IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

NATCHITOCHES PARISH HOSPITAL SERVICE DISTRICT and JM SMITH CORPORATION d/b/a SMITH DRUG COMPANY on behalf of themselves and all others similarly situated, Plaintiffs, v. TYCO INTERNATIONAL, LTD.; TYCO INTERNATIONAL (US) INC.; TYCO HEALTHCARE GROUP LP; THE KENDALL HEALTHCARE PRODUCTS COMPANY, Defendants.	§	Civil Action No. 05-12024 PBS **JURY TRIAL DEMANDED**

TYCO INTERNATIONAL (US) INC., TYCO HEALTHCARE GROUP LP, AND THE KENDALL HEALTHCARE PRODUCTS COMPANY'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

REDACTED VERSION

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I. INTRODUCTION

Under governing law and the facts of this case, defendants Tyco Healthcare Group LP *et al.* (collectively, "Covidien") are entitled to judgment in their favor on all of Plaintiffs' antitrust claims. Plaintiffs' case reduces to the novel allegation that Covidien's offer of low prices and good deals for medical sharps disposal containers somehow led to foreclosure of rivals and artificially high prices for all hospital and other purchasers in the market. As an initial and dispositive matter of law, Plaintiffs' unprecedented theory directly conflicts with binding United States Supreme Court and First Circuit decisions holding that above-cost discounts, like the ones challenged here, cannot support antitrust liability. As Judge (now Justice) Breyer explained in the First Circuit's seminal decision in *Barry Wright Corp. v. ITT Grinnell Corp.*, to allow plaintiffs to challenge above-cost discounts "threatens to 'chill' highly desirable procompetitive price cutting ... [and] would more likely interfere with the procompetitive aims of the antitrust laws than further them." 724 F.2d 227, 235-36 (1st Cir. 1983). On this basis alone, Plaintiffs' claims should be dismissed.

Plaintiffs cannot salvage their case by re-labeling their pricing allegations as "de facto" exclusive dealing. The undisputed facts establish that the contracts they challenge do not compel any purchases at all, let alone 100% of a customer's business. Indeed, a named plaintiff in this case, Natchitoches Parish Hospital Service District ("Natchitoches"), expressly testified that Covidien's contracts and price practices created no impediments whatsoever to buying products from Covidien's rivals and that Natchitoches felt perfectly free to buy any sharps container it chose from any vendor it preferred.

Plaintiffs' purported exclusive dealing claim also fails because the practices they challenge do not, in any way, seal off a substantial portion of the market or every available sales

channel, and are easily terminable on short notice. The undisputed evidence from Plaintiffs' experts, third parties, and other sources demonstrates that Covidien's market share, prices and margins have declined during the relevant time period while the market share and sales of its major competitors have increased.

In addition to failing on the law and the facts, Plaintiffs' claims should be dismissed on the independent ground that the alleged damages in this case are completely speculative. Plaintiffs' damages calculations and claims depend entirely on quantifying the alleged effect of the challenged contracts on Covidien's rivals. Plaintiffs' fatal problem is that neither of their experts, Prof. Einer Elhauge on liability or Dr. Hal Singer on damages, calculated that essential input. Prof. Elhauge has expressly disclaimed any responsibility for quantifying the effect of the challenged contracts on Covidien's rivals and testified that Dr. Singer had sole responsibility for that. However, Dr. Singer has unequivocally testified that Prof. Elhauge had sole responsibility for quantifying the contract effects on Covidien's rivals and that he uncritically adopted Prof. Elhauge's figures without confirming their accuracy in any way. Consequently, neither of Plaintiffs' experts can provide one of the crucial inputs into the damages model. This deficiency renders Plaintiffs' damages claims fatally speculative and improper for submission to the jury.

II. FACTUAL BACKGROUND

A. Products And Market

This case arises out of the sale of containers for the disposal of sharp medical instruments in the United States. Sharps containers are either "disposable" or "reusable."[1] Covidien is a leading supplier of sharps containers. Other major suppliers include Becton

[1] Plaintiffs allege that the relevant antitrust market in this case is the United States market for all sharps containers. Complaint ¶¶ 23-24. Solely for purposes of this motion, Covidien does not dispute that disposable containers and reusable container services compete with each other and are in the same relevant market.

Dickinson ("BD"), a medical device company with billions of dollars in annual sales, and Stericycle, Inc. ("Stericycle"), which entered the national reusable container market just a few years ago and is growing sales and adding customers at a rapid rate. Daniels Sharpsmart, Inc. ("Daniels") is a reusable sharps container company based in Australia that entered the U.S. market in 2003 and currently has approximately [redacted] of the overall market. SOF 1.[2] Plaintiffs estimate that Covidien's market share has dropped steadily from [redacted] in 2001 to less than [redacted] in 2007. SOF 2.

Witnesses from BD and Stericycle expressly testified that [redacted]. SOF 3. BD's witness, James Shaw, testified that, in the late 1990s, [redacted]. SOF 4. BD [redacted]. SOF 5. As a result, BD [redacted] since 1996 and by 2007 had [redacted]. SOF 6. Mr. Shaw expressly testified that [redacted]. SOF 7. He also testified that [redacted]. SOF 8.

Stericycle's witness, Richard Kogler, gave similar testimony about the robustness of competition in the container market. Specifically, he testified that, in 2003, after acquiring a regional reusable sharps container company, [redacted]. SOF 9. Stericycle converted [redacted] new accounts in 2004, added [redacted] new

[2] All cited documents and testimony are referenced in Covidien's Statement of Undisputed Facts ("SOF") and attached as exhibits to the Declaration of James Donato filed herewith.

accounts in 2005, and converted almost another [redacted] accounts in 2006 -- [redacted]. SOF 10-12. Mr. Kogler testified that [redacted] and [redacted] SOF 13-14. He emphasized that [redacted] SOF 15.

Daniels, a substantially smaller container supplier than BD or Stericycle, entered the U.S. market in 2003 and sells reusable containers. Daniels has experienced significant product and business challenges that are completely unrelated to Covidien. SOF 16-24. In particular, Daniels [redacted]. SOF 25-27.

B. Group Purchasing Organizations (GPOs)

Some purchasers of sharps containers choose to utilize sales terms and prices pre-negotiated by GPOs. Hospitals and other healthcare facilities created GPOs to combine their purchasing power to negotiate better prices from medical suppliers. SOF 28. GPOs do not actually buy or sell medical products but rather function as "administrative middlemen" that negotiate contracts with manufacturers on behalf of GPO members. Complaint ¶¶ 37, 56. GPO membership is voluntary, and many facilities belong to multiple GPOs, change their GPO memberships, or purchase outside GPOs. SOF 29.

GPOs choose manufacturers through a competitive bid process, after which contract positions are sometimes awarded to one company -- a sole-source contract -- and sometimes to two or more companies, depending on what the GPO believes is in its members' best interests. SOF 30. Most GPOs have treated disposable and reusable containers as separate bid categories.

SOF 31. Covidien's rivals have been successful with GPOs. For example, BD [redacted]. SOF 32. GPO contracts are terminable at will on short notice -- typically 90 days or less. SOF 33.

Being on contract with a GPO does not in any way guarantee sales for a supplier. GPO contracts do not require members to buy anything from contracted vendors but simply give them the option of buying products at pre-negotiated prices. SOF 34. Covidien's contract with the largest GPO, Novation, expressly states that "[redacted]" SOF 35. Hospital members routinely buy products outside of GPO contracts, and Plaintiffs' expert estimates that [redacted] of Covidien's sharps container sales do not involve GPOs. SOF 36-37.

C. Plaintiffs' Market Experience

Significantly, Plaintiff Natchitoches' own experiences in the container market underscore the absence of anticompetitive conduct by Covidien. Natchitoches' witness, Stephen Crowder, testified that he purchases Covidien sharps containers because he likes the products' features and considers them safe and effective, and that nothing prevents him from buying competing sharps containers. SOF 38-39. Natchitoches belongs to multiple GPOs and utilizes whichever contract gives it the best deal. SOF 40. Mr. Crowder believes that GPOs have helped Natchitoches receive better pricing and that he is free to purchase products entirely outside of GPO contracts without penalties or threats. SOF 41-42. Mr. Crowder testified that he does not think Covidien's sharps containers were priced too high or that Covidien has done anything wrong or improper. SOF 43.

D. Summary of Plaintiffs' Claims

Despite the express testimony by Natchitoches, Plaintiffs contend that Covidien's contracts have substantially foreclosed competition in the container market by imposing "de facto" exclusive dealing requirements. Plaintiffs allege that Covidien's "market-share" discounts and GPO contracts compel hospitals to buy most of their product needs from Covidien.[3] Complaint ¶¶ 41, 48-49. In essence, Plaintiffs argue that Covidien's low prices are so attractive that hospitals are reluctant to switch to other suppliers because they do not want to lose their discounts and good prices. Plaintiffs seek to characterize the potential loss of an above-cost price discount as an anticompetitive "penalty."[4] *Id.* Plaintiffs also contend that Covidien's sole-source GPO contracts impair competition because they allegedly deprive rivals who are not on contract of the most efficient avenue to consumers. Elhauge Report (Ex. A) ¶ 110. Plaintiffs contend Covidien substantially foreclosed competition and monopolized the market in violation of Sections 1 and 2 of the Sherman Act.

III. LEGAL STANDARDS

Familiar standards mandate summary judgment in favor of Covidien. Summary judgment should be granted when no genuine issue of material fact exists and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The moving party satisfies its initial burden by providing evidence negating any element of its opponent's claims or by showing an absence of evidence in its opponent's case. *Celotex Corp. v. Catrett,* 477 U.S. 317,

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[3] Plaintiffs devote a portion of their complaint to allegations of anticompetitive "bundling" by Covidien. But Plaintiffs have effectively abandoned this claim. Specifically, (1) Plaintiffs' liability expert has opined that the alleged bundles did not have any independent anticompetitive effect; (2) Plaintiffs have failed to perform the price-cost comparisons required by law to properly evaluate bundles; and (3) it is undisputed that the challenged bundles covered a small, legally insignificant portion of the relevant market. Any one of these conditions, standing alone, would be enough to dismiss any bundling claim by Plaintiffs. Plaintiffs have also dropped any claim that Covidien entered into conspiracies with other suppliers.

[4] Plaintiffs do not allege that any of Covidien's prices are predatory or below cost. *See* Section IV.A. below.

325 (1986). Once that showing is made, the nonmoving party must come forward with specific facts, supported by admissible evidence, to support its claims. *Matsushita Elec. Indus. Co. Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). The nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Id.* at 586-87. The proof must be such that a reasonable jury could return a verdict for the nonmoving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

As the Supreme Court and First Circuit have held, summary judgment is perfectly appropriate in antitrust cases. *Matsushita*, 475 U.S. at 587; *Podiatrist Ass'n, Inc. v. La Cruz Azul De P.R., Inc.*, 332 F.3d 6, 13 (1st Cir. 2003). Indeed, as many courts have recognized, "summary judgment is particularly favored [in antitrust cases] because of the concern that protracted litigation will chill pro-competitive market forces." *PepsiCo, Inc. v. Coca-Cola Co.*, 315 F.3d 101, 104 (2d Cir. 2002); *Thompson Everett, Inc. v. Nat'l Cable Adver., L.P.*, 57 F.3d 1317, 1322 (4th Cir. 1995) (antitrust cases "particularly well-suited for Rule 56 utilization").

IV. ARGUMENT

A. As A Matter Of Law, Covidien's Voluntary, Above-Cost Discounting Contracts Are Not Anticompetitive

Under governing case law, Plaintiffs cannot sustain any antitrust claims against Covidien. Plaintiffs' theory is that the above-cost discounted prices Covidien offers -- and the so-called "financial penalties" that they contend result when hospitals choose to give up discounts from Covidien in favor of buying from another supplier -- amount to anticompetitive conduct.[5] This theory fails as a matter of well-established and binding law.

[5] Plaintiffs allege that under market share discounts "health-care providers risked forfeiting substantial rebates if they filled even a small percent of their Sharps Containers needs with products from [Covidien's] competitors." Complaint ¶ 41. Plaintiffs contend that Covidien's GPO contracts subjected non-compliant hospitals to financial "penalties" in the form of foregone price incentives. *Id.* ¶ 37.

The First Circuit has flatly rejected the claim that above-cost discounts like the ones Plaintiffs challenge here can violate the antitrust laws. In *Barry Wright Corp. v. ITT Grinnell Corp.*, a conceded monopolist supplier offered a single large buyer (which accounted for more than 50% of the total market) special discounts of 25-30% in exchange for the buyer's commitment to purchase almost all of its product needs for two full years. 724 F.2d 227, 229 (1st Cir. 1983). The challenged contract also contained an "onerous" non-cancellation clause. *Id.* The plaintiff alleged that the special discounts, long-term contract and non-cancellation clause amounted to exclusionary conduct that improperly foreclosed competition under Sherman Act Sections 1 and 2, among other claims. *Id.* at 230.

In an opinion by Judge (now Justice) Breyer, the First Circuit affirmed the dismissal of all claims and held that "exclusionary" discounts are not actionable unless they lower prices below an appropriate measure of the defendant's costs. The First Circuit warned that, in a case such as the one before this Court, "[o]ne can foresee conflicting testimony by economic experts" as to whether the challenged discounts encouraged or restrained competition, and the court acknowledged that "even the most competitive of price cuts may hurt rivals; indeed, such may well be its object." *Id.* at 235.[6] The court then set a binding, bright-line test for this Circuit:

> In sum, we believe that such above-cost price cuts are typically sustainable; that they are normally desirable (particularly in concentrated industries); that the "disciplinary cut" is difficult to distinguish in practice; that it, in any event, primarily injures only higher cost competitors; that its presence may well be "wrongly" asserted in a host of cases involving legitimate competition; and that to allow its assertion threatens to "chill" highly desirable procompetitive price cutting. For these reasons, we believe that a precedent allowing this type of attack on prices that exceed both incremental and average costs would more likely

[6] In fact, the court considered the exact theory of harm advanced by Plaintiffs here -- that the challenged discounts could exclude less efficient firms that might someday develop into more effective competitors and drive down "but for" market prices -- and squarely rejected it as a basis for liability. *Id.* at 233-34. "The antitrust laws very rarely reject such beneficial 'birds in hand' for the sake of more speculative (future low-price) 'birds in the bush.'" *Id.* at 234.

interfere with the procompetitive aims of the antitrust laws than further them.[7] *Id.* at 235-36.[8] Thus, even accepting all of Plaintiffs' allegations as entirely true, Covidien's above-cost discounts are simply not actionable in this Circuit.[9]

The holding of *Barry Wright* is not only binding precedent in the First Circuit but its principles have been widely applied by the Supreme Court to all forms of pricing conduct. Indeed, each time the Court has addressed the standards for allegedly anticompetitive pricing under the Sherman Act, it has held that plaintiffs must allege and prove that the defendant sold its goods at a price below some measure of its costs. *See, e.g.*, *Matsushita*, 475 U.S. at 585 & n.8; *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 117 & n.12 (1986). As the Court has explained, "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.... [w]e have adhered to this principle *regardless of the type of antitrust claim involved.*" *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990) (emphasis added). The Court extended this analysis in *Brooke*

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[7] As the court explained about the necessity for a bright-line rule, "while technical economic discussion helps to inform the antitrust laws, those laws cannot precisely replicate the economists'(sometimes conflicting) views. For, unlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve." *Id.* at 234.

[8] *See also,* 2 AREEDA & HOVENKAMP, ANTITRUST LAW, Vol. IIIA ¶ 768b2 at 149-50 (Ex. DDD) (with loyalty discounts, "injury to an equally efficient rival seems implausible ... [a]s the First Circuit did in *Barry Wright*, we would test illegality by the ordinary rules applying to predatory pricing and allow all above-cost single-item discounts").

[9] Several other courts have also ruled that above-cost discounts conditioned on high levels of purchasing fully comply with the antitrust laws. *See Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1059, 1062-63 (8th Cir. 2000) (discounts requiring customers to buy at least 80% of their needs from the defendant were not "in any way exclusive" when prices remained above cost and rivals could "lure customers away by offering superior discounts."); *J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc.*, No. 1:01-cv-704, 1:03-cv-781, 2005 WL 1396940, at *10-*11, *14, *17 (S.D. Ohio June 13, 2005) (market-share discounts that can be abandoned in favor of a better offer not anticompetitive); *Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co.*, 94 F. Supp. 2d 804, 806-07, 813-14, 816 (E.D. Ky. 1999) (incentives in exchange for a substantial share of business not anticompetitive when rivals "presumably need offer only a more attractive [proposal]" to convert customers); Herbert Hovenkamp, Competitive Effects of Group Purchasing Organizations' (GPO) Purchasing and Product Selection Practices in the Health Care Industry, at 2 (April 2002) (Ex. EEE) ("incentives to purchase a certain percentage of [products]" from a supplier "are output enhancing" and "have uniformly been found procompetitive under the antitrust laws").

Group Ltd. v. Brown & Williamson Tobacco Corp., holding that "a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs" and demonstrate a probability of recoupment. 509 U.S. 209, 222, 224 (1993).

The Court's most recent antitrust decisions have hammered home this bedrock principle. In *Pacific Bell Telephone Co. v. Linkline Communications, Inc.* -- decided in February 2009 -- the Court once again conclusively held that a plaintiff cannot make out a claim for anticompetitive pricing under the Sherman Act unless it can allege and prove below-cost pricing. 555 U.S. ___, 129 S. Ct. 1109 (2009). Summarizing the evolution of pricing jurisprudence from *Matsushita* and *Cargill* through *Brooke Group* and to the present, the Court explained that, "[t]o avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low." *Id.* at 1120. "[A] plaintiff must demonstrate that: (1) the prices complained of are below an appropriate measure of its rival's costs; and (2) there is a dangerous probability that the defendant will be able to recoup its investment in below-cost prices." *Id.* (internal quotations omitted).[10]

This unbroken progression of Supreme Court precedent over more than 20 years establishes a bright-line rule: where, as here, a plaintiff seeks to condemn a defendant's discounted prices, it must prove that those prices are below the defendant's costs. Whether classified as "market-share," "loyalty," or "volume" discounts, courts have consistently held that pricing incentives and practices must result in a price below a proper measure of costs before they can be condemned. The reason is simple: if discounted prices are above cost, equally

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[10] *See also Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 549 U.S. 312, 318-19 (2007).

efficient competitors can lure business away by offering a better price.[11]

Here, the undisputed evidence shows that Plaintiffs cannot prove Covidien's market-share discounts lowered its prices below any measure of its costs. Nowhere in their complaint do Plaintiffs even allege that Covidien's prices for any of its sharps containers were below any measure of cost. To the contrary, Plaintiffs affirmatively assert that Covidien's prices were "well above the marginal cost for its Sharps Containers." Complaint ¶ 26. This admission alone is fatal to Plaintiffs' case. Plaintiffs' liability expert has made no effort to determine whether Covidien's prices were below (or even anywhere near) its costs. SOF 44. He has not even attempted to show that Covidien's actual rivals -- much less hypothetical equally efficient rivals -- could not profitably compete for hospital business simply by lowering their own prices. SOF 45.[12] Consequently, Plaintiffs' antitrust claims fail as a matter of law.

B. Plaintiffs Cannot Prove That Covidien's Discounting Programs And Sole-Source GPO Contracts Unlawfully Exclude Competition

Plaintiffs' effort to style their pricing claims as "de facto exclusive dealing" is a transparent attempt to evade the dispositive law just discussed. It is also an utterly self-defeating maneuver because the governing law of "exclusive dealing" is equally fatal to Plaintiffs' case.

To proceed with either a Section 1 or a Section 2 claim based on exclusive dealing,

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[11] Prof. Elhauge's analyses testing the impact of the challenged practices on the market focus only on Covidien's share and sole-source discounts and ignore bundling discounts. However, it is important to note that courts considering bundling practices also look for discounts that put product prices *below* an appropriate measure of costs. *See Cascade Health Solutions v. Peacehealth*, 515 F.3d 883, 903-04 (9th Cir. 2008); *Virgin Atl. Airways Ltd. v. British Airways PLC*, 69 F. Supp. 2d 571 (S.D.N.Y. 1999); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

[12] Prof. Elhauge apparently hopes to rely on his own legally irrelevant definition of foreclosure. He claims that foreclosure occurs anytime "free competition does not exist" for a customer's business. Elhauge Depo. (Ex. VV) at 133:16-23. Thus, in his view, anticompetitive "foreclosure" exists even if the allegedly unjustified impediment only makes it "*one penny* more expensive for rivals to compete." *Id.* at 133:24-134:9 (emphasis added). No wonder the leading antitrust treatise has dismissed Prof. Elhauge's discounting theories, which, while "popular with plaintiffs' lawyers," would establish standards that "[a] federal court could never apply [without] chilling procompetitive behavior." 3 AREEDA & HOVENKAMP, ANTITRUST LAW, 2008 Supp. ¶ 749b at 145-46 & n.48 (Ex. FFF).

Plaintiffs must first prove that Covidien's contracts truly amount to "exclusive" deals that actually preclude competition. *See Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of Rhode Island*, 373 F.3d 57, 65-66 (1st Cir. 2004).[13] If Plaintiffs cannot do so, then the inquiry is over -- the contracts are lawful. *See Tampa Elec.*, 365 U.S. at 329-30. Even if exclusivity is established for the particular challenged contract, Plaintiffs must also prove that the accused practice substantially foreclosed the relevant market and harmed competition overall. *Id.* at 327. Plaintiffs' claims fail both tests because Covidien's contracts are neither exclusive nor do they foreclose or otherwise impair competition.

1. None Of Covidien's Contracts Require Exclusive Dealing

As an initial and dispositive matter, neither Covidien's sole-source GPO contracts, nor its market-share discounts or bundled sales programs, are exclusive arrangements. "Exclusive dealing" occurs only when a contract, either on its face or in practical effect, requires buyers to purchase exclusively from a supplier. *See, e.g., Barry Wright*, 724 F.2d at 229, 235-37 (rejecting foreclosure claim where contract did not require customer to buy "all its requirements" from defendant, and customer had "legal power to buy ... small ... and then ... larger" amounts from competitors); *Paddock Publ'ns, Inc. v. Chicago Tribune Co.*, 103 F.3d 42, 46 (7th Cir. 1996) ("An exclusive dealing contract obliges a firm to obtain its inputs from a single source."); *W. Parcel Express v. United Parcel Serv. Of Am., Inc.*, 190 F.3d 974, 976 (9th Cir. 1999) (same). Because the contracts and discounts that Plaintiffs challenge do not require customers to buy

[13] Courts apply the tests developed under § 3 of the Clayton Act for all exclusive dealing claims. *See Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 335 (1961) (exclusionary contracting practices cannot violate §§ 1 or 2 of the Sherman Act, if they do not "fall within the broader proscription of § 3 of the Clayton Act"); *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 393 (7th Cir. 1984) (tests essentially identical); *see also, Williams v. I.B. Fischer Nevada*, 999 F.2d 445, 448 (9th Cir. 1993) (agreement that "does not establish a section 1 claim ... cannot form the basis of a section 2 claim").

anything from Covidien, let alone deal exclusively with it, they do not even remotely qualify as exclusive.

On their face, none of the alleged discounts or GPO contracts compel customers to buy a single sharps container from Covidien. By their express terms, the accused hospital contracts simply allow customers to choose to commit to a greater share or volume of purchases from Covidien in exchange for discounts. SOF 46. Hospitals are free to decline the discount and buy from a competitor at any time. SOF 34. The only "consequence" is the completely unremarkable fact that their price may be adjusted to reflect their actual levels of purchases. SOF 47. Covidien's sole-source GPO contracts also do not require hospital members to purchase anything from Covidien. Indeed, the terms of the contracts and the uniform testimony of the GPO witnesses (and Plaintiff Natchitoches' own 30(b)(6) witness) demonstrate that hospitals are free to use -- or not use -- the pricing discounts offered by their GPOs. SOF 34, 36. This undisputed evidence of purchasing freedom is fatal to Plaintiffs' claims of exclusive dealing and foreclosure. *Barry Wright*, 724 F.2d at 229, 235-37; *Paddock Publ'ns*, 103 F.3d at 46.

In *Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group L.P.*, Case No. 2:05-cv-06419-MRP-AJW (C.D. Cal. July 9, 2008) (Ex. GGG), the Central District of California held that these very principles compelled summary judgment in favor of Covidien in a putative direct purchaser case premised on virtually the same allegations as those at issue here. The *Allied* court expressly determined that Covidien's "market-share" and sole-source GPO contracts, by their very nature, did not constitute exclusive dealing arrangements or anticompetitive conduct. The court held that "market-share agreements do not create an unreasonable restraint on competition ... the only direct consequence for a hospital that fails to meet its compliance level is 'potentially being charged the price that reflects its actual tier level of purchases.'" *Id.* at 7 (citation omitted).

The court further held that the sole-source contracts at issue were lawful because they "do not require GPO member hospitals to purchase any or all of their ... supplies from [Covidien]." *Id.* at 12. "[T]he fact that they would lose the preferential pricing under the sole-source contract [if they bought from rivals] is not evidence of anticompetitive harm." *Id.* at 13. This recent, on-point decision eviscerates Plaintiffs' case.

2. Covidien's Contracts Have Not Substantially Foreclosed The Market

Even true exclusive deals, which are not present in this case, rarely raise antitrust concerns. "[I]t is widely recognized that in many circumstances they may be highly efficient ... and pose no competitive threat at all." *E. Food Servs., Inc. v. Pontifical Catholic Univ. Servs. Ass'n, Inc.*, 357 F.3d 1, 8 (1st Cir. 2004). Accordingly, "such agreements pose a threat to competition only in very discrete circumstances," and there will be "no serious effects" when exclusive dealing (1) does not foreclose a substantial portion of the market; (2) the agreements are short term or easily terminable; or (3) new entry and expansion by competitors is feasible. *Id.*; *see also, Stop & Shop*, 373 F.3d at 65-67; *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162-64 (9th Cir. 1997) (recognizing these factors and adding the existence of alternative distribution channels). Every one of these factors applies here.

a. No substantial foreclosure

Even assuming Plaintiffs could show that Covidien's contracts amounted to exclusive dealing arrangements -- which they have not and cannot -- Plaintiffs' own estimate of the portion of the marketplace purportedly "foreclosed" by Covidien is insufficient to impose antitrust liability. Specifically, "[f]or exclusive dealing, foreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent." *Stop & Shop*, 373 F.3d at 68; *see also, Jefferson Parish Hosp. Dist. No. 2 v. Hyde*,, 466 U.S. 2, 46-47 (1984) (O'Connor, J., concurring)

(30% not actionable because "[p]lainly . . . the arrangement forecloses only a small fraction of the [relevant] markets. . ."); *Omega*, 127 F.3d at 1162 (38% foreclosure not actionable). Moreover, the First Circuit has found 50% "foreclosure" of a relevant market inadequate when, as here, the challenged contracts do not require total exclusivity, are not long-term, and provide benefits to sophisticated buyers. *Barry Wright*, 724 F.2d at 236-38.

Prof. Elhauge estimates the purported "foreclosure" from Covidien's sole-source contracts covered, at most, only [redacted] of the relevant product market,[14] while share discounts allegedly covered only [redacted] of the market.[15] SOF 48-49. It is undisputed that Covidien's bundling programs covered a small, legally insignificant portion of the market -- at all times less than [redacted] percent. SOF 50. Even if one were to improperly presume that foreclosure occurred, these participation levels are insufficient to state a claim under the antitrust laws. *Stop & Shop*, 373 F.3d at 68; *Jefferson Parish,* 466 U.S. at 46-47; *Barry Wright*, 724 F.2d at 236-38.[16]

b. Short-term, terminable contracts

All of the accused GPO contracts are also terminable at will on short notice and are thus presumptively lawful. Even true exclusive contracts do not, as a matter of law, cause foreclosure if they are easily terminable on short notice. *See, e.g., U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 596 (1st Cir. 1993) (termination with 30

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[14] Covidien offers these foreclosure numbers only for the purposes of this motion and to show that Plaintiffs' own evidence is completely insufficient to impose liability.

[15] Prof. Elhauge has significantly inflated this foreclosure figure by assuming that Covidien's 2001 Healthtrust contract included a 90% market-share commitment requirement, even though he concedes that the actual contract contained no such provision. Elhauge Reply Report (Ex. WW) ¶ 66 ("the Healthtrust/HPG contracts that have been produced thus far do not list a specific share requirement"). Not only is such a requirement absent from the contract, but Healthtrust's 30(b)(6) witness expressly testified that [redacted]. *See* SOF 51.

[16] In addition, these estimates relate solely to market "coverage," not true market "foreclosure." As Dr. Ashenfelter noted, the only "foreclosure" analysis that is even remotely proper from an economic perspective indicates that, at most, a grand total of **4.6** market share points may have been diverted to Covidien by the challenged practices. Ashenfelter Draft Report (Ex. ZZ) at 26-27. Put another way, Covidien's contracts had no effect on over 95% of the market.

days notice a *de minimis* restraint); *Roland Mach.*, 749 F.2d at 394-95 (exclusive dealing arrangements terminable in less than a year are presumptively lawful); *CDC Techs., Inc. v. IDEXX Labs., Inc.*, 186 F.3d 74, 81 (2d Cir. 1999). Here, the challenged GPO contracts provided for termination without cause on just 90 days' notice, and the GPOs further demonstrated their ability to add new sharps container vendors through the opening of separate reusable bidding tracks. SOF 31, 33. The discounting contracts Plaintiffs challenge allow hospitals to forego the discount and switch suppliers at any time and thus are terminable at will. SOF 34, 47; *see also* 3 AREEDA & HOVENKAMP, ANTITRUST LAW, 2008 Supp. ¶ 749b at 149 (Ex. FFF) (a market-share discount "presents a contract of 'zero' duration").

c. Alternate distribution channels

Viable alternatives to GPO contracting plainly exist and further vitiate any purported foreclosure. Courts have made clear that no competitor is guaranteed "the best, most efficient [or] cheapest" channel to customers. *Omega*, 127 F.3d at 1163; *Stop & Shop*, 373 F.3d at 67; *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F.3d 1379 (5th Cir. 1994). As long as competitors are "free to sell directly, to develop alternative distributors, or to compete for the services of the existing distributors[,] [the] [a]ntitrust laws require no more." *Omega*, 127 F.3d at 1163; *Stop & Shop*, 373 F.3d at 67 (relevant market is *all* potential customers, not just those in a more efficient network); *Seagood Trading Corp. v. Jerrico, Inc.*, 924 F.2d 1555, 1572-73 (11th Cir. 1991); *CDC Techs.*, 186 F.3d at 81.

As described above, it is undisputed that alternate channels to customers exist in this market outside of GPOs. *See* Section II.B. Manufacturers can reach customers either directly or through alternate channels such as medical product distributors, or smaller group buying organizations. Whether these are more or less efficient channels is irrelevant. That they exist is

dispositive.

d. Competition is flourishing

Plaintiffs' claims also fly in the face of overwhelming evidence that competition is not foreclosed. As detailed above, BD and Stericycle testified that [redacted]. The evidence also shows that Covidien's market share is moderate and declining, its prices have gone down, and its margins are shrinking. SOF 2, 52.

These undisputed facts demonstrate that Covidien did not "foreclose" the market or wield monopoly power. *See, e.g., Omega,* 127 F.3d at 1164 (no foreclosure where competitor experienced "actual entry and expansion" and market share grew from "6% to 8%"); *Rebel Oil Co., Inc. v. Atl. Richfield Co.*, 51 F.3d 1421, 1439 (9th Cir. 1995) ("plaintiff must show that new rivals are barred from entering the market and show that existing competitors lack the capacity to expand their output"); *see also, Exxon Corp. v. Berwick Bay Real Estate Partners*, 748 F.2d 937, 940 (5th Cir. 1984) (per curiam) ("monopolization is rarely found when the defendant's share of the relevant market is below 70%"); *Colo. Interstate Gas Co. v. Natural Gas Pipeline Co. of Am.*, 885 F.2d 683, 694 n.18 (10th Cir. 1989) (70% to 80% required); *U.S. v. Dentsply Int'l, Inc.*, 399 F.3d 181, 187 (3d Cir. 2005) ("a share significantly larger than 55% has been required to establish prima facie market power"); *Winter Hill Frozen Foods & Servs, Inc. v. Haagen-Dazs Co., Inc.*, 691 F. Supp. 539, 547 (D. Mass. 1988) ("the competitor's declining market share is evidence that such [a] competitor lacks [market] power").[17]

[17] This lack of monopoly power or substantial market power is a separate and independent ground for dismissing Plaintiffs' case. *See, e.g., Wojcieszek v. New England Tel. & Tel. Co.*, 977 F. Supp. 527, 533 (D. Mass. 1997); *E. Food Servs.*, 357 F.3d at 5 (market power required element in a Section 1 claim).

Finally, separate and apart from these factors, the pro-competitive benefits of Covidien's contracts clearly outweigh any purported anticompetitive effects. Sole-source contracts have numerous, well-recognized benefits and generate vigorous *ex ante* competition that reduces prices for hospitals while preserving their purchasing freedom. *E. Food Servs.*, 357 F.3d at 8; *Stop & Shop*, 373 F.3d at 65-66; *see also,* Ordover Report (Ex. B) ¶¶ 78-79. "Market-share" and "bundled" discounts allow manufacturers to lower their average production costs and pass these savings on to consumers. *Cascade,* 515 F.3d at 895-96; 3 AREEDA & HOVENKAMP, ANTITRUST LAW, 2008 Supp. ¶ 749b2 at 163 (Ex. FFF) ("This fact undoubtedly accounts for much of the discounting that goes on in such high technology markets as those for medical devices or pharmaceuticals."). The "market-share" component of these deals allows all hospitals, big and small, the opportunity to share in these savings. 3 AREEDA & HOVENKAMP ¶ 749b2, ANTITRUST LAW, 2008 Supp. at 146 n.51 (Ex. FFF); 2 AREEDA & HOVENKAMP, ANTITRUST LAW, Vol. IIIA ¶ 768b2 at 148 & n.24 (DDD). Combined with the prior factors, these pro-competitive benefits doom Plaintiffs' claims. *See Barry Wright*, 724 F.3d at 237-38 (rejecting claim of 50% percent foreclosure when the contracts did not completely exclude competition, were short term, and provided pro-competitive benefits to sophisticated buyers).

C. Plaintiffs Cannot Prove Antitrust Damages

As if these many defects were not enough, Plaintiffs' claims fail for the entirely independent reason that they cannot prove damages by any non-speculative estimation. In order to recover damages, an antitrust plaintiff must present "a just and reasonable estimate" of damages that is not based on "speculation or guesswork." *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 264 (1946); *see also Coastal Fuels of P.R., Inc. v. Caribbean Petroleum Corp.*, 79 F.3d 182, 200 (1st Cir. 1996); *Wells Real Estate, Inc. v. Greater Lowell Bd. of Realtors*, 850 F.2d 803, 816 (1st Cir. 1988). Where a plaintiff's estimate of damages "relies too heavily on

speculation and conjecture" and "is not sufficient to get the Court beyond the guessing stage," those damages must be rejected as a matter of law. *Home Placement Serv., Inc. v. Providence Journal Co.*, 819 F.2d 1199, 1209 (1st Cir. 1987) (internal quotations omitted); *see also Wells Real Estate*, 850 F.2d at 816 ("If the plaintiff's proffered evidence permits no more than pure speculation and guesswork, then the damage evidence is insufficient as a matter of law.").

Plaintiffs' evidence of antitrust damages manifestly fails to meet this standard. Plaintiffs' damages expert, Dr. Singer, attempts to model the "but-for prices" that would have prevailed absent Covidien's market-share discount programs and sole-source contracts. A crucial input into this model is an accurate estimate of the amount of foreclosure allegedly suffered by Covidien's rivals, or -- put differently -- the impact of the challenged practices on rivals' market shares.[18] SOF 53.

Neither Dr. Singer nor Prof. Elhauge actually claims to have measured the foreclosure Covidien's contracts caused. Instead, Plaintiffs' experts have played a game of "hot potato," in which each expert has expressly stated that the burden of accurately quantifying the impact of the challenged contracts on rivals was entirely the responsibility of the other. Dr. Singer unequivocally and repeatedly testified that he "turn[ed] over … the role of estimating the magnitude of foreclosure to Professor Elhauge" and that he was "not asked to prove foreclosure," only to "convert that foreclosure, assuming it occurred … into a but-for price." SOF 54. As Dr. Singer testified, "I have not been asked, nor have I formed an independent opinion as to whether Professor Elhauge's calculation of the differential in rival penetration was the appropriate analysis. I just -- that's not something that I considered to be my task." *Id.* At

[18] As Dr. Ashenfelter noted in his draft report, "Dr. Singer's analysis requires a measurement of sharps container market shares in the 'but-for' world, and he chooses to use the output of one of Professor Elhauge's econometric analyses to supply these market shares." Ashenfelter Draft Report (Ex. ZZ) at 4.

the Daubert hearing, however, Prof. Elhauge made plain that he was only "opining on the fact of impact, not the precise amount of anticompetitive impact," which he insisted was "the subject of Dr. Singer's testimony as the damages expert." SOF 55. As Prof. Elhauge explained, "what I *haven't* done, which is the relevant damages question, is quantify the difference between rival shares in the actual world and the but-for world."[19] *Id.* (emphasis added).

This record is fatal to Plaintiffs' case. Each expert assigned the task of measuring the impact of Covidien's challenged contracts to the other, such that, in the end, neither performed the crucial analysis at all. Dr Singer's model rests on a vital input he uncritically imported from Prof. Elhauge's calculations, but Prof. Elhauge says he never intended those calculations to be precise and he only meant to show the existence of some impact. Consequently, Dr. Singer's calculation of damages is entirely speculative and cannot go to the jury.

V. CONCLUSION

For these reasons, Covidien respectfully requests that summary judgment be entered in Covidien's favor on all of Plaintiffs' claims.

Dated: July 29, 2009

Respectfully submitted,

/s/ *James Donato*

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[19] As shown in Covidien's pending *Daubert* motion (which, if granted, would constitute an independent basis for dismissal), Prof. Elhauge concedes that his simultaneous comparisons, which purport to measure the mere existence of foreclosure resulting from Covidien's contracts, are infected with selection bias (SOF 56), which irreparably impairs the validity of those calculations. Although Prof. Elhauge attempts to downplay the impact of that selection bias, his calculations are incorporated -- without any correction -- into Dr. Singer's damages model. SOF 57. Thus, even assuming that Prof. Elhauge's calculations could form the necessary inputs for Dr. Singer's model, which they do not, the presence of selection bias without any correction renders Dr. Singer's ultimate calculations of the amount of damages hopelessly speculative. *See, e.g.*, *Bouchard v. Am. Home Prods. Corp.*, 213 F. Supp. 2d 802, 810 (N.D. Ohio 2002) (holding that an article "overly tainted with selection bias ... may not form the basis of [an expert's] opinion"); *Valentine v. Pioneer Chlor Alkali Co., Inc.*, 921 F. Supp. 666, 676-77 (D. Nev. 1996) (rejecting study where "[t]he probability of selection bias is too high to be overlooked").

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CERTIFICATION UNDER LOCAL RULE 7.1(A)(2)

Counsel for Covidien conferred with plaintiffs' counsel and attempted in good faith to resolve the issues raised in this Motion. Plaintiffs are opposed to Covidien's requested relief.

CERTIFICATE OF SERVICE

I hereby certify that the foregoing was filed through the ECF system will be sent electronically to the registered participants as identified on the Notice of Electronic Filing (NEF) and copies will be sent to those indicated as non-registered participants on July 29, 2009.

/s/ *James Donato*

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