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Third Circuit Court of Appeals Affirms Dismissal of Claim that "Loyalty Discounts" Violate Antitrust Laws

The United States Court of Appeals for the Third Circuit issued a significant opinion in an antitrust case this week, in which it upheld a summary judgment ruling that a pharmaceutical manufacturer's "loyalty discount" contracts were not anticompetitive as a matter of law. The Court's opinion reaffirms the principles that the "antitrust laws are concerned with the protection of competition, not competitors," and that price discounts typically do not cause harm to competition, even when their effect is to disadvantage a dominant firm's smaller rivals.

Eisai Inc. v. *Sanofi Aventis U.S., LLC,* No. 14-2017, involves two competing pharmaceutical manufacturers. The plaintiff (Eisai) alleged that the defendant (Sanofi) engaged in unlawful monopolization, exclusive dealing, and unreasonable restraint of trade in violation of the federal antitrust laws. Sanofi allegedly did so by entering into contracts with hospital group purchasing organizations (GPOs) for the drug Lovenox®, an anticoagulant. These contracts offered discounts to hospitals contingent on their share of Lovenox® purchases, as compared to their purchases of competing drugs. For example, when a hospital's purchases of Lovenox® were less than 75% of its total purchases of the relevant products, the hospital would receive a flat 1% discount (regardless of the volume of Lovenox® the hospital purchased). Hospitals that purchased a 75% or greater share of Lovenox®, by contrast, would receive bigger discounts—rising as high as 30%—"based on a combination of the volume purchased and the market share." (Slip Op. at 6.) In addition to meeting volume and market-share requirements, hospitals seeking to qualify for more than a 1% discount also were required to provide access for Lovenox® on the hospital's formulary that was no less favorable than any other drug in the same class.[1]

Eisai argued that Sanofi's "market share" or "loyalty" discounts, coupled 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 a monopoly position within the class of drugs that compete with Lovenox®.[2] According to Eisai's expert (Professor Einer Elhauge) Sanofi was able to do this because demand from hospitals for Lovenox® fell into two categories: one portion that was susceptible to competition from rivals ("contestable demand"), and a second portion that was less susceptible to competition, due to factors such as Lovenox®'s distinct medical indications ("incontestable demand"). Elhauge opined that Sanofi's loyalty program "bundled" incontestable demand with contestable demand by requiring hospitals to purchase a large share of Lovenox® to qualify for significant discounts, and thus made it difficult for smaller rivals to compete for any significant portion of a hospital's purchases. (Slip Op. at 9–10.)

The Court of Appeals Opinion

The Third Circuit affirmed summary judgment in favor of Sanofi and dismissed Eisai's claims, concluding that Eisai was unable to demonstrate an antitrust violation as a matter of law.[3]

First, the Court found that Eisai had not presented evidence of substantial foreclosure of competition, which is required to support an exclusive dealing claim. The Court determined that "identification of a few dozen hospitals out of almost 6,000 in the United States" that allegedly wanted to purchase Eisai's product but did not, due to Sanofi's contracts, failed to demonstrate substantial foreclosure. (Slip Op. at 15–16.) This was especially true if a hospital's reason for not wanting to switch from Sanofi to a competitor was "the loss of the discounts" offered by Sanofi. (*Id.* at 16.) While Eisai's expert characterized Sanofi's discounts as "payoffs," and the threatened loss of such discounts as penalties, the Court rejected these labels. It found that Professor Elhauge's foreclosure opinion was based on nothing more than "consumer preference," and that "the threat of a lost discount is a far cry from the anticompetitive conduct" at issue in prior cases where liability for exclusive dealing had been found. (*Id.* at 16, 21.) The Court specifically noted the lack of evidence in the record that a hospital that terminated its participation in Sanofi's discount program, or violated the program's terms, would be required to repay prior contractual savings or suffer supply shortages as a result. (*See id.* at 20–21.)[4]

Second, the Court held that Eisai had not presented evidence that Sanofi's conduct "caused or was likely to cause anticompetitive effects in the relevant market." (Slip. Op. at 21.) In particular, Eisai had failed to show that Sanofi's conduct had caused output to decline or prices to rise. Although Eisai demonstrated that prices for Lovenox® had increased over time, the Court found "no reason to believe that Sanofi's allegedly anticompetitive conduct was the cause," noting that Eisai's prices had increased at a similar rate. (*Id.* at 22.) Given Eisai's failure to present evidence of either substantial foreclosure or anticompetitive effects, the Court held that Eisai had failed to show that "the probable effect of Sanofi's conduct was to substantially lessen competition in the relevant market, rather than to merely disadvantage rivals." (*Id.* at 22–23.)

The Court did, however, disagree with Sanofi's argument that Eisai's claims failed as a matter of law under the "price-cost" test—*i.e.,* that because Sanofi's discounted prices were not below-cost, the discounts could not be considered anticompetitive. (Slip Op. at 24.) The Court reaffirmed its prior holding, in *ZF Meritor LLC* v. *Eaton*, 696 F.3d 254 (3d Cir. 2012), that "when pricing predominates over other means of exclusivity, the price-cost test applies," and observed that "[t]his is usually the case when a firm uses a single-product loyalty discount or rebate to compete with similar products." (*Id.* at 26.) But the Court concluded that the price-cost test was not dispositive here, because "[o]n Eisai's telling, the bundling [of contestable and incontestable demand] – not the price – served as the primary exclusionary tool." (*Id.* at 27.) In light of its finding that "Eisai's claims are not substantiated and that they fail a rule of reason analysis," however, the Court determined it was unnecessary to adopt a bright-line rule with respect to similar claims that might be asserted in the future. (*Id.*)

Significance of the Decision

Following *Eisai*, it will become increasingly difficult for an antitrust plaintiff to challenge single-product volume and/or market-share discounts under the antitrust laws. Even where, as in *Eisai*, a plaintiff alleges that a portion of demand for a defendant's product is "incontestable," the prospect that customers who switch some of their purchases away from the defendant's product may lose discounts likely will not be sufficient to establish that competitors are excluded or competition is foreclosed. The Court's ruling that a plaintiff seeking to show an anticompetitive effect must present concrete evidence linking a reduction in output, or an increase in price relative to competitors, to the conduct at issue poses an additional obstacle for plaintiffs. The Third Circuit's decision moves the Court in line with a trend in other circuits, which have expressed skepticism of the notion that a firm can violate the antitrust laws by offering single-product, above-cost loyalty discounts.[5]

At the same time, the Court's decision not to apply the price-cost test to Eisai's claims suggests that, at least in the Third Circuit, the fact that a loyalty discount is above-cost may not provide a safe harbor for defendants. Depending on the type of challenge that is made to a loyalty discount program, and how the program is structured, the Court's decision indicates that a full rule of reason analysis may be more appropriate than review limited to whether the discounted prices are above or below the defendant's costs. Nonetheless, the Court's willingness to affirm summary judgment in favor of Sanofi confirms that whether or not the price-cost test applies, the issues in such cases may be susceptible to resolution as a matter of law, before trial.

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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:

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[1] A formulary is "a list of medications approved for use in the hospital based on factors such as a drug's cost, safety, and efficacy." (Slip Op. at 7.)
[2] For purposes of summary judgment, the Court accepted Eisai's contention that the market share of Lovenox® during the relevant period ranged from 81.5% to 92.3%.
[3] Paul, Weiss previously issued a client alert discussing the district court's decision in this case. *Federal Court Rules 'Loyalty Discounts' Do Not Violate Antitrust Laws Unless Below-Cost* (Apr. 22, 2014), *available at* https://www.paulweiss.com/media/2465527/22april14_alert.pdf.
[4] The Court also declined to extend the holding of *LePage's Inc.* v. *3M*, 324 F.3d 141 (3d Cir. 2003) (en banc), which held that bundling of different products together into one rebate program could be anticompetitive if that bundling led to the exclusion of a single-product producer from the market. The Court ruled that the bundling alleged by Eisai, which "conditioned discounts on . . . different types of demand for the same product" did not "present the same antitrust concerns as in *LePage's*." (Slip Op. at 19.) The Court also acknowledged widespread criticism of the *LePage's* decision from other Circuit Courts and academic commentators, but noted that "*LePage's* remains the law of this Circuit." (Id. at 18-19 n.35.)
[5] *See, e.g., Allied Orthopedic Appliances Inc.* v. *Tyco Health Care Grp. LP,* 592 F.3d 991 (9th Cir. 2010); *Concord Boat Corp.* v. *Brunswick Corp.,* 207 F.3d 1039, 1060 (8th Cir. 2000); *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 235–36 (1st Cir. 1983) (holding that discounts offered in exchange for a customer's agreement to take nearly all of its requirements for a product from the defendant were not exclusionary because the discounts were above-cost); NicSand, Inc. v. 3M Co., 507 F.3d 442, 452 (6th Cir. 2007) (en banc) (dismissing a complaint challenging a supplier's upfront payments to retailers in exchange for exclusivity on the grounds that the "'payments'" were "nothing more than price reductions

offered to buyers for the exclusive right to supply a set of stores under multi-year contracts" and that such reductions were lawful as long as they did not result in below-cost prices) (quotation marks omitted); *Virgin Atl. Airways Ltd*. v. *British Airways PLC*, 257 F.3d 256, 264–65 (2d Cir. 2001) (affirming summary judgment on a challenge to British Airways' "incentive agreements" with corporate clients and travel agencies because Virgin failed to demonstrate that the pricing offered under these agreements was below cost).