ABA Section of Antitrust Law

Corporate Counseling Committee

Monthly Antitrust Update

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Antitrust Updates for January 2017

- Aetna/Humana Merger Blocked
- Anthem/Cigna Merger Blocked
- FTC Qualcomm Lawsuit
- Questcor Settlement
- European Competition Law Developments

Aetna/Humana Merger Blocked

Presented by
Elaine Ewing

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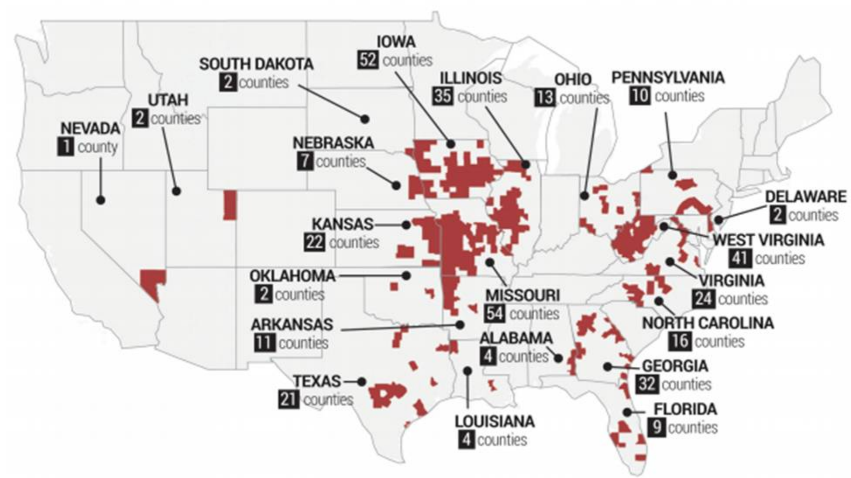
aetna Humana

Overview: Aetna Blocked from Buying Humana

- Aetna agreed to purchase Humana for $37 billion, with a $1 billion breakup fee
- DOJ sued to block the merger, alleging it would illegally reduce competition in:
  - Medicare Advantage plans in 364 counties in 21 states
  - ACA exchange plans in 17 counties in FL, GA, MO
- Judge Bates enjoined the merger; Aetna and Humana will not appeal

Counties where DOJ alleged presumptively illegal concentration in Medicare Advantage market



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aetna Humana

Different Markets for Medicare "Original" and "Advantage"

Major Differences in "Original Medicare" and Medicare Advantage

Original Medicare (+ Med Supp plans)	Medicare Advantage
• Run by federal government	• Private insurers bid to cover seniors
• Requires private "Med Supp" plans to cover out-of-pocket costs	• Caps out-of-pocket costs without supplemental plans
• Beneficiaries tend to be richer, more educated	• Beneficiaries tend to be poorer, less educated
• Accepted by virtually all providers	• Uses narrow networks to cut cost
• Default option	• Opt-in
• Government service	• Regulated margins, bidding, overhead

Ordinary Course Documents Suggested Separate Markets

- Aetna did not assess prices of Med Supp plans when pricing Medicare Advantage
- Discussion of competitors focused on other insurers, not Original Medicare

Econometric Evidence That Few Seniors Switched

- "Durable preferences" shown from switching data
- Experts at trial, ordinary course internal studies came to same conclusions

Divestiture to Molina Healthcare Deemed Insufficient

- The court concluded that divestiture to Molina was insufficient because:
  - Molina had failed to enter Medicare Advantage markets before
  - Divestiture required ongoing relationship between the merged company and Molina
  - Low purchase price raised concerns that this was a "fire sale"
- Molina documents included problematic board and CEO emails
  - "The image that comes to my mind here is ***the dog chasing the car and we are the dog***. What happens if we catch it?"
    - CEO responds: "I guess it depends on if it is a mini Cooper or a Suburban."
  - "[T]his is a very different business from what we do…Unless we can acquire some talent as part of the deal, ***I think we are woefully under-resourced to be able to take this on[.]***"
    - CEO responds, "Agree wholeheartedly."

"[T]he board, CFO, and CEO all doubted Molina's ability to successfully operate the divestiture plans. That, combined with the extremely low purchase price, raises genuine concern" – Judge Bates

Aetna Allegedly Used Withdrawal from Exchanges as Leverage

- Internal documents showed Aetna treated 17 counties in DOJ complaint differently
  - "Most of this [withdrawal] is a business decision except where DOJ has been explicit about the exchange markets. There we have no choice."
  - Documents evaluated 17 complaint counties separately
  - Aetna exchange head emailed "I was told to be careful about putting any of that in writing. I will have the attorney client privilege ccd by tomorrow."

- Aetna statements to DOJ unhelpful to Aetna
  - At the Aetna CEO's deposition, Aetna's counsel stated that if they were not "happy" with an upcoming meeting regarding the merger, "we're just going to pull out of all the exchanges." Aetna's CEO affirmed, stating: "Nice."
  - Aetna sent a letter to DOJ (forwarded to HHS) stating that if the merger were blocked, "we believe it is very likely that we would need to leave the public exchange business entirely."

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aetna Humana

The Court Gave Very Little Weight to Aetna's Withdrawal

- Judge Bates rejected both parties' positions on Aetna's withdrawal; found that Aetna was likely to compete in at least some of 17 counties after 2017
  - The DOJ argued that because Aetna withdrew to evade antitrust review, the court should examine competition as it existed before withdrawal
  - The defendants argued that once Aetna withdrew from the complaint counties, "that was the ball game" regardless of the reasons
- Judge Bates instead analyzed whether Aetna was likely to compete in Florida complaint counties in the future. He found it <u>was</u> likely to compete because Aetna was profitable in Florida and could readily re-enter
- The market concentration in the complaint counties was thus presumptively illegal, and DOJ showed evidence of head-to-head competition

"Because [the withdrawal] was not driven by what one would expect—a firm's profit motive…it is not probative of how Aetna will behave in the future." –Judge John D. Bates

Anthem/Cigna Merger Blocked

Presented by
Elaine Ewing

Overview: Anthem Blocked from Buying Cigna

- Anthem agreed to purchase Cigna for $54 billion, with $1.85 billion breakup fee – largest health insurance merger in history
- DOJ sued to block the merger, alleging it would reduce competition in:
  - **National accounts** – Higher prices for entities buying nationwide coverage for employees
  - **Local commercial markets** – 35 metro areas where Anthem and Cigna are key competitors
  - **Purchase of healthcare services** – Reduced reimbursement to providers through monopsony power
- Judge Amy Berman Jackson blocked the merger, finding it would reduce competition, at least in national accounts and the local commercial market in Richmond, VA
- Anthem has appealed, and oral arguments are set for March 24^{th}
- Cigna is trying to terminate the merger agreement and has sued Anthem for $13 billion in damages

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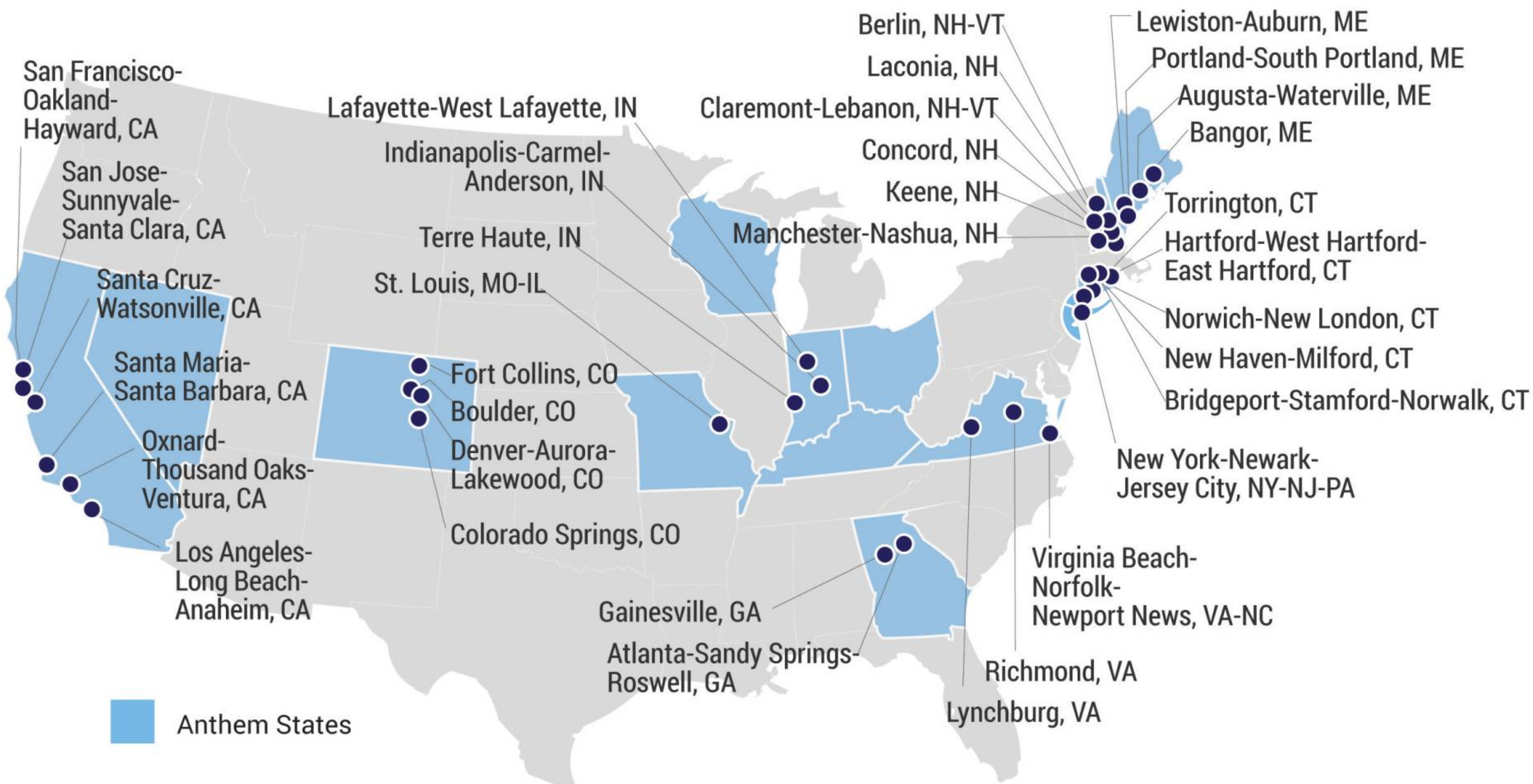
Anthem

Geographic Markets Alleged: USA, 14 States, 35 Metro Areas



Head-to-Head Competition for National Accounts

- National accounts are companies with > 5,000 employees, operate in multiple states, have lengthy bidding processes to choose their insurers, and often use large consulting firms to help pick plans
- Anthem and Cigna have dedicated national account business units
- Documents show a “[d]ogfight” for national accounts
  - Anthem “bounty” programs rewarded salespeople for winning against Cigna
  - Anthem salespeople had more flexibility in pricing against Cigna
  - Anthem documents stated Cigna “should not exist” and targeted it for fierce competition
- Defendants argued national employers could assemble networks of providers from regional insurers
- Judge Jackson found that national accounts that used multiple carriers still often used “big four” national carriers rather than regional rivals

Efficiency Defense Rejected

- Defendants argued merger would allow lower costs with the same value
  - Anthem negotiated better discounts with providers, while Cigna had better value-based options
  - Defendants claimed that the merged company could provide Cigna value with Anthem costs
- Judge Jackson found “product” was not healthcare, but administrative and insurance services
  - No evidence that bargaining for deeper discounts would improve this product; instead, transaction would lead to higher prices

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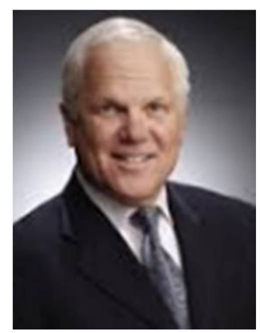
Anthem

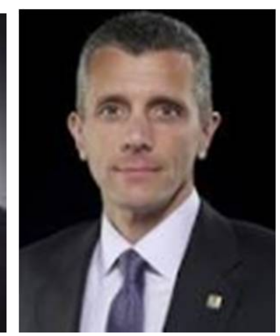
Anthem-Cigna Split Hurt Deal's Chances

- Disagreement on strategy
  - Cigna objected to integration plans that favored Blue Cross members over Cigna
  - Cigna stopped participating in integration efforts on advice of counsel and Anthem established separate integration teams
- Lack of harmony hurt efficiencies arguments
  - Cigna cross-examined Anthem witnesses
  - Cigna refused to sign Anthem's Findings of Fact & Conclusions of Law
  - Judge Jackson found this friction cast doubt on efficiencies

*"**Your approach to the regulatory strategy**, when coupled with your approach to integration and other matters, appear to be designed to cause commercial harm to Cigna while **simultaneously strengthening your fellow Blues**." – Cigna letter to Anthem*



Anthem CEO
Joseph Swedish



Cigna CEO
David Cordani

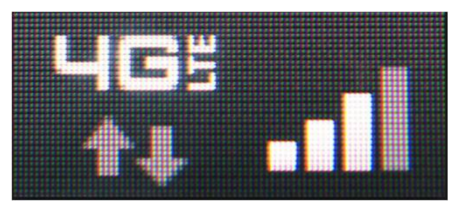
FTC Qualcomm Lawsuit

Presented by
Brian Byrne

Overview of the Case

- The FTC voted 2-1 to file a complaint alleging, in part, that Qualcomm used its market power in baseband processors to disadvantage its rivals
  - Commissioner Ohlhausen dissented, and pushed the FTC to withdraw the case
- Qualcomm produces or licenses:
  - **Baseband processors** - Microchips for cell phones and tablets
    - Industry estimates put Qualcomm market share at 50% in baseband processors overall and 65% market share in 4G LTE baseband processors in 2016
  - **Standard-essential patents (“SEPs”)** – Patents necessary for networked technology, including baseband processors; Qualcomm had agreed to license SEPs on “Fair, Reasonable, and Non-Discriminatory” (“FRAND”) terms

A Qualcomm baseband processor



Qualcomm holds patents necessary for cellular network standards, like 4G LTE

Alleged Anticompetitive Conduct

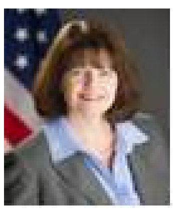
- Allegedly forced OEMs to pay Qualcomm elevated SEP royalties on rivals' chips by threatening to withhold Qualcomm chips
  - FTC calls this a "no license-no chips" policy that uses market power to "tax" competitor chips
  - Qualcomm executives have denied such a condition existed
- Allegedly refused to license SEPs to competing chipmakers
  - Qualcomm allegedly violated FRAND commitments, as it only licensed to OEMs
  - Qualcomm allegedly could threaten OEMs due to its chip market power; so licenses covering rivals' chips were granted to OEMs rather than chipmakers
- Allegedly foreclosed rivals from working with an important OEM, Apple, by conditioning Apple's royalty rebates on exclusivity

*"Qualcomm **withholds its baseband processors unless a customer accepts a license to [SEPs]** on terms preferred by Qualcomm, **including elevated royalties that the customer must pay when using competitors' processors** ("no license-no chips")."* Complaint, at 2

Qualcomm founder Irwin Jacobs with the company's "Patent Wall"

Will Trump FTC Withdraw the Case?

- Then-Commissioner Maureen Ohlhausen (R) dissented in the 2-1 vote
- She argued that because the FTC failed to allege Qualcomm's license fees were not "FRAND," it had not stated a case



"If Qualcomm charges reasonable royalties for its patents, then ***there is no anticompetitive "tax"****…but* ***only the procompetitive monetization*** *of legitimate patent rights."*

- Trump FTC appointments could easily shape the agency's approach to this case
  - Ohlhausen is now Acting FTC Chair
  - Then-Chair Edith Ramirez (D) has resigned
  - Trump will ultimately appoint three more Commissioners, including two Republicans

"[I]n the Commission's 2-1 decision to sue Qualcomm, I face an extraordinary situation: an enforcement action based on a flawed legal theory (including a standalone Section 5 count) that ***lacks economic and evidentiary support****, that was brought on the* ***eve of a new presidential administration****, and that, by its mere issuance, will* ***undermine U.S. intellectual property rights*** *in Asia and worldwide. These extreme circumstances compel me to voice my objections."*
Commissioner Maureen Ohlhausen

Private and Public Challenges Worldwide

- Apple filed suits in the U.S. and China
  - Asserts that Qualcomm failed to license its SEPs on FRAND terms, fails to license to chip competitors, forced Apple into exclusivity with Qualcomm
  - Challenges the validity of some Qualcomm SEPs
  - Alleges that Qualcomm tried to extort Apple to block truthful cooperation with South Korean investigation
- Korean and Chinese antitrust regulators impose fines
  - Chinese National Development and Reform Commission (NDRC) fined Qualcomm $975 million (2015)
  - Korea Fair Trade Commission (KFTC) fined Qualcomm $854 million (2016)
- European Commission brought charges for illegal payments to secure exclusivity and predatory pricing (2015)
- U.S. class actions filed
  - Securities fraud suit filed on behalf of shareholders
  - Antitrust suit filed on behalf of consumers

Questcor Settlement

Presented by
Kenneth Reinker

Overview of the Case

- In 2001, Questcor acquired the rights to Acthar Gel, a natural adrenocorticotropic hormone ("ACTH") drug
  - Acthar currently is the only therapeutic ACTH drug sold in the United States.
  - Acthar is FDA approved for multiple indications, and it is the standard of care in infantile spasms, a rare but serious seizure disorder that affects infants under two years old
- Starting in 2006, Questcor increased prices from $40 to $34,000 per vial
- In 2013, Questcor acquired Synacthen Depot, a synthetic ACTH drug. Synacthen Depot was used abroad for infantile spasms (as well as other indications), but was not FDA approved or in U.S. development
- FTC investigated, and FTC and Questcor settled in Jan. 2017
- FTC alleged that Questcor acquired Synacthen Depot to protect Acthar's monopoly and to prevent other bidders from developing it
- (Mallinckrodt acquired Questcor in 2014 – after the acquisition of Synacthen and after the most significant price increases.)

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QUESTCOR PHARMACEUTICALS, INC.

FTC's Aggressive Legal Position – New, Lower Standard for Alleged Monopolists?

- Synacthen was pre-clinical drug that had no patents and that was never approved, sold, or in clinical development for the United States
- FTC complaint alleges that Questcor acquiring Synacthen Depot was monopolization because it was "conduct reasonably capable of contributing significantly to Questcor's maintenance of monopoly power"
- FTC never alleged that the acquisition was likely to harm competition
  - To the contrary, FTC's complaint shows that entry was not likely, stating there was "Significant uncertainty that Synacthen, a pre-clinical drug, would be approved by the FDA"
  - FTC only alleged that other bidders "planned to develop Synacthen" and that another bidder would have "pursued its plans to develop Synacthen," not that they would have succeed
  - FTC did not allege that Synacthen Depot was necessary to enter. Instead, FTC only alleged Synacthen Depot had a "proven formulation" and documentation of its "manufacturing process," and thus that a buyer would not need to develop a formulation or manufacturing on its own

Highly Unusual Remedies

- Settlement requires
  - Disgorgement of $100 million to FTC and states
  - A limited license of Synacthen Depot in only two indications infantile spasms and nephrotic syndrome. Mallinckrodt retained rights to the drug in all other indications.
- Disgorgement used only in rare cases
  - Commissioner Ohlhausen wrote separately and noted concerns with use of disgorgement here
  - Traditionally, limited to clear violations with a reasonable basis for calculating amount
  - Obama FTC withdrew policy statement limiting disgorgement in 2012 (over Ohlhausen dissent) and sought disgorgement in multiple cases (including obtaining $1.2 billion from Cephalon)
- Partial divestitures "splitting" intellectual property are rare
  - Typically, split divestitures are disfavored for not fully remedying competitive harm
  - But here, Mallinckrodt was pursuing development of Synacthen Depot for Duchenne Muscular Dystrophy and "splitting" the drug allowed Mallinckrodt to continue those efforts

European Competition Law Developments

Presented by
Romina Polley

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EC's E-commerce Investigations

- The Commission announced the opening of three separate investigations in the e-commerce sector.
- These aim to determine whether certain **online sales practices** breach EU antitrust rules (Art. 101 TFEU), by preventing consumers from (i) enjoying cross-border choices; (ii) buying consumer electronics, video games and hotel accommodation at competitive prices.
- The three investigations aim to tackle:
  - Retail price restrictions
  - Discrimination on the basis of location and geo-blocking
- These investigations highlight the Commission's recent focus on challenging vertical restraints and cross-border selling restrictions. This is remarkable because vertical infringements, in particular RPM, have rather been an enforcement priority at Member State level in the past.

Investigation I: Consumer electronics manufacturers

- The Commission is investigating **Asus, Denon & Marantz, Philips, and Pioneer**.
- The investigation will focus on whether online retailers are able to set their own prices for electronic products, such as household appliances, notebooks, and hi-fi products.
- The effect of these price restrictions may be aggravated as online retailers are using a pricing software which automatically adapts retail prices to those of leading competitors, resulting in an impact on overall online prices for these products.

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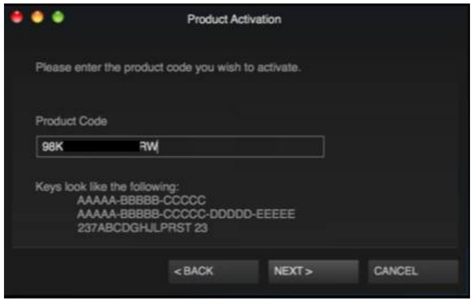
Investigation II: Video Games

- The investigation concerns **geo-blocking practices**, where customers are prevented from buying digital content, in this case PC video games, because of their location or country of residence.
  - The Commission's investigation focusses on bilateral agreements concluded between **Valve Corporation**, owner of the **Steam** game distribution platform, and five PC video game publishers, **Bandai Namco**, **Capcom**, **Focus Home**, **Koch Media** and **ZeniMax**.
  - To be able to start playing a game, PC video game users must confirm that their copy of the game is not pirated. This is done by using an "Activation Key" on Steam.
  - The investigation concerns whether the bilateral agreements require/have required the use of activation keys for the purpose of geo-blocking – granting access to a purchased game only to consumers in a particular EU Member State.
  - The concern is that cross-border competition is reduced by the restriction of parallel trade within the single market, which prevents consumers from buying cheaper games that may be available in another Member State.



Investigation III: Hotels

- The Commission is investigating agreements between important European tour operators – **Kuoni, REWE, Thomas Cook** and **TUI** – and **Meliá Hotels**.
- Following customer complaints, the Commission will analyze whether the agreements between the tour operators and hotels contain clauses that discriminate between customers, based on their nationality or country of residence, breaching EU competition law rules.
- As a result of such alleged discrimination, some customers would be prevented from booking rooms at the best prices, or even seeing the hotel's availability.

FCO's Draft Guidance on Vertical Restraints in Food Retail Sector

- On January 25, the German competition authority (FCO) published its draft *"Guidance notice on the prohibition of vertical price fixing in the brick-and-mortar food retail sector."*
- The draft is open for public consultation and comments can be submitted until March 20, 2017.
- This draft summarizes the FCO position on vertical price fixing over the years, responding to calls from the business community.
- The current draft attempts to supersede the 2010 note, which provided guidance on how to effectively terminate infringements and cooperate with the FCO in the FMCG retailer investigation pending at the time.
- **Criticism:** The draft contains a number of black and white examples that fail to give guidance on grey zone conduct.

“Hybrid” Settlements – The *Timab Case*

- On January 12, the ECJ dismissed an appeal by **Timab Industries** and confirmed the European Commission’s 2010 decision, fining 12 companies for participating in the *Animal feed phosphates* cartel.
  - The participants in the cartel were invited to settlement proceedings with the Commission. During the settlement procedure, the Commission indicated a fine range of €41-44 million to Timab, for its participation in a single and continuous infringement from December 1978 – February 2004.
  - Timab withdrew from the settlement discussions and abandoned its leniency statements regarding its participation in the infringement during 1978- 1993 period.
  - The Commission imposed a fine on Timab - €60m - which significantly deviated from the number it indicated in the settlement discussion (despite a shorter duration of the infringement).
  - Timab claimed it was “*penalized*” for having withdrawn from the settlement procedure, and that its fine in the adversarial procedure should have been capped at €44m but increased by 10% only (settlement discount).
  - On May 20, 2015, the General Court dismissed Timab’s appeal, on the basis that the Commission is not required to adopt, in an adversarial procedure, the range of fines indicated during the abandoned settlement procedure.
  - The ECJ confirmed the Commission's ability to take into account new information received in the course of a standard procedure cartel investigation to depart from ranges of fines discussed during settlement talks after failed settlement discussions.