



The *GSK France* Decision of March 2007

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Outline of the presentation

1. Facts

2. Predation Test

3. Application of the test

A brief history of the case

- **July 2000: Flavelab refers the case to CC, asks for interim measures**
- **November 2000: CC does not grant interim measures**
- **December 2001: Flavelab goes bankrupt**
- **April 2002: Flavelab acquired by Panpharma**
 - *2003: Complaint withdrawn – CC proceeded ex officio*
- **July 2004: Statement of objections**
 - *2006: first hearing, supplementary SO, final hearing*
- **March 2007: Decision on the merits, fining GSK France**
- **Paris Court of Appeal's judgement expected early 2008**

Products

- **Anti-infective drugs (“J” in the ATC classification)**
- **Sold (almost) only to hospitals (bidding markets)**
 - **Community market not involved**
- **Market A: Injectable Aciclovir (ATC: J05A)**
 - Treatment of herpes
- **Market B: Injectable cephalosporins 2nd generation**
 - Prevent infections during surgical operations
 - Cefuroxime and Cefamandole
 - Not disputed

Market A: Aciclovir

Market size

**≈10 m€
in 1999 and 2000**

GSK:

Injectable Zovirax®

since 1983

Market B:

Injectable cephalosporins

Market size

**≈ 2m€
in 99 and 00**

GSK: Zinnat®

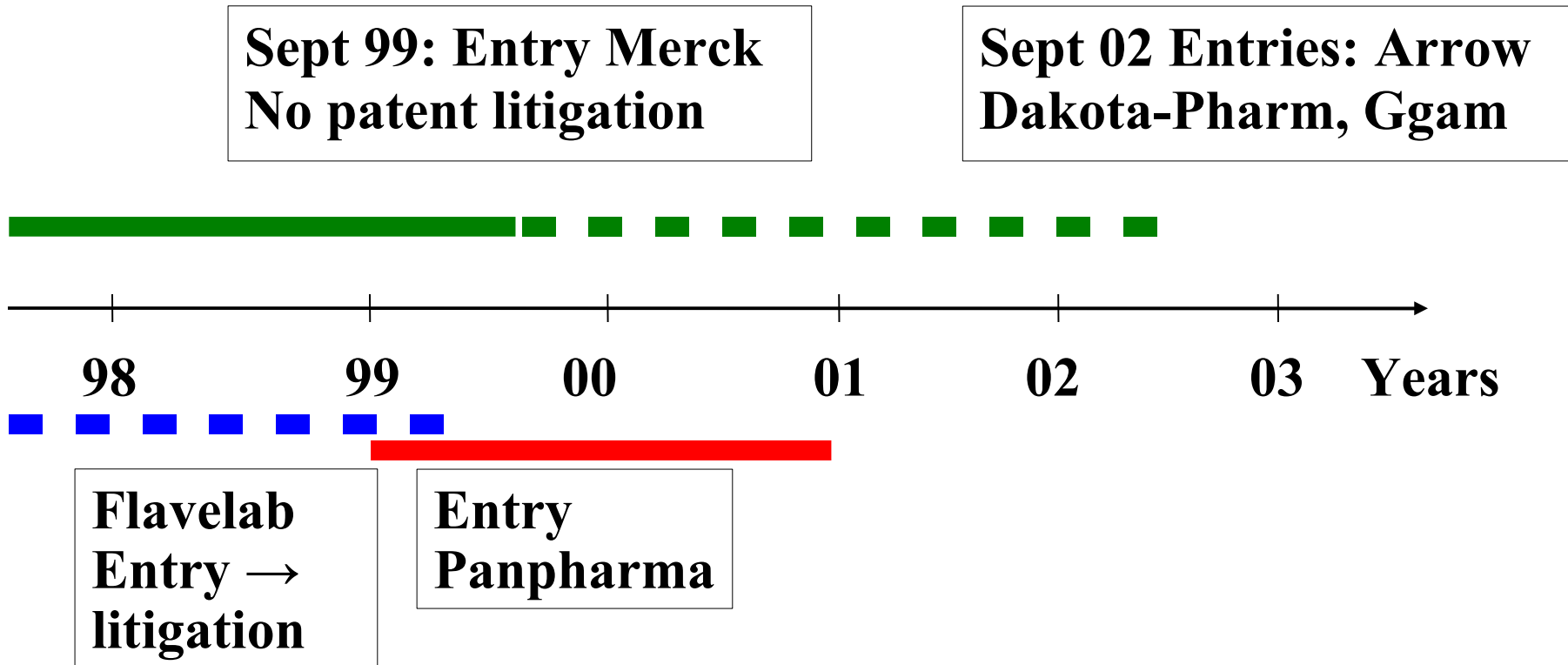
Lilly: Kéfandol®

Antitrust definition of markets and position of the firms

- **Market A:** No substitute for Injectable Zovirax® according to the regulator and hospitals' pharmacists
- GSK dominant
 - Market share: 90% in 2000, 80% in 2001
 - Supposedly protected until 2002
 - Merck's entry late 1999 (around 10% in 2000)
- **Market B** (Lilly and GSK)
 - Definition is not disputed
 - No dominant position on this market

TIMELINE

Market A: Zovirax® protection extended until Sept 2002



Market B: Zinnat® protected until May 1999

Predation period: 1999-2000

Practices

- **1999-2000: below cost pricing on market B**
 - Zinnat® purchased from the *Adechsa* company
 - Retail prices < purchase prices (PP)
 - Purchase prices computed from invoices net of all discounts and rebates
 - 12 markets (hospitals, dosage) in 1999, 29 in 2000
 - Selective price cuts: prices below cost when faced to generics

- **Bundled rebates: special prices conditioned to the joint purchase of Zinnat® and Zovirax®**
 - **4 instances in 1999**

Test

- **Price > ATC: ok (but exceptional circumstances)**
- **ATC > Price > AVC: burden of proof on CC**
 - Multiple indicators: hard evidence, selective price cuts, supplementary practices, likely recoupment, fact-based theory of harm (e.g. Vulnerable prey, etc.)
- **AVC > Price: burden of proof on defendant**
 - defendant can rebut presumption by proving recoupment ex ante impossible (low entry barriers), perishable goods, learning by doing, switching cost...

**Standard of proof suggested by CC = same as Motta (2004)
to be confirmed by the Court of Appeal**

Relevant cost benchmark

- **GSK:** Drug purchased from a unit of the same group, transfer prices within a group, no economic meaning
- **CC:** There are only two possibilities
 1. Subsidiary company (GSK France) is held liable
 - Competitive benchmark = maximization of the short-run profit of the subsidiary
 2. Parent company (UK group, 2nd-largest drug company in the world) is held liable
 - Competitive benchmark = maximization of the short-run profit of the parent company

Liability and competitive benchmark

- **CC considered GSK France liable**
 - Internal organization and decision process of the firm: large autonomy of the subsidiary company
 - “business unit” dedicated to hospital drugs, with a certain discretion to fix prices
 - The subsidiary company claimed that “*no other company in the group was concerned by the practices*”
- Once a firm is considered liable, one should use its costs.
 - Purchase price (PP) = lower bound of AVC**
 - **AVC (>PP)** also include distribution costs (marketing, etc.)
 - PP effectively paid (invoices), quantity-dependent

Ex ante / Ex post

- **GSK**: CC should dismiss instances with **Bid = PP**
- **CC**: Since purchase prices are falling, ex post test conservative

$$\text{Bid for year } (t+1) \leq \text{PP } (t+1) < \text{PP } (t)$$

- GSK did not explain how expectations are formed, so $\text{PP}(t)$ seems a reasonable prior
- $\text{PP}(t+1)$ follows from retroactive rebates that cannot be anticipated

Price analysis at which level?

- **GSK:** CC should consider average prices across all hospitals
- **CC:** exclusion occurs at the hospital level. Bids at each invitation to tender relevant, because of selective price cuts

- **GSK:** contests selective price cuts
- **CC:**
 - This is only an indicator (makes predation less costly)
 - Large differences in the bids depending on competitive pressure (can be anticipated depending on the wording of the public market)

Bids with comp. < PP(n) < PP(n+1) < Bids without comp.

Link between markets A and B

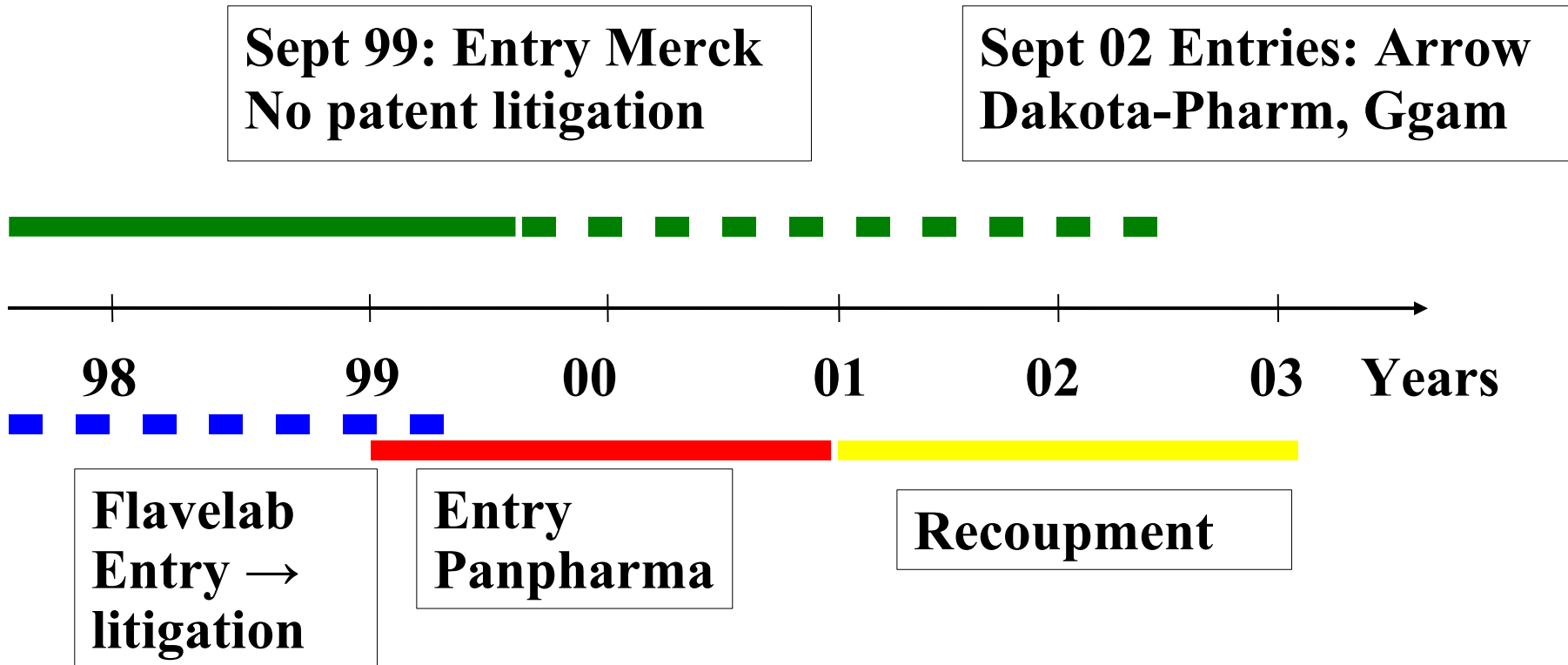
- **GSK** : contests the link
- **CC:**
 - Same seller: GSK France (hospital business unit)
 - Same buyers (hospitals) buy Zinnat® et Zovirax®
 - Bundled rebates in 1999
 - Rationale for predation in (small) market B: deterring generic drug companies from following Merck into (large) market A.
 - Same as in *Akzo*: the incumbent prices below cost in the small market to deter ECS from entering its core market

Theories of harm (1/2)

- Threats of entry in 1999 in spite of patent's extension
 - **In 1999, 7 (3) generic drug companies had regulatory approvals to enter market A (B)**
 - Merck: small-scale entry on market A in 1999, but 1m€ in 2000
 - GSK was unsure about the outcome of a patent litigation, did not challenge Merck in court
- Build a reputation of aggressiveness [Kreps and Wilson, 1982]
 - Two types of incumbent: tough/weak, 2 markets, 2 periods
 - After entry on market B at $T=1$, I has incentives to prey to avoid entry on market A (deter entry or discipline an entrant)

TIMELINE

Market A: Zovirax® protection extended until Sept 2002



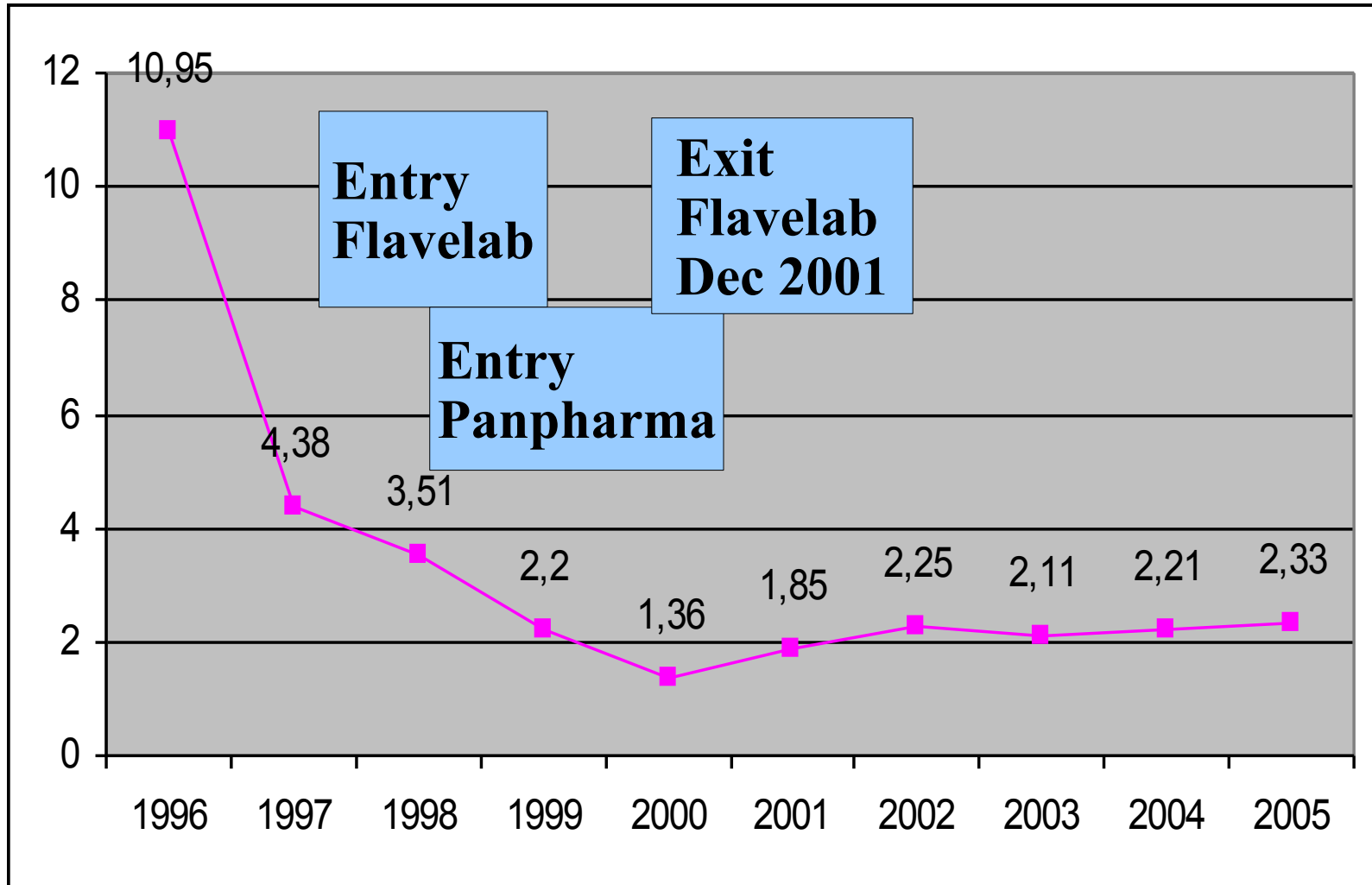
Market B: Zinnat® protected until May 1999

Predation period: 1999-2000

Theories of harm (2/2)

- **CC** also mentions a possible financial predation scenario leading to Flavelab's bankruptcy
- Common story: I sacrifices short-run profit to manipulate E's profit expectations, distort entry decisions, and recoup later
 - Sacrifice is impossible to check → look for short-run losses
 - Conservative test
- **Reminder: Since $P < AVC$, CC has not the burden of establishing such a theory; the defendant has to prove it is manifestly impossible and to give an objective justification**

Average Price Zinnat® 1.5g (€)



**Interim measure
decision Nov 2000**

Possibility of recoupment

- **GSK:** No entry barrier after patent's expiration, recoupment impossible
- **CC:**
 - No need to prove recoupment ex post
 - BotEC just to reply to the defendant's point
 - Losses on market B: 75 000 € in 1999-2000 (very little!)
 - Gains on market B in 2001-2002 = extra profit earned by pricing above the competitive price (Proxy: price of generic drugs) = 400 000€
 - Recoupment even easier on market A, where GSK has more market power (this is just an example)

Other arguments

- **GSK:** raised prices for fear of being found guilty of predation, following CC 2000 decision, not for recoupment
- **CC:** The motivation of the price rise does not matter. This is just to show that recoupment is not impossible.
- **GSK:** Flavelab went bankrupt because inefficient
- **CC: Flavelab** good at selling Cefamandol (in market B) and Flavelab affected by predation (concerned drug accounted for half of its sales to hospitals in 1998)
- **CC: GSK did not provide any justification for its behavior**

Meeting competition defense

- **GSK:** price cuts necessary to align on Flavelab
- **CC:** GSK could have aligned without violating the conservative ex post predation test

GSK Bids below costs for $n+1 < PP(n+1) < \text{Flavelab} < PP(n)$

- **GSK:** Price cuts necessary to align on Kefandol® (Lilly)
- **CC:** Not true: Kefandol® price $>$ predatory prices of GSK

Evolution of markets

- **Market B:**
 - 3 generic drug companies have approval, only one enters.
 - 6 years after patent's expiration (2005), GSK market share (in sales revenue) = 17 %
- **Market A**
 - 3 years after patent's expiration (2005), GSK market share (in sales revenue) = 51 %
 - Out of 13 firms having regulatory approval, only 5 enter
 - Generic drug companies active on market B observe the aggressive behaviour
 - Panpharma did not try to enter market A

Sanctions

- **Infringement** of Art. 82 (multinational firms, imports, etc.)
- **Seriousness**
 - Exclusionary practices
 - 40 markets involved, generics' entry delayed
 - GSK: first supplier of hospitals
- **Fine: 10 m€**
 - Legal ceiling at the time: 5 % of GSK France turnover in the last accounting year: 1.6 b€
 - Fine < 1 % of the ceiling
 - Fine \approx Size of market A
- **Publication of the decision in professional journals**

Conclusion

- **Sends a simple message to markets:**

“If you are an autonomous firm and if you are in dominant position, don’t sell below your average variable cost, unless you have an objective justification for it”