UNITED STATES DISTRICT COURT
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.	)	1:05-CV-12024-PBS

MEMORANDUM AND ORDER

November 20, 2009

Saris, U.S.D.J.

I. INTRODUCTION

The plaintiff class brings this antitrust action alleging that defendant Covidien has violated Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2, by engaging in improper exclusive dealing in its domestic marketing and sale of containers for the disposal of sharp medical instruments. Additionally, Plaintiffs claim that Covidien unlawfully maintained monopoly power through these practices. Covidien has

moved for summary judgment. After hearing and review of the filings and the extensive evidentiary record, the Court **DENIES** the Motion for Summary Judgment. Because trial in this case is less than three weeks away, this opinion will be brief.

II. BACKGROUND

The Court has written at length on the facts of this case in two prior opinions certifying a nationwide plaintiff class (Docket Nos. 130, 169). See Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int'l, Ltd., No. 05-12024, 2008 U.S. Dist. LEXIS 109925 (D. Mass. Aug. 29, 2008); Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int'l, Ltd., 247 F.R.D. 253 (D. Mass. 2008). The following facts are undisputed except where stated.

This case arises from Covidien's sales practices as a leading supplier in the United States of sharps containers, used for the disposal of needle-inclusive medical products such as syringes, blood collection devices, and IVs. There are both disposable and reusable sharps containers; the containers look like plastic covered wastebaskets. The definition of the market is the United States market for all Sharps containers. Covidien does not dispute that disposable and reusable containers services compete with each other and are in the same relevant market. Since October 4, 2001, the start of the class period, which runs through the present, Covidien has controlled approximately fifty-four to sixty-five percent of the sharps container market in the

United States. In Plaintiffs' view, Covidien used its market strength to exclude competitors and maintain monopoly power by:

1. imposing market share purchase requirements that obligated its buyers to purchase all or substantially all of their sharps containers requirements exclusively from Covidien; and

2. entering into exclusive contracts with Group Purchasing Organizations ("GPOs"), which negotiate contracts between manufacturers/suppliers and their member hospitals, thereby foreclosing competitors from the most efficient means of distribution.

Plaintiffs claim that these practices substantially foreclosed from competition the nationwide market for disposable and reusable sharps containers, as well as the smaller market of GPO-brokered services and contracts. Plaintiffs' expert estimates that the foreclosure from sole source GPO contracts covered forty to seventy-eight percent of the relevant product market; market share discounts covered thirty-two to thirty-nine percent of the market. Bundling programs foreclosed eleven percent. On an aggregated basis, the expert found forty-three to forty-seven percent foreclosure. Plaintiffs argue that Covidien's unsanitary business practices harmed competition in these markets by depressing its rivals' output and producing higher supra-competitive prices for sharps containers than would otherwise have prevailed.

III. LEGAL STANDARD

"Summary judgment is appropriate when 'the pleadings,

depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.'" Barbour v. Dynamics Research Corp., 63 F.3d 32, 36-37 (1st Cir. 1995) (quoting Fed. R. Civ. P. 56(c)). To succeed on a motion for summary judgment, "the moving party must show that there is an absence of evidence to support the nonmoving party's position." Rogers v. Fair, 902 F.2d 140, 143 (1st Cir. 1990); see also Celotex Corp. v. Catrett, 477 U.S. 317, 325 (1986).

Once the moving party has made such a showing, "the burden shifts to the non-moving party, who 'may not rest on mere allegations or denials of his pleading, but must set forth specific facts showing there is a genuine issue for trial.'" Barbour, 63 F.3d at 37 (quoting Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 256 (1986)). The non-moving party must establish that there is "sufficient evidence favoring [its position] for a jury to return a verdict [in its favor]. If the evidence is merely colorable or is not significantly probative, summary judgment may be granted." Anderson, 477 U.S. at 249-50 (internal citations omitted). The Court must "view the facts in the light most favorable to the non-moving party, drawing all reasonable inferences in that party's favor." Barbour, 63 F.3d at 36 (citation omitted).

IV. DISCUSSION

Section 1 of the Sherman Act prohibits "every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States . . . ." 15 U.S.C. § 1. A Section 1 claim requires "(1) the existence of a contract, combination or conspiracy; (2) that the agreement unreasonably restrained trade . . . and (3) that the restraint affected interstate commerce." Lee v. Life Ins. Co. of N. Am., 829 F. Supp. 529, 535 (D.R.I. 1993), aff'd, 23 F.3d 14 (1st Cir. 1994). Exclusionary dealing claims do not constitute per se violations of Section 1, and are analyzed instead under a comprehensive "rule of reason" analysis. Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 236 (1st Cir. 1983) (Breyer, J.).

Section 2 of the Sherman Act makes it unlawful to "monopolize . . . any part of the trade or commerce among the several States." 15 U.S.C. § 2. A Section 2 claim requires "first, the 'possession of monopoly power in the relevant market' and, second, the 'acquisition or maintenance of that power' by other than such legitimate means as patents, 'superior product, business acumen, or historical accident.'" Barry Wright, 724 F.2d at 230 (quoting United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966)). In determining whether a manufacturer maintained its monopoly improperly, courts "should ask whether its dealings . . . went beyond the needs of ordinary business

dealings, beyond the ambit of ordinary business skill, and 'unnecessarily excluded competition from the . . . market." Id. (quoting Greyhound Computer Corp. v. Int'l Bus. Machs. Corp., 559 F.2d 488, 498 (9th Cir. 1977)).

A. Market Share Discount Contracts

Covidien argues that the discounts and rebates offered under its market share contracts do not violate the Sherman Act because they are above cost. The market share contracts give purchasers discounts if they purchase virtually all their needs from Covidien. Although Plaintiffs' theory is that the contracts are unlawful exclusionary dealing arrangements, Defendants argue that predatory pricing caselaw governs the analysis of the "loyalty" discounts given by Covidien as part of the market share contracts.

To prove predatory pricing under Section 2 of the Sherman Act:

> a plaintiff . . . must prove that the prices complained of are below an appropriate measure of its rival's costs. . . . As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting.

Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222-23 (1993) (rejecting a predatory pricing challenge to the defendants' above-cost volume rebate scheme). The second

prerequisite to holding a competitor liable under the antitrust laws for charging low prices is a demonstration that it had a dangerous probability of "recouping its investment in below-cost prices." Id. at 224. The Supreme Court cautioned, "Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws . . . ." Id. at 225; accord Pacific Bell Tel. Co. v. Linkline Commc'ns, Inc., 129 S. Ct. 1109, 1120 (2009) (rejecting a price-squeeze claim under Section 2 of the Sherman Act where defendant's retail prices remained above cost); Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 324-25 (2007) (reversing holding for plaintiffs who challenged monopolist's practice of bidding up input costs to undermine rivals' profitability under Section 2 of the Sherman Act). The lesson of this caselaw is that, generally speaking, above-cost discounting is not anticompetitive.

As stated, this case deals with a claim of exclusionary dealing, not predatory pricing. Exclusive dealing agreements are not "universally forbidden by the Sherman Act – indeed, they are quite common – but may, depending on the circumstances, unreasonably restrain trade." Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I., 373 F.3d 57, 65 (1st Cir. 2004). "Because such agreements can achieve legitimate economic benefits (reduced cost, stable long-term supply, predictable prices), no presumption against such agreements exists today."

Id. To prevail in attacking an exclusive dealing agreement, a plaintiff must show the extent of foreclosure from the exclusive dealing, taking into account other foreclosures in the market. Id. at 66. Although foreclosure levels are unlikely to be of concern where they are less than thirty or forty percent, "high numbers do not automatically condemn, but only encourage closer scrutiny" based on other factors like how much of the market must remain open for scale economics and ease of re-entry. Id. at 68.

The parties disagree on whether Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227 (1st Cir. 1983) (Breyer, J.) precludes an exclusive dealing claim here. There, the First Circuit rejected an exclusionary dealing claim under Sections 1 and 2 of the Sherman Act involving special volume discounts, a two-year contract that foreclosed fifty-percent of the market, and a non-cancellation clause. 724 F.2d at 229-30. The lawfulness of contracts that obligate a buyer to purchase exclusively from a seller, all his requirements for the specified time period, or a large dollar amount must be analyzed under the "rule of reason." Id. at 236. With respect to the claim that the volume discounts granted under the contract were unreasonably low, the court concluded that "the Sherman Act does not make unlawful prices that exceed both incremental and average costs." Id. The court reasoned that "above-cost price cuts are typically sustainable" and that "a precedent allowing this type of attack on prices that exceed both incremental and average costs would

more likely interfere with the procompetitive aims of the antitrust laws than further them." Id. at 235-36. The Court also held that the two-year agreement for a fixed dollar amount had legitimate business justifications, citing "the nature of the contracts and the market, their fairly short time period, their business justifications, the characteristics of the parties, and their likely motives as revealed by their business interests . . . ." Id. at 238. The court added that the district court reasonably could have concluded that the provision was not exclusionary, since it would not likely have affected the actions of so large and legally sophisticated a buyer. Id. at 238-39 (holding that the purchaser "is not a small firm that [the manufacturer] could likely bully into accepting a contract that might foreclose new competition.").

The court acknowledged that a threat posed by a non-cancellation clause that imposed penalties that would discourage a buyer from pursuing another cause of action might be anti-competitive: "And it is this threat, and the consequent additional deterrence to the 'breach and pay' damages course of action that constitutes the unreasonable anticompetitive aspect of the clause." Id. at 238 (rejecting the argument, however, as too remote in that case given the purchaser's size and legal ability to challenge the penalties).

Many courts have rejected exclusionary dealing claims based primarily on above-cost discounts. See, e.g., Concord Boat Corp.

v. Brunswick Corp., 207 F.3d 1039, 1059 (8th Cir.), cert. denied, 531 U.S. 979, 1063 (2000) (reversing jury verdict and holding that defendant's discount programs were not exclusive dealing contracts when prices remained above cost and rivals could "lure customers away by offering superior discounts"); Cascade Health Sol'ns v. PeaceHealth, 515 F.3d 883, 901 (9th Cir. 2008) (holding that, in the normal case, above-cost pricing will not be considered exclusionary conduct); St. Francis Med. Ctr. v. C.R. Bard, Inc., No. 07-CV-00031, 2009 WL 3088814, at *20-*21, *23-*24 (E.D. Mo. Sept. 28, 2009) (relying in part on Concord Boat and the Supreme Court's pricing cases to grant summary judgment for defendant medical device manufacturer on claims relating to its allegedly anticompetitive market share discount and GPO contracts); cf. J.B.D.L. Corp. v. Wyeth-Ayerst Labs., Inc., No. 1:01-cv-704, 1:03-cv-781, 2005 WL 1396940, at *10-*12, *14, *17 (S.D. Ohio June 13, 2005) (reasoning that market share discounts that can be discarded in favor of other offers are not anti-competitive, but rejecting defendant's argument that "lack of predatory pricing mandates dismissal of the Section 2 claims.")

Particularly relevant is the recent decision in Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group L.P., No. 2:05-cv-06419-MRP-AJW, slip op. 7-11 (C.D. Cal. July 9, 2008), granting summary judgment for the defendant in an action challenging similar market share discount contracts because the contracts did not contractually obligate hospitals to buy any

product at all, even where the hospitals stated a commitment to do so. The only direct consequence of failure to meet the compliance level was being charged the price that reflected "its actual tier level of purchases." Id. at 8-9. The court there concluded that "regardless of whether Tyco's discounts represent a penalty price or involve kickbacks to hospitals, they do not 'force' hospitals to do anything." Id. at 9. It explained, "It is impossible to articulate a scenario based solely on price, where price-sensitive hospitals would remain wedded to market-share arrangements if a switch to generics would serve them better." Id.

The same court had, two years previously, upheld a jury verdict for plaintiffs in a similar case, Masimo Corp. v. Tyco Health Care Group, L.P., No. 02-cv-4770-MRP, 2006 WL 1236666 (C.D. Cal. Mar. 22, 2006), aff'd, Nos. 07-55960, 07-56017, 2009 WL 3451725 (9th Cir. Oct. 28, 2009). In Masimo, the court had concluded that Tyco's market-share agreements were unreasonably restrictive of competition, despite being easily terminated on their face, primarily because "[a] number of hospitals were financially locked into purchasing . . . Tyco sensors to support their installed Tyco monitors." 2006 WL 1236666, at *3-5, *17. What was present Masimo, but not in Allied Orthopedic, was an element of coercion beyond the loss of above-cost discounts.

Under the emerging caselaw, Defendants have the better argument that, without more, above-cost market share discounts

cannot constitute improper exclusionary dealing that violates the Sherman Act. However, Plaintiffs do not rely solely on the market share discounts to demonstrate exclusionary conduct. They highlight at least two additional coercive factors.

First, they emphasize the contractual and practical obstacles preventing hospitals from terminating the contracts. Plaintiffs point to the fact that the market share contracts have no termination clauses, and therefore are not terminable at all. Covidien contends that those agreements are not anticompetitive because they are contracts of zero duration, leaving Plaintiffs free to purchase from non-contracted vendors at any time without suffering consequences except paying prices for the level of purchases made. See U.S. Healthcare, Inc. v. Healthsource, Inc., 986 F.2d 589, 596 (1st Cir. 1993) (reasoning that an exclusive service agreement with a thirty-day termination clause constituted a de minimus constraint). Plaintiffs offer evidence, however, that the contracts imposed affirmative purchase obligations at the outset, ran for indefinitely long terms, and lacked termination clauses, leaving buyers effectively unable to exit the agreements without breaking their commitments and the threat of suffering financial penalties through the loss of previously-accrued rebates and discounts. (See Pl.'s Resp. to Def.'s Statement of Facts ¶¶ 46, 47.) Therefore, they argue that they were exclusive dealing arrangements that forced them to buy

all their requirements from Covidien for an indefinite duration. See Concord Boat Corp., 207 F.3d at 1059 ("The principle criteria used to evaluate reasonableness of a contractual arrangement include the extent to which competition has been foreclosed in a substantial share of the relevant market, the duration of any exclusive arrangement, and the height of entry barriers.").

In addition to these formal contractual obligations, Plaintiffs assert that, in at least some instances, most notably the Spectrum contract with Novation, the largest GPO, Covidien policed and bullied its customers to ensure satisfaction of their ex ante purchasing commitments. For example, under several of Defendant's GPO agreements, sales representatives reviewed member-hospitals' purchasing activity to determine each member's compliance with market share commitments and, furthermore, required members to disclose their purchase records for review. (See Pl.'s Resp. to Def.'s Statement of Facts ¶ 35; Expert Report of Prof. Einer Elhauge ¶ 149.) Moreover, this active policing led to actual penalties for noncompliant members who were refused rebates on sharps containers already purchased and, more significantly, "clawing back" previously-received rebates. (Pl.'s Resp. to Def.'s Statement of Facts ¶¶ 47, 51.) At oral hearing, Covidien responded that this Novation contract with retroactive penalties foreclosed only eleven percent of the market for part of the class period. The extent of the policing

in other GOP contracts is unclear on this record.

Second, Plaintiffs offer evidence that at least some of Covidien's end-user contracts applied not just to single products, but across a range of bundled items, requiring buyers to commit to purchasing a substantial portion of their requirements for all products in order to receive rebates on any of them. (See id. ¶ 47.) Such programs may be exclusionary even where the discounts are above cost, since "'[d]epending on the number of products that are aggregated and the customer's relative purchases of each, even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce.'" LePage's v. 3M, 324 F.3d 141, 155 (3d Cir. 2003) (en banc), cert. denied, 542 U.S. 953 (2004) (quoting Areeda & Hovenkamp, Antitrust Law § 794, at 83-84 (Supp. 2002) and holding above-cost bundled rebates improper under Section 2 of the Sherman Act); see also Masimo, 2009 WL 3451725, at *1 (characterizing such contracts as "the hallmark of exclusive dealing"); St. Francis, No. 07-CV-00031, slip op. at 43, 51; Masimo, 2006 WL 1236666, at *5, *6 (upholding jury verdict for plaintiffs where competitors could not price low enough to compensate for the cost of replacing existing machinery compatible only with defendant's products). But see Cascade, 515 F.3d at 900-03 (rejecting LePage's and analyzing bundled discounts under Brooke Group's predatory pricing framework).

Assessed in a light most favorable to them, Plaintiffs have presented evidence (albeit disputed) of (1) substantial foreclosure (32-39%) of the market which triggers stricter scrutiny; (2) above-cost loyalty discounts; (3) indefinitely long affirmative commitments to buy all or nearly all of their requirements from Covidien; (4) bundling; (5) a policing and enforcement process designed to prevent departure; and (6) evidence of anti-competitive motive. Covidien has cogent counterpoints for each of these contentions and has set forth business justifications for its practices. However, the Court declines to preside over a paper trial with such a massive record where the facts are not clear. Summary judgment is not warranted.

B. Sole Source GPO Contracts

Plaintiffs' second major claim is that Covidien's sole source GPO contracts excluded competitors unfairly from the GPO services market, which they claim is the most efficient distribution channel for medical supplies. Approximately sixty percent of Covidien's Sharps containers sales involve GPOs. (Pl.'s Statement of Facts, ¶¶ 36-37.) Covidien argues that Plaintiffs are not entitled to the most efficient distribution channel, and that other avenues exist, since its sole source agreements do not compel Plaintiffs to purchase through their GPOs. Also, Covidien argues that members are not required to

purchase through the GPO and can purchase through other GPOs.

Courts have held that, if the distribution channel foreclosed is significantly more efficient than the others available, foreclosing it is anti-competitive. See, e.g., United States v. Microsoft Corp., 253 F.3d 34, 70-71 (D.C. Cir.) (en banc), cert. denied, 534 U.S. 952 (2001) (holding that defendant violated Section 2 of the Sherman Act where its "agreements, including the non-exclusive ones, severely restricted Netscape's access to those distribution channels leading most efficiently to the acquisition of browser usage share" even though a substantial market-wide foreclosure share was not calculated) (internal quotations omitted and emphasis added); LePage's, 324 F.3d at 159-60 & n.14 (upholding a jury's verdict of exclusionary dealing that cut rivals off from large retail superstores, which "provide a crucial facility to any manufacturer--they supply high volume sales with the concomitant substantially reduced distribution costs."); Abbott Labs. v. Teva Pharms. USA, Inc., 432 F. Supp. 2d 408, 423 (D. Del. 2006).

Here, Plaintiffs' expert has defined a relevant market of GPO-brokered services based on evidence that rivals' alternatives for selling their products were not reasonably interchangeable. (See Expert Report of Prof. Einer Elhauge ¶¶ 12, 23, 62-69.) Specifically, he has identified the unique advantages of GPOs in reducing transaction costs, obtaining significantly lower prices (on average 12.1% less than non-GPO pricing), and their

tremendous effect on sales, which distinguish the GPO market from the wider market for sharps containers. (Id.) Covidien argues that under even the sole source contracts, hospital purchasers can buy from Covidien's rivals through other GPOs or on their own without penalty. While this appears to be true under some GPO contracts during much of the class period, up to seventy-eight percent of the GPO services market was sole-source with Covidien so that, in Plaintiffs' view, rivals did not have an efficient avenue to hospital buyers without the GPO "administrative middleman." This foreclosure from the GPO market raised rivals' costs and created barriers to entry. The plaintiffs having presented evidence of this foreclosure, Covidien must defend its exclusive dealing contracts by providing a procompetitive justification for the sole source contract. Microsoft, 253 F.3d at 83-84.

Covidien's claims that the GPO market was not substantially foreclosed is also disputed. Plaintiffs offer evidence that, while GPOs have the right to terminate sole source agreements with ninety-days notice, an exiting GPO would have to abandon the entire contract, not simply the sharps containers, and accept lower administrative fees. (Pl.'s Resp. to Def.'s Statement of Facts ¶ 33.) Plaintiffs also present evidence that the selection process by which GPOs choose sole source manufacturers is not competitive and that, in at least some cases, GPO agreements prohibit hospital membership in multiple GPOs. (Id. ¶¶ 29, 30.)

C. Market and Monopoly Power

Covidien argues that its declining market share, prices, and profit margins all indicate that it does not have the substantial market or monopoly power required under Section 2 of the Sherman Act. In Covidien's view, competition is now flourishing. Plaintiffs estimate that Covidien's market share dropped from sixty-five to fifty-four percent in 2007. The parties' experts disagree substantially as to whether Covidien's prices and profit margins have, in fact, fallen during the relevant period. Plaintiff's expert marshals considerable evidence, including Defendant's internal documents, to demonstrate that, in fact, Covidien's prices and margins have increased slightly or remained stable throughout most of the class period. (Id. ¶ 52.) In any event, declining market share alone does not preclude a finding of market power. See Am. Tobacco Co. v. United States, 328 U.S. 781, 795-96 (1946) (finding monopolization despite decline in market share from 90.7% to 68%); Reazin v. Blue Cross and Blue Shield of Kan., Inc., 899 F.2d 951, 970 (10th Cir.), cert. denied, 497 U.S. 1005 (1990); see also Winter Hill Frozen Foods & Servs. v. Haagen-Dazs Co., 691 F. Supp. 539, 547 (D. Mass. 1988) ("[I]n the context of evaluating whether a particular competitor has market power . . . declining market share is evidence that such competitor lacks such power, although it is not dispositive.") (emphasis added). Since there is a genuine issue

of fact as to Covidien's market power, summary judgment is not warranted.

D. Damages

Covidien argues that Plaintiffs' damages expert, Dr. Singer, relied on imprecise inputs provided by Professor Elhauge regarding the impact of Covidien's practices. As Plaintiffs note, Covidien has previously briefed and subsequently withdrawn a Daubert challenge to Dr. Singer's expert testimony pursuant to an agreement between the parties, waiving its pretrial objections and reserving this issue for cross-examination at trial. Since Covidien has waived its pretrial objections on this point, it cannot re-raise it as a basis for summary judgment.

ORDER

Defendant's Motion for Summary Judgment [Docket No. 266] is **DENIED**.

S/PATTI B. SARIS
United States District Judge