauses, restricted competitors' access to hospitals and thus amounted to *de facto* exclusive-dealing arrangements. It contended that Sanofi used these arrangements to lock out competition and to preserve its alleged monopoly position within the class of drugs that compete with Lovenox®.

For purposes of summary judgment, the court accepted Eisai's allegation that Sanofi had monopoly power, finding that the market share of Lovenox® during the relevant period ranged from 81.5% to 92.3%. Nevertheless, the court granted summary judgment for Sanofi, concluding that Eisai had failed to establish a triable issue as to whether Sanofi's contracts were anticompetitive.

Eisai did not dispute that the discounts Sanofi offered -- even at the highest level -- resulted in prices that were below Sanofi's costs. Thus, the primary point of contention between the parties at summary judgment was whether Sanofi's contracts should be analyzed under the price-cost test. The court agreed with Sanofi that the price-cost test applied.

Eisai and its expert witnesses (Einer Elhauge and Nicholas Economides) argued, *inter alia*, that Sanofi's contracts prevented customers from buying less expensive rival products, raised rivals' costs, and imposed "disloyalty penalties" on customers who failed to satisfy Sanofi's purchase requirements. The court rejected these arguments. Contrary to Eisai's allegations, the evidence showed that customers can and did buy from Sanofi's rivals, and nothing in Sanofi's contracts prevented them from doing so other than a low price. The contention that Sanofi's practices raised rivals' costs was, the court found, nothing more than another observation about the effects of Sanofi's pricing. And Eisai's argument that Sanofi's prices were not really discounts, but rather "disloyalty penalties," was "a matter of semantics." (Op. at 65.)

The court concluded that because price was the "predominant mechanism of exclusion" alleged, Eisai's antitrust claims were subject to the price-cost test. And because there was no dispute that Lovenox® ever was sold to hospitals at "a price that was below Sanofi's cost even after discounts were applied," those claims failed as a matter of law. (*Id.* at 70.)

The court further concluded that even if Eisai's claims were evaluated under a conventional rule of reason analysis, Eisai had failed to establish a viable claim for exclusive dealing. Because the only consequence of not purchasing the required percentage of Lovenox® was "that the customer 'simply lost its negotiated

[2] A formulary is a healthcare organization's "continually updated list of medications and related information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis, phrophylaxis, or treatment of disease and promotion of health." (Op. at 11.)

discount,'" the court found that Sanofi's contracts were not exclusionary as a matter of law. (*Id.* at 71.) Eisai failed to prove that there was any substantial number of customers who wanted to buy its products but could not do so because of Sanofi's contracts. Indeed, during the time period in which the discounts were offered, Sanofi's market share fell while Eisai's share went up. Moreover, the court observed that market-share discounts were common in the market as a whole and used by Eisai and other competitors as well as Sanofi.

In summary, the court found that Eisai, like antitrust plaintiffs in other cases involving unsuccessful challenges to market-share discounts, "could have offered greater discounts or improved [its] products in order to maintain and increase [its] market shares. The fact that [it] did not and suffered a loss in profits is of no concern to the antitrust laws." (*Id.* at 85.)

The District Court's analysis may provide important guidance with respect to future antitrust claims based on market-share and other forms of loyalty discounts. Moreover, the principles set forth in *Eisai* are not limited to the pharmaceutical industry, but apply broadly across the wide range of businesses and industries in which loyalty discounts are used.

*   *   *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Robert A. Atkins
212-373-3183
ratkins@paulweiss.com

Craig A. Benson
202-223-7343
cbenson@paulweiss.com

Jay Cohen
212-373-3163
jaycohen@paulweiss.com

Andrew C. Finch
212-373-3460
afinch@paulweiss.com

Kenneth A. Gallo
202-223-7356
kgallo@paulweiss.com

William B. Michael
212-373-3648
wmichael@paulweiss.com

Jacqueline P. Rubin
212-373-3056
jrubin@paulweiss.com

Moses Silverman
212-373-3355
msilverman@paulweiss.com

Joseph J. Simons
202-7370
jsimons@paulweiss.com

Aidan Synnott
212-373-3213
asynnott@paulweiss.com

Daniel A. Crane
212-373-3208
dcrane@paulweiss.com