PUBLIC VERSION

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	)	
	)	
Plaintiff,	)	
v.	)	Civ. No.______
	)	
CARDINAL HEALTH, INC. and BERGEN-BRUNSWIG CORP.,	)	
	)	
Defendants.	)	
	)	
FEDERAL TRADE COMMISSION,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civ. No.______
	)	
McKESSON CORP. and AMERISOURCE HEALTH CORP.,	)	FILED UNDER SEAL
	)	
Defendants.	)	

MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTIONS FOR PRELIMINARY INJUNCTIONS

MELVIN H. ORLANS
Attorney
Office of the General Counsel
Federal Trade Commission
Washington, D.C. 20580
(202) 326-2475

WILLIAM J. BAER
Director
RICHARD G. PARKER
MICHAEL E. ANTALICS
RICHARD LIEBESKIND
Attorneys
Bureau of Competition
Federal Trade Commission
Washington, D.C. 20580
(202) 326-2821

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Preliminary Statement

The proposed merger of Cardinal and Bergen Brunswig and the proposed acquisition of AmeriSource by McKesson will replace competition between the nation's four largest drug wholesalers with a duopoly controlling nearly 80% of the market. Without judicial intervention, hospitals, pharmacies, and government purchasers will find themselves paying higher prices for drug wholesaling services. Accordingly, the Federal Trade Commission ("Commission") asks this Court to enjoin both proposed transactions pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b), pending a full administrative trial on the merits.[1]

Competition between the defendants has led to lower prices and better services in the distribution of drugs, and the substantial reduction in that competition caused by either of these mergers will have the opposite effect. Drug wholesalers provide services that are essential to the efficient functioning of the health care system: next day delivery of a full line of drugs, coupled with sophisticated ordering, inventory control, and tracking systems. These services enable hospitals and pharmacies to control purchases and inventory, lowering the costs of drugs. The four merging firms are the largest and the most uniquely capable firms in the market.

These two transactions threaten to alter permanently that competitive landscape, by combining these four drug wholesalers and creating a dominant duopoly with nearly 80% of the

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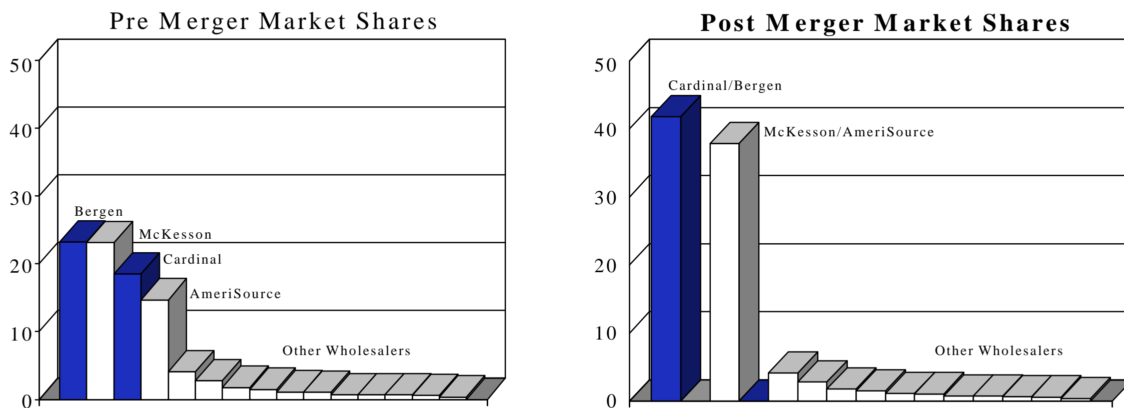
[1] Section 13(b) of the FTC Act authorizes the Commission to seek, and empowers this Court to grant, preliminary relief pending the completion of administrative proceedings challenging the proposed acquisition. Section 13(b) further provides that the Commission must commence its administrative proceeding within 20 days after the issuance by a federal court of any preliminary injunction or temporary restraining order. The Commission is empowered to bring an administrative complaint challenging the transactions under Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, and under Section 5 of the FTC Act, 15 U.S.C. § 45. Pertinent portions of Sections 5 and 13(b) of the FTC Act, 15 U.S.C. §§ 45, 53(b), and Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18, 21, are set out in Appendix I to this memorandum.

market. The market will be transformed from one in which four firms compete by lowering price and improving service into one in which two firms will be so dominant that the drive to compete will be substantially diminished. If these transactions are not enjoined, a market that is moderately



concentrated will become highly concentrated. When mergers increase concentration as much as they do here, "it will be presumed" that such mergers "are likely to create or enhance market power or facilitate its exercise."[2]

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[2] U.S. Dept. of Justice & Federal Trade Comm'n, *Horizontal Merger Guidelines* § 1.51, at 10-11 (1997) (hereinafter "*Merger Guidelines*") (Appendix II hereto); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 364 (1962) ("without attempting to specify the smallest market share which would be considered to threaten undue concentration, we are clear that 30% presents that threat"); *United States v. Phillipsburg Nat'l Bank*, 399 U.S. 350, 365-67 (1970); *FTC v. PPG Indus., Inc.,* 798 F.2d 1500, 1502-03 (D.C. Cir. 1986); F. Scherer & D. Ross, *Industrial Market Structure & Economic Performance* 82 (3d ed. 1990) ("when the leading four

While these market shares are sufficient to establish the Commission's *prima facie* right to relief, the Commission has assembled additional compelling evidence that these mergers likely will reduce competition substantially. The defendants acquired, built or expanded distribution centers throughout the country in order to compete nationally. They are now competing to fill up this "excess capacity" by offering lower prices and service improvements. These mergers will remove that "excess capacity" from the market, and remove the force driving competition in this market.

The link between overcapacity and downward pressure on price is made clear in the parties' business documents.

PX at , and " ."

PX at .[3] Cardinal's Chairman wrote that as the major wholesalers pursued their " " but the "

." PX at . Mr. Walter confirmed this analysis in his testimony:

Tr. 25.

These mergers are defendants' chosen means to remove their incentives to cut price. When the Cardinal/Bergen merger was announced,

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firms control 40 percent or more of the total market, oligopolistic behavior becomes likely").

[3] Citations to "PX __" are to plaintiff's exhibits, submitted herewith. PX 1 is plaintiff's exhibit list; PX 2 is an annotated guide to those exhibits. Citations to, *e.g.*, " Dec." are to declarations submitted as PX 10-80. Citations to, *e.g.*, " Tr." are to investigational hearing testimony taken during the Commission's investigation and submitted as PX 92-96, 419 and 475-493. Appendix III provides a cross-reference for declarations and deposition testimony.

PX at .

PX at . McKesson and AmeriSource agreed to their own merger, reducing to two the number of "dominant players" and taking still more "excess capacity" out of the market.

Competition between these four firms drives innovation and pricing today. A decade ago, competition for drug wholesaling was basically local or regional in nature. Except for McKesson, which was the first firm to operate nationally, wholesalers served primarily local markets. As in other health care markets, increased consolidation and the need to utilize sophisticated information technology drove both customers and wholesalers to expand nationwide. Buyers have consolidated and expanded geographically through the formation of nationwide hospital group purchasing organizations ("GPOs") and independent pharmacy buying groups, or the creation of multi-region drugstore and hospital chains. Cardinal, Bergen, McKesson, and AmeriSource are the only firms that attained national scope. They did so primarily by acquiring other wholesalers, transforming the business into one based increasingly on volume, nationwide service, technological innovation and nationwide price negotiations.

No new firms have entered the market since 1981. All that remains after the rapid consolidation of the past decade are the four defendants -- seeking to become two -- and a fringe of about 40 much smaller drug wholesalers, who have about 20% of the market among them. This fringe of smaller firms has shrunk in recent years, as many firms have been acquired by the more efficient, leading wholesalers. The fringe has been unable to take market share from the four national firms in the past, and is even less likely to do so in a market dominated by a post-

merger duopoly in which each of the merged firms will be more than eight times larger than Bindley-Western, the largest member of the fringe. These small wholesalers, , have higher costs and lack important services demanded by the market. They simply cannot be expected to challenge price hikes by the merged defendants. Dec. ¶¶ 15-16; Dec. ¶ 24.

The specter of serious consumer injury from these transactions is real. Consumers from every significant segment of the market -- hospitals, independent drugstores, and chain drugstores -- have expressed concern about the mergers and are prepared to testify in this proceeding. These witnesses include largest retail chains, including , independent pharmacies and their buying groups, many government purchasers such as , some of the largest hospital GPOs, including , and large hospital chains and HMOs such as .

The Commission is prepared to demonstrate that each of these transactions is unlawful and threatens significant harm to millions of consumers. The public's interest in free and open competition, both during the administrative trial and ultimately if the transactions are found to be illegal, mandates that a preliminary injunction be entered.

Argument

I. SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT ESTABLISHES A PUBLIC INTEREST STANDARD FOR GRANTING INJUNCTIVE RELIEF.

Section 13(b) of the FTC Act provides that a preliminary injunction may be granted "upon a proper showing that, weighing the equities and considering the FTC's likelihood of ultimate

success, such action would be in the public interest." In enacting Section 13(b), Congress adopted the "public interest" standard common in litigation by government agencies to enforce statutory requirements, in place of the traditional four-part test applicable to private parties seeking a preliminary injunction.[4] *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1081-82 (D.C. Cir. 1981).

In deciding whether to grant injunctive relief under the "public interest" standard, this Court "must (1) determine the likelihood that the FTC will ultimately succeed on the merits and (2) balance the equities." *FTC v. University Health, Inc.*, 938 F.2d 1206, 1217 (11th Cir. 1991); *Warner Communications,* 742 F.2d at 1160; *FTC v. Staples, Inc.,* 970 F. Supp. 1066, 1071 (D.D.C. 1997). In applying the first part of that test, the Court's "task is not to make a final determination on whether the proposed [acquisition] violates Section 7, but rather to make only a preliminary assessment of the [acquisition]'s impact on competition." *University Health*, 938 F.2d at 1218; *Warner Communications,* 742 F.2d at 1162; *see Staples*, 970 F. Supp. at 1070-71.[5] The FTC satisfies its burden in this regard if it "raise[s] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of

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[4] In particular, the FTC is not required to show irreparable harm. *FTC v. Warner Communications, Inc.,* 742 F.2d 1156, 1159 (9th Cir. 1984). Nonetheless, without an injunction, the public interest in effective antitrust enforcement will be irreparably harmed, because competition will be eliminated in the interim and because of the inadequacy of eventual relief through post-consummation divestiture. *See* pp. 43-44 below.

[5] This Court need not resolve all conflicts of evidence or analyze extensively all antitrust issues. Such final resolution is the province of the administrative proceeding. *Warner Communications*, 742 F.2d at 1164.

Appeals." *University Health*, 938 F.2d at 1218; *Warner Communications*, 742 F.2d at 1162; *Staples*, 970 F. Supp. at 1071.

In balancing the equities, the major public equity is the effective enforcement of the antitrust laws. Without a preliminary injunction, the government often cannot restore competition via divestiture, to the public's detriment. *Weyerhaeuser*, 665 F.2d at 1086 n.31. Section 13(b) enables the Commission to protect that interest by preventing businesses from being acquired so that competition will continue in the marketplace until the legality of the proposed acquisition is finally determined. *FTC v. Exxon Corp.*, 636 F.2d 1336, 1342-43 (D.C. Cir. 1980). Thus, "section 13(b) itself shows congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy and reflects a continuing congressional concern with the means of halting incipient violations of Clayton § 7 before they occur." *FTC v. Lancaster Colony Corp.*, 434 F. Supp. 1088, 1097 (S.D.N.Y. 1977). Although the Court may properly consider private equities as well as public, the public equities are to be given far greater weight in the balance. *Warner Communications*, 742 F.2d at 1165; *PPG*, 798 F.2d at 1506.

II. EACH PROPOSED MERGER VIOLATES THE ANTITRUST LAWS.

Section 7 of the Clayton Act prohibits any merger or acquisition "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." Section 7 is intended to arrest anticompetitive mergers "in their incipiency" and, accordingly, requires a prediction as to the merger's likely impact on future competition. *Philadelphia Nat'l Bank*, 374 U.S. at 362.[6] In this

[6] Because Section 7 addresses the probable future effects of an acquisition, it necessarily requires predictions and inherently "deals in probabilities, not certainties." *Brown Shoe Co. v.*

case, the defendants' own documents show that the acquisition will enable them to charge higher prices. That fear of higher prices and reduced services is precisely what has motivated these defendants' own customers -- hospitals, GPOs, retail pharmacy chains, independent pharmacy groups and government agencies -- to be concerned about the consequences of these two mergers.

The defendants know full well that each of these combinations will reduce competition. Immediately after the announcement of the Cardinal/Bergen merger,

What was positive was that the merger would ease price pressures:

PX at (emphasis added).

" ." PX at ; *see also* PX , . Other company documents show that these defendants seek to reduce competition by acquiring their rivals.

PX at .

United States, 370 U.S. 294, 323 (1962). To establish a violation, the government need only show a reasonable probability, not a certainty, that the proscribed anticompetitive activity may occur. "All that is necessary is that the merger create an appreciable danger of [anticompetitive] consequences in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for." *Hospital Corp. of America v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038 (1987); *Staples*, 970 F. Supp. at 1072.

PX at .

This direct evidence that the defendants themselves expect anticompetitive effects simplifies the Court's predictive judgment. Such evidence inexorably leads to the conclusion that competition will be reduced substantially, unless these mergers are enjoined. Traditional analysis under Section 7 compels the same result. That analysis requires determinations of: (1) the "line of commerce" or product market; (2) the "section of the country" or geographic market; and (3) the transaction's probable effect on concentration in the product and geographic markets. Proof of these facts give rise to a presumption of unlawfulness. *Philadelphia Nat'l Bank*, 374 U.S. at 363; *United States v. Baker Hughes, Inc.,* 908 F.2d 981, 982-83 (D.C. Cir. 1990). Even if the defendants offer evidence to rebut this presumption, the Commission stands ready to prove that each merger is likely to reduce competition. Here the traditional Section 7 analysis confirms what defendants' customers already know: The proposed acquisitions will put them at substantial risk of higher drug wholesaling prices and diminished service.

A. <u>Drug Wholesaling Is a Relevant Product Market.</u>

The relevant product market is defined in terms of the "reasonable interchangeability of use" between the product itself and substitutes for it. *Brown Shoe*, 370 U.S. at 325. The relevant product market "must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn . . . ." *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 612 n.31 (1953). In other words, a relevant product market is the smallest group of products over which prices could be profitably increased by a "small but significant" amount (normally 5 percent) for a substantial period of time (normally

one year).[7] *Staples*, 970 F. Supp. at 1076 n.8; *Merger Guidelines* § 1.11, at 5-6.[8]

To apply this test, courts look to customers' perceptions of the marketplace, the existence of special classes of customers who desire particular products and services, and the defendants' documents reflecting the "business reality" of "how the market is perceived by those who strive to profit in it," *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128, 1132 (D.D.C. 1986), *vacated as moot*, 829 F.2d 191 (D.C. Cir. 1987), and industry or public perception of separate markets.[9] Defendants' own documents -- and their customers -- establish that drug wholesaling is a unique bundle of products and services.[10]

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[7] Wholesalers collect an "upcharge" (or "sell margin") from their customers for wholesaling services, *i.e.*, a surcharge or discount on the price of the underlying drug, normally expressed in basis points (hundredths of a percent). Dec. ¶ 12. Cardinal's average upcharge is basis points (or of the cost of the drug), and Bergen's is basis points. PX at . McKesson's average upcharge is basis points, while AmeriSource's is basis points. PX . Wholesalers typically require more prompt payment from customers than manufacturers require from wholesalers, so wholesalers earn additional income from the "float."

[8] While these *Guidelines* are not binding on the courts, courts have considered them in determining a proposed acquisition's impact on competition. *See, e.g., Olin Corp. v. FTC*, 986 F.2d 1295, 1299 (9th Cir. 1993), *cert. denied*, 510 U.S. 1110 (1994); *University Health,* 938 F.2d at 1211 n.12; *PPG*, 798 F.2d at 1503; *Staples*, 970 F. Supp. at 1076, 1082.

[9] *United States v. Grinnell Corp.*, 384 U.S. 563, 572 (1966); *Brown Shoe*, 370 U.S. at 325; *Olin*, 986 F.2d at 1299, 1302-03; *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 218 n.4 (D.C. Cir. 1986) ("industry or public recognition of the [market] as a separate economic unit matters because we assume that economic actors usually have accurate perceptions of economic realities"); *Merger Guidelines* § 1.11, at 5-6.

[10] Courts have recognized that when customers prefer a combination of products and services like drug wholesaling, that cluster of goods and services can constitute a distinct market or submarket. *Philadelphia Nat'l Bank*, 374 U.S. at 356-57; *General Indus. Corp. v. Hartz Mountain Corp.*, 810 F.2d 795, 805-06 (8th Cir. 1987) (pet supplies); *FTC v. Alliant Techsystems*, 808 F. Supp. 19, 20 (D.D.C. 1992) (munitions systems); *Hospital Corp. of America*, 106 F.T.C. 361, 465-66 (1985) (acute inpatient hospital services); *aff'd*, 807 F.2d 1381 (7th Cir. 1986), *cert. denied*, 481 U.S. 1038 (1987); *Staples*, 970 F. Supp. at 1073-76 (office

1. *Drug Wholesalers Provide a Unique Service.*

Full line drug wholesalers provide thousands of dispensing pharmacists access to more than 25,000 products made by hundreds of manufacturers. Hospitals, retail drugstores and other drug dispensers need access to the broad range of drugs available for prescription. PX at ; Dec. ¶¶ 6-7; Dec. ¶11; Dec. ¶¶ 7,10;

Dec. ¶ 11. By using wholesalers, customers and manufacturers avoid the significant costs and inconvenience of dealing directly with each other for relatively small, infrequent individual purchases.[11] Customers also avoid the costs of maintaining significant inventories, and avoid the labor and facilities costs of warehousing drugs. Even those customers who maintain their own warehouses (almost all of whom are chain drug stores) rely on wholesalers for all but the fastest-moving drugs.

Drug wholesalers offer uniquely valuable services. An individual drugstore or hospital anywhere in the United States can order electronically or by telephone any needed drug, and can have it the next day on an "as needed" basis. That transaction and other transactions are recorded in reports that allow retailers and hospitals to track their purchases, which in turn allow them to

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superstores a product market).

[11] A form of distribution may be a relevant product market. *Staples*, 970 F. Supp. at 1074-76 (sale of office supplies by office supply superstores); *JBL Enters. v. Jhirmack Enters.*, 698 F.2d 1011, 1016-17 (9th Cir. 1982) (sale of beauty products to beauty salons and other professional outlets), *cert. denied*, 464 U.S. 829 (1983); *California v. American Stores*, 697 F. Supp. 1125, 1129 (C.D. Cal. 1988) (supermarkets), *rev'd in part on other grounds*, 872 F.2d 837 (9th Cir. 1989), *rev'd*, 495 U.S. 271 (1990), *reinstated in pertinent part*, 930 F.2d 776 (9th Cir. 1991).

control and account for their inventory carrying costs, and determine whether they are ordering the most cost effective products.

Customers cannot replicate these services themselves or obtain them from manufacturers. Customers of all types have stated that they would not increase their direct purchases from manufacturers even in the face of a 5-10% or greater price increase.[12] The evidence shows that customers find drug wholesalers' services unique because only drug wholesalers offer a ready source for a full line of product[13] delivered to individual sites on a daily or more frequent basis. *E.g.,* Dec. ¶ 6; Dec. ¶ 8; Dec. ¶ 11; Dec. ¶ 5. Customers often demand a 95% or higher "fill rate," *i.e.*, that wholesalers deliver 95% or more of ordered product overnight. Tr. 128; *see, e.g.* Dec. ¶ 8; Dec. ¶ 6; Dec. ¶ 6; Dec. ¶ 6; Dec. ¶ 15. Customers require overnight daily delivery service at least Monday through Friday -- a need that manufacturers cannot meet efficiently.[14] Hospitals critically

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[12] Dec. ¶ 6 ; Dec. ¶ 15; Dec. ¶ 26; Dec. ¶ 4; Dec. ¶ 13; Dec. ¶ 16; Dec. ¶ 8; Dec. ¶ 6; Dec. ¶ 5; Dec. ¶ 8; Dec. ¶¶ 9-10.

[13] Because of the broad scope and unpredictability of the ultimate customers' demand for specific prescription drugs, customers demand a full line of prescription drugs, both branded and generic, and a wide range of brands, from drug manufacturers. *E.g.*, Dec. ¶¶ 6-7; Dec. ¶ 5; PX at ; Dec. ¶¶ 6, 11.

[14] *E.g.,* Dec. ¶ 5 (hospitals); Dec. ¶ 9 (hospital buying group); Dec. ¶ 2 (drugstore chain); *see also* Dec. ¶ 22; Dec. ¶ 2; Dec. ¶¶ 2-3, 5; Dec. ¶¶ 12-13.

depend on drug wholesalers to provide emergency service within a few *hours* of order placement, as well as regular daily deliveries.[15]

The evidence plainly demonstrates the practical significance of value-added services to customers. Dec. ¶¶ 5-7; Dec. ¶ 5; Dec. ¶ 5; Dec. ¶ 6; *see also* PX at . These services include electronic ordering, inventory management systems, reports and analyses of pharmaceutical purchases, emergency delivery service, pharmaceutical repackaging, private label programs, generic source programs and co-op advertising programs. Wholesalers' on-line computer systems permit electronic ordering and payment by the customer, as well as electronic invoicing and billing by the wholesaler. *E.g.,* Dec. ¶ IV; Dec. ¶ 6; Tr. 14-15. Computerized ordering permits wholesalers to confirm an order virtually instantaneously. The wholesaler can respond with next-day delivery or, if the wholesaler does not have an item in stock, the customer can order it from another wholesaler for delivery the next day.[16] Customers use the data and reports these systems provide to lower their inventory costs by

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[15] *E.g.,* Dec. ¶ 11; Dec. ¶ 5.

PX at (" "); *see also* PX at (").

[16] Customers use secondary wholesalers to provide an alternative if their primary wholesaler fails to supply product. *E.g.,* Dec. ¶ 5; Dec. ¶ II. Secondary wholesalers frequently charge much higher prices than primary wholesalers due to the higher costs of serving lower volumes. *E.g.,* Dec. ¶ 8 .

optimizing purchasing decisions.[17] Customers also use computerized information from the wholesaler to track pharmaceutical use and product movement, negotiate contracts with manufacturers and receive manufacturer rebates based on product use. Dec. ¶ 7 ; Dec. ¶ 7; Dec. ¶ 11; Dec. ¶ 5; Dec. ¶ 9.

Wholesalers also provide retail drug stores with in-store pharmacy computer systems that help process health insurance claims, monitor drug interactions, and process prescriptions. Other value-added services include point-of-sale scanning systems, store layout plans based on product movement, repackaging services, private label programs, patient counseling programs, and local advertising and promotional materials. Dec. ¶ 8; Dec. ¶ 7; Dec. ¶¶ 6-7; Dec. ¶ 6.

2. *Direct Purchasing and Self Warehousing Are Not Viable Options*.

.[18] That argument is incorrect. Self-warehousing is not the same

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[17] *E.g.*, Dec. ¶ 5; Dec. ¶ 6; Dec. ¶¶ 5-6; Dec. ¶ 6; *see also* Dec. ¶¶ 5-6 (" ").

[18] , the *Guidelines* specifically state that captive sales should only be included "to the extent that such inclusion reflects their competitive

as wholesaling, since the self-warehousing customer does not and could not practically provide itself (or receive from manufacturers) next-day, just-in-time delivery of its immediate needs from a full line of pharmaceuticals. The self-warehousing customer only warehouses its high-volume drugs; it relies on wholesalers for the drugs it cannot maintain efficiently (because of inventory carrying costs), but that wholesalers can and do inventory more cost-effectively. *E.g.*, Dec. ¶¶ 7, 10; Dec. ¶ 11; Dec. ¶ 2.[19]

a. *Hospitals and other institutional customers*[20] buy almost all their prescription drugs from drug wholesalers. PX at ; *see, e.g.,* Dec. ¶ (purchase approximately 90%-95% from wholesalers); Dec. ¶ (95% from

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significance in the relevant market prior to the merger." § 1.31, at 8; *see* Arquit, "Perspectives on the 1992 U.S. Government Horizontal Merger Guidelines," 61 Antitrust L.J. 121, 126 (1992); 2A P. Areeda, *Antitrust Law* ¶ 535e, at 194. The cases likewise only include captive sales when the economic realities of the competitive situation so indicate. *Grumman Corp. v. LTV Corp.*, 665 F.2d 10, 13-14 (2d Cir. 1981); *United States v. Blue Bell, Inc.*, 395 F. Supp. 538, 541-42 (M.D. Tenn. 1975).

[19] *See* PX at ; PX ; PX at . . *See* PX . The defendants' own assessment of what constitutes the market is highly probative. *See, e.g.*, *Staples*, 970 F. Supp. at 1079 (business documents show that defendants "focus primarily on competition from other superstores"); *American Stores*, 697 F. Supp at 1129 ("in fact, the State has presented evidence that defendants' own marketing documents focus on supermarket shoppers and competition from other supermarkets and do not evaluate convenience stores, gasoline service stations, etc. as competitors").

[20] The hospital and institutional customer segment includes individual hospitals and multi-hospital systems (both private and government-affiliated), long-term care facilities (such as nursing homes), clinics and staff model HMOs (which function like hospitals).

wholesalers); Dec. ¶ (about 90% from wholesalers).[21] Unlike wholesalers, manufacturers typically require significant minimum purchases, if they sell direct at all. Dec. ¶ 16; Dec. ¶ 2; Dec. ¶ 2; Dec. ¶ 2. Purchasing directly from manufacturers, in large quantities, substantially increases inventory, purchasing and labor costs. These direct purchases thus are more costly than buying from wholesalers. *E.g.,* Dec. ¶ 6; Dec. ¶ 15; PX at . Hospital and institutional customers today generally lack the resources or infrastructure to support significant direct purchases. *E.g.,* Dec. ¶ 10; Dec. ¶ 15; Dec. ¶ 4; Dec. ¶ 9; Dec. ¶ 15.

Hospitals require a high level of services from their pharmaceutical suppliers, including 24-hour emergency delivery plus rapid order turnaround, higher fill rates, *e.g.*, Dec. ¶ 11; Dec. ¶ 5; PX at ; different inventories than retailers, *e.g.,* Dec. ¶ 11; a high degree of delivery accuracy, computer compatibility, electronic ordering and payment capability, and state-of-the-art systems for data management. Dec. ¶ 5; Dec. ¶¶ 5-7; Dec. ¶ 5.

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[21] The prescription drug products that hospitals and institutions purchase directly from manufacturers are generally limited to some very high cost or high volume items, specialty products (*e.g.,* blood products, vaccines, biotechnology drugs) that drug manufacturers may require to be purchased directly for several reasons (*e.g.,* need to locate in case of a recall, product in short supply, special handling requirements), and some emergency orders. *E.g.,* Dec. ¶ 4; Dec. ¶ 5; Dec. ¶ 3; Dec. ¶ 4.

The trend is in precisely the opposite direction: Over the last decade, hospitals increasingly have shifted their prescription drug purchases to drug wholesalers, which provide "just-in-time delivery," and away from direct purchases from drug manufacturers, which do not. PX at ; *see also* Dec. ¶ 5; Dec. ¶ 13; Dec. ¶ 3. Customers began rethinking self-warehousing when upcharges were about 4% -- compared to today's levels of 1% or less (sometimes much less). Tr. 56-59. Because of the high cost of internalizing these functions, hospitals will not reverse the trend and switch back to direct distribution to defeat a small increase in the wholesaler's upcharge.[22]

b. *Independent drug stores* purchase more than 90% of their prescription drugs through drug wholesalers. PX at . The reason is simple: It is significantly less expensive to use wholesalers than to incur the inventory carrying costs, negotiating costs, labor costs and the many other transaction costs involved in self-warehousing. Dec. ¶ 14; Dec. ¶ 8. It is far more cost-effective to buy from wholesalers than from manufacturers, many of whom will not sell to independents in any event. Dec. ¶ 15; *see also* Dec. ¶ 16 (90% of drug manufacturers unwilling to sell directly).

c. *Chain pharmacies.* Many chain pharmacies do not purchase directly from manufacturers or warehouse prescription drugs. Instead they buy all or most of their prescription drugs through wholesalers. These firms, like hospitals and independent pharmacies, would not begin direct purchasing even in the face of price increases substantially greater than 5%. *E.g.,*

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[22] Dec. ¶ 4; Dec. ¶ 6; Dec. ¶ 8; Dec.¶¶ 15, 20-23; Dec. ¶ 4; Dec. ¶ 10; Dec. ¶¶ 20-23; Dec. ¶ 13.

Dec. ¶ 4; Dec. ¶ 3; Dec. ¶ 10.

Many drug manufacturers do not ship products directly to retailers. *See, e.g.*, Dec. ¶ 3; Dec. ¶ 5; Dec. ¶ 26. The high cost of carrying thousands of pharmaceutical products in inventory and providing daily delivery to their retail locations would be enormous. *E.g.,* Dec. ¶ 3; ¶¶ 2, 4.

While some of the largest drugstore chains purchase many drugs directly from drug manufacturers, this "self-warehousing" is very different in scope and character from the cluster of services drug wholesalers provide. Self-warehousing firms store drugs in their warehouses primarily to maintain ready inventories of high-volume, high-turnover products. *E.g.,* Dec. ¶ 4; Dec. ¶ 11; Dec. ¶ 3; Dec. ¶ 6; Dec. ¶ 2. They deliver from these warehouses once a week or less frequently, and do not resupply their stores daily. Dec. ¶ 3; Dec. ¶ 9; Dec. ¶ 16; Dec. ¶ 11.

Even chains that maintain drug warehouses would not find it profitable to increase their direct purchases from manufacturers significantly in the event of a 5% increase in the upcharge. Dec. ¶ 11; Dec. ¶ 27, 30; Dec. ¶ 6; Dec. ¶ 6. The direct purchases are those that are most frequently dispensed, so inventory carrying costs are not as great. These firms still must be able to buy and receive thousands of items ("SKUs," or stock-keeping units) from wholesalers for drugs not regularly stocked in their own warehouses or stores, to cover out-of-stock situations, for emergencies and other shortfalls in inventory at their own distribution centers. *E.g.,* Dec.

¶ 3; Dec. ¶ 3; Dec. ¶¶ 7, 8. Handling such critical SKUs internally would force customers to begin making daily deliveries to their stores, which would increase their costs enormously. , for instance, has more than stores nationwide.

. Because retailers cannot economically replace the services of drug wholesalers, they are concerned that these mergers will lead to significant price increases to themselves and their customers.[23]

B. The United States Is A Relevant Geographic Market.

The relevant geographic market within which to assess the effects of an acquisition must "correspond to the commercial realities of the industry and be economically significant." *Brown Shoe*, 370 U.S. at 336-37. The test is a practical one: Are there producers beyond certain geographic boundaries whose competitive activities significantly affect those of producers within the boundaries? *Id.; see Merger Guidelines* § 1.2, at 6-8.

The nation as a whole is a relevant geographic market here. Drug wholesalers must be licensed by the U.S. Food and Drug Administration and Drug Enforcement Administration, and must distribute drugs from locations within the United States. 21 U.S.C. § 301 *et seq.*; 21 U.S.C. § 801 *et seq.* The market is plainly no broader than the United States as a whole. The nationwide market is highly concentrated, and dividing the United States into smaller geographic markets will

[23] Dec. ¶ 6; Dec. ¶¶ 10, 13; Dec. ¶ 8; Dec. ¶¶ 6, 7; Dec. ¶ 6; Dec. ¶ 9; Dec. ¶ 8; Dec. ¶¶ 14-16; Dec. ¶ 11.

not change that result.[24] Before the Commission, the parties did not propose or identify any markets smaller than national markets,[25] and -- so far as the Commission is aware -- no market can be defined that will not be highly concentrated as a result of these mergers.

As discussed at pp. 30-33 below, there are many customers who require national coverage from their wholesalers, and those customers' options will fall from four to two as a result of these mergers. Dec. ¶ 6; Dec. ¶ 8. Even local customers -- hospitals or drugstores with only one location -- benefit from price and service competition at the national level. Individual local hospitals and drugstores have (and take advantage of) access to national GPOs and buying groups. Those GPOs and buying groups negotiate for drug wholesaling services in a national market, and thus obtain better prices for individual customers than those customers could obtain locally. Dec. ¶¶ 6-7; Dec. ¶ 11; Dec. ¶¶ 4, 12-13. The salutary effect of nationwide pricing on local competition is made clear

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[24] In *Grinnell,* the Supreme Court found that the market for central station fire alarm services was national, even though individual central stations (then) typically served customers within a radius of 25 miles. 384 U.S. at 575. The Court reached its conclusion because "the business of providing such a service is operated on a national level," *id.*, and the "broader national market . . . reflects the reality of the way in which [defendants] built and conduct their business." *Id.* at 576; *cf. Brown Shoe*, 370 U.S. at 327 ("further division [of the product market] does not aid us in analyzing the effects of this merger").

[25] specifically disavowed regional markets:

PX The geographic market is national, since national competition benefits even competition for purely local customers.

C. These Mergers Will Significantly Increase Concentration in the U.S. Drug Wholesaling Market.

It is well established that the "market shares which companies may control by merging is one of the most important factors to be considered" when analyzing the likely effects of an acquisition. *Brown Shoe*, 370 U.S. at 343.[26] Where a merger results in a significant increase in concentration and produces a firm that controls an undue percentage of the market, the combination is so inherently likely to lessen competition substantially that it "must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." *Philadelphia Nat'l Bank*, 374 U.S. at 363. On this evidence alone the Commission establishes its *prima facie* case that each merger violates the antitrust laws. Having done so, the Commission is entitled to a presumption that the mergers are illegal. But the outcome here need not rest on that presumption; as shown at pp. 24-44 below, substantial evidence -- including defendants' own business documents and their customers' testimony -- proves that these mergers in fact are likely to reduce competition.

The market shares of McKesson, AmeriSource, Cardinal, Bergen, and other firms are set forth in PX 4. As a result of their proposed merger, Cardinal's market share will increase from

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[26] Courts recognize that "significant market concentration makes it 'easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.'" *University Health*, 938 F.2d at 1218 n.24. "Where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels." *PPG*, 798 F.2d at 1503.

17% to over 40% after acquiring Bergen, increasing the HHI by 755 to 2333.[27] If McKesson, the nation's largest drug wholesaler, acquires AmeriSource, its market share will increase from 24% to about 38%, increasing the HHI by 663 to 2242. If both deals are consummated, the level of concentration will rise from 1579 to 2996. Either merger would leave the market highly concentrated. Both mergers will have an overwhelming effect, leaving two dominant firms that dwarf any fringe firm.

The market shares and substantial increases in concentration that would be produced by each of these consolidations far exceed the threshold that the Supreme Court established as raising a presumption of illegality under Section 7: "Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat." *Philadelphia Nat'l Bank*, 374 U.S. at 364.

When analyzing market share statistics to determine whether a firm has market power, an important factor that must be considered is the size of the merged entity in comparison to the other market participants. *Phillipsburg Nat'l Bank*, 399 U.S. at 367 (three times the size); *PPG*, 798 F.2d at 1502-03 (two and one-half times as large). Where a merger produces a firm that is significantly larger than its closest competitors, it increases the likelihood that the firm will be able to raise prices without fear that the small sellers will be able to take away enough business to

[27] The *Merger Guidelines* measure concentration using the Herfindahl-Hirschman Index ("HHI"), which is calculated by summing the squares of the market share of each participant. A merger that results in an HHI over 1800 indicates a highly concentrated market; an increase in the HHI of 50 points in a highly concentrated market raises significant antitrust concerns. Where the post-merger HHI is over 1800 and the increase in the HHI is over 100 points, it is presumed that the merger will be anticompetitive. *Merger Guidelines* § 1.51, at 10-11.

defeat the price increase.[28] Here the concentration level is roughly the same as in *PPG*,[29] and the merging firms will be eight times the size of the next largest wholesaler and almost 20 times larger than any of the remaining local and regional firms.[30]

D. These Mergers Will Harm Competition.

By proving that each of these mergers will increase concentration significantly in the U.S. drug wholesaling market, the Commission establishes its *prima facie* right to injunctive relief. The burden now shifts to the defendants to rebut this presumption. *United States v. Marine Bancorporation*, 418 U.S. 602, 631 (1974); *Baker Hughes*, 908 F.2d at 982-83. Assuming *arguendo* that defendants come forward with sufficient evidence to rebut that presumption, the Commission has assembled evidence that easily meets its "ultimate burden of persuasion" that

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[28] *See United States v. Rockford Mem. Corp.*, 898 F.2d 1278, 1283-84 (7th Cir.) (Posner, J.), *cert. denied*, 498 U.S. 920 (1990); *Pacific Coast Agric. Export Ass'n v. Sunkist Growers*, 526 F.2d 1196, 1204 (9th Cir. 1975), *cert. denied*, 434 U.S. 959 (1976); H. Hovenkamp, *Federal Antitrust Policy* § 12.4c (1993) ("markets may often have small niches or pockets where new firms can carve out a tiny position for themselves without having much of an effect on competitive conditions in the market as a whole").

[29] 798 F.2d at 1502-03. Courts have barred mergers resulting in substantially lower concentration levels. *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 902 (7th Cir. 1989) (acquisition increased market shares of largest firm from 23% to 32%); *Hospital Corp. of Am.*, 807 F.2d at 1384 (acquisition increased market share of second largest firm from 14% to 26%); *Warner Communications*, 742 F.2d at 1163 (four-firm concentration ratio of 75%); *United States v. United Tote*, 768 F. Supp. 1064, 1069-70 (D. Del. 1991) (merger between two firms with 13 and 27% of sales, increasing the HHI from 3940 to 4640, held presumptively unlawful); *Coca-Cola*, 641 F. Supp. at 1134, 1139 (combined market share of 42% held presumptively unlawful); *FTC v. Bass Bros. Enters. Inc.*, 1984-1 Trade Cas. ¶ 66,041 at 68,609-10 (N.D. Ohio 1984) (acquisition increased market share of second largest firm from 20.9% to 28.5%).

[30] In *PPG*, Judge Bork found that "an entity with a combined market share two and one half times larger than that of the nearest competitor and rais[ing] the HHI to 3295," left "no doubt that the pre- and post-acquisition HHIs and market shares found in this case entitle the Commission to some preliminary relief." 798 F.2d at 1503.

these mergers will in fact substantially reduce competition. *Baker Hughes*, 908 F.2d at 983. We outline here the evidence of anticompetitive effect that we will present, should the need arise.

1. *The Mergers Will Reduce Price Competition.*

These four defendants provide the most intense competition in this industry. AmeriSource is the most aggressive competitor -- the maverick -- frequently beating its national competitors with low prices.[31]

A wide range of consumers, including chain pharmacies, independent pharmacies, group purchasing organizations and government purchasers, are concerned that these mergers will be anticompetitive. Each of these witnesses testifies that the mergers, or either of them, would significantly reduce competition and expose customers to price increases and service reductions:

Chain Pharmacies: "

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Dec. ¶ 9.

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[31] Dec. ¶ 17 ("

"); Dec. ¶ 1; Dec. ¶ 6; Dec. ¶ 8; Dec. ¶ 9; Dec. ¶ 4; Dec. ¶ 6; Dec. ¶ 5 Dec. ¶ 11 ("

"); PX at ("

"); PX at and PX at

"); PX at (AmeriSource is " "); PX ; PX at and PX at (AmeriSource " "); PX at ("

"); PX ; PX

at

(" ").

See p. 10 n.7 above. "Acquisition of a maverick firm is one way in which a merger may make coordinated interaction more likely, more successful, or more complete." *Merger Guidelines* § 2.12, at 13-14.

Group Purchasing Organizations: "

" Dec. ¶ 12.

Independent Pharmacies: "

." Dec. ¶ 12.

Government Agencies: "

" Dec. ¶ 12.

. *See also* PX

.

These mergers will reduce competition in at least three ways: They will vastly reduce "excess capacity"[32] and the pressure on price that capacity creates; they will make it even easier for Cardinal and McKesson to coordinate their behavior; and they will all but eliminate competition for national customers.

a. *Elimination of "Excess Capacity."* As each of the defendants has grown and expanded, their networks of distribution centers have become able to handle a substantially greater volume of business. This growth in capacity has been the catalyst for vigorous price

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[32] Defendants currently operate 99 distribution centers. McKesson plans to close as a result of its acquisition of FoxMeyer (it has already closed 21). Defendants plan to close of these 99 distribution centers following the mergers.

competition. The drive to fill their warehouses compels each of the four national competitors to cut prices and to improve services in order to take business from each other. When that incentive is substantially removed, prices can be expected to rise, or at least not fall to the same extent as they would have without the merger.[33]

that underused capacity has pushed prices down. *See* PX at (" "); PX at (" "); PX at (" "); *id.* at (" "). As recently as July 1997, goal was to " ," *i.e.*, price. That goal was seen as " ." PX at .

The defendants hope that consolidation will be the antidote for their capacity-price problem. Chairman hoped for " " in excess capacity: " ." PX at . Once the Cardinal/Bergen acquisition was announced, informed his board " ." PX at . took a similar

[33] Defendants may argue that prices have consistently fallen for pharmaceutical wholesale services and are likely to continue to fall after these acquisitions. Whether prices will fall post-acquisition (as compared to current prices) is not the appropriate inquiry. Rather the relevant question is whether prices are likely to fall as much with the acquisition. *See* *Staples*, 970 F. Supp. at 1082-83 n.14 ("when the Court discusses 'raising prices' it is also with respect to where prices would have been absent the merger, not actually an increase from present price levels").

PX at ; PX at , .

view, noting "

." PX at . A major brokerage firm

PX at

.

The elimination of "excess" capacity harms consumers and competition in two ways: It reduces downward pressure on price, and it reduces the level of service provided to customers. Service will be reduced to customers -- particularly hospitals -- who will lose nearby distribution centers. While the parties plan to serve customers from more distant warehouses, the result will be that hospitals and other customers will not receive the same levels of service, including emergency service, on which they have come to rely. That reduction in service will directly increase health care costs, even if the wholesalers' prices do not change.[34]

b. *McKesson and Cardinal Will Be More Likely To Coordinate Pricing.* By reducing the number of major competitors to two, the mergers will make it easier for Cardinal and McKesson to coordinate their behavior. The ability of firms to coordinate their actions -- to pull their competitive punches, with the expectation that their competitors will do the same -- is one of the central concerns of the antitrust laws.

The most important determinant of the practicability of coordination is the number of

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[34] Dec. ¶¶ 7-8; Dec. ¶ 6; Dec. ¶ 14; Dec. ¶ 13; Dec. ¶ 6; Dec. ¶ 6; Dec. ¶ 19; Dec. ¶ 13.

participants in the market.[35] It is obvious that having only two national players makes it easier to coordinate. bids in this market are "transparent," *i.e.*, known to its competitors. PX at ; Tr. 107. The two firms can coordinate without actually agreeing on a price, since each firm already knows the prices of the other firm and can act accordingly. The two firms simply can adhere to a tacit understanding that they will not go after each other's customers.

The potential for anticompetitive coordination here is not hypothetical or theoretical. There is evidence that coordination *already* has occurred, using the vehicle of a multi-supplier drug wholesaling contract

" ." Tr. 44-45.

[35] "The relative lack of competitors eases coordination of actions, explicitly or implicitly, among the remaining few to approximate the performance of a monopolist." *FTC v. PPG Indus.*, 628 F. Supp. 881, 885 n.9 (D.D.C. 1986). By reducing the number of national firms from 4 to 2, coordination obviously will be enhanced. Courts have found violations where the decrease in the number of competitors was less significant. *See Elders Grain,* 868 F.2d at 902 (reduction from 6 to 5 competitors); *Hospital Corp. of America,* 807 F.2d at 1387 (reduction from 11 to 7 competitors); *Bass Bros.*, 1984-1 Trade Cas. At 68,609-10 (reduction from 7 to 5).

testified, "

." Tr. 81-82.

For example,

wrote to complaining about

." PX at .

The anticompetitive significance of all of these actions

was apparent to at least one who warned her superiors that "

." PX .

illustrate at least one mechanism by which coordination could

occur as well as a proclivity among the defendants to attempt to retard or eliminate price

competition.[36] If three of five major wholesalers

were able to coordinate pricing with some degree of success at a time when the three accounted for 65% of sales to hospitals, allowing the market to go to two wholesalers controlling 82% of sales to hospitals, PX 7, would make future coordination that much easier.

c. *Competition for National Customers.* Drugstores, hospitals and institutional purchasers increasingly buy on a national basis. Beginning in the 1980s, hospitals and retail pharmacy industries began to consolidate their purchasing. Hospitals merged to form national chains, or banded together to form GPOs. PX at 44-45; *see, e.g.,* Dec. ¶¶ 1-2; Dec. ¶¶ 1-2; Dec. ¶ 2. Retail drug store chains have also consolidated and formed buying groups. *E.g.,* Dec. ¶¶ 2-3; Dec. ¶¶ 2-5. As customers have become national, they have increasingly demanded nationwide drug wholesaling services. Dec. ¶¶ 6-8; PX at ; PX at ; *see* PX at . They demand multiple, geographically dispersed distribution points to serve their operations or members.[37] *E.g.,* Dec. ¶ 6;

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[36] Many courts have found that evidence of past or ongoing coordination strongly suggests the potential for coordination post-merger. *Elders Grain*, 868 F.2d at 905 ("it comes as no surprise that there is a history of efforts to fix prices in the industry--a history that predates the market structure even more prone to collusion that the challenged acquisition created"); *Rockford Mem. Corp.*, 717 F. Supp. at 1286 (describing the Rockford hospitals' efforts to boycott a new Blue Cross plan that would decrease their revenues), *cert. denied*, 455 U.S. 982 (1982); *Bass Bros.*, 1984-1 Trade Cas. at 68,616 (finding evidence of "signaling and coordinating" across-the-board industry price increase).

[37] "

Dec. ¶ 9; Dec. ¶ 8; Dec. ¶ 4;

Dec. ¶¶ 5-6. By using one wholesaler, a GPO, hospital group or retail chain can receive one integrated set of data on its members' purchasing and product use patterns. This integrated set of data is important in negotiating contracts with manufacturers.[38] These national buyers also can negotiate a more favorable contract with a wholesaler by offering that wholesaler almost all of its members' purchase volume instead of splitting that volume among several wholesalers. Dec. ¶ 4; *see also* Dec. ¶¶ 4-6; Dec. ¶ 8.[39]

The defendants themselves recognize the need to have a broad network to provide national coverage.[40] chairman noted in 1995, " ." PX at ; PX at (" "). chief

." PX at .

[38] Wholesalers' information systems are not compatible, *see, e.g.*, Dec. ¶ 6, so national customers prefer to minimize the number of wholesalers (and incompatible systems) they use. *E.g.*, Dec. ¶¶ 7, 9; Dec. ¶¶ 6, 10; Dec. ¶ 4; Dec. ¶ 9; Dec. ¶ 5.

[39] Customers' costs could rise if they diverted some business away from their primary wholesaler. Customers receive more favorable upcharges by consolidating their drug purchases with a single wholesaler. *E.g.,* Dec. ¶ 4; ¶¶ 4-5; Dec. ¶¶ 4, 6; Dec. ¶ 5; Dec. ¶¶ 5, 10; Dec. ¶ 2; Dec. ¶ 5; ¶¶ 3-4; ¶ 3.

[40] Wholesalers need national networks of distribution centers to enable them to provide ground delivery to customers. Air freight from one "hub" warehouse is not an alternative. " ." Tr. 67; *accord* Dec. ¶ 13; Tr. 61-62 ( ).

operating officer testified, "

." PX at The

also observes a "

." Dec. ¶ 18.[41]

Many customers, especially GPOs with wide geographic coverage, require contracts with two or three wholesalers in order to provide sufficient coverage and back up services.

Dec. ¶ 8; Dec. ¶ 7; Dec. ¶ 7. With four wholesalers competing so as not to be excluded, the customer is able to obtain competitive prices. By reducing the number of competitive alternatives to two, however, the transactions will eliminate their ability to play off competing wholesalers to get the best two bargains.

, a GPO with approximately members in states, explained:

Dec. ¶ 7; *see* Dec. ¶ 8.

Dec. ¶ 7. Chain pharmacies express a similar view. *See* Dec. ¶ 9 ("

"); Dec. ¶ 9 (

41

Dec. ¶ 4.

“

”).

2. *Fringe Wholesalers Cannot Constrain the Merged Firms.*

These four merging firms are the only competitors that provide all of the services involved, in the most timely, efficient and cost effective fashion.[42]

smaller wholesalers,

The largest of these fringe firms, Bindley Western, will be about one-ninth the size of either Cardinal/Bergen or McKesson/AmeriSource after these mergers. *See* PX 4. The next largest, Neuman Distributors, is about half the size of Bindley, *id.*, and operates solely in the northeast and in Michigan.

No other wholesaler has even 2% of the market. *See* PX 4. These fringe firms, as a group, have the same 20% of the market they had in 1993

showing that they have been unable to take share away from the four leading firms. Clearly the fringe, individually and collectively, lack the ability to constrain the majors.

That is the key antitrust question: whether these fringe firms can and will constrain an anticompetitive increase in price (or reduction in service) by Cardinal and McKesson. As smaller

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[42] Dec. ¶¶ 7-8; Dec. ¶ 3; *see also,* Dec. ¶ 13 (“

”);

Dec. ¶ 8

; Dec. ¶¶ 4, 7 (merging defendants “

”).

wholesalers acknowledge, as customers fear and as the merging defendants themselves note internally, these fringe wholesalers -- who typically have higher costs and less sophisticated service offerings -- would be unable to constrain a price increase by the majors.

testified:

PX at . In the same testimony, he observed: "

." *Id.*

chairman likewise testified that, "

" of the major

wholesalers. Tr. 102. This point was emphasized in 1997 presentations to

PX

at ; PX at .

called the four national firms

PX at .

Id. document notes that

PX at . Other documents confirm this conclusion.[43]

Because of their much smaller scale, fringe wholesalers typically operate at a cost disadvantage, making them unable to match the pricing of the merging defendants. Many fringe

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[43] PX at ("

"); PX at ; PX at ("

"); PX at (

); PX at (

").

firms do not receive the discounts from manufacturers that national wholesalers enjoy.

Dec. ¶¶ 4, 5; ¶ 3. Many are less able to take advantage of volume, discounted, or late-date product deals offered by manufacturers, because they lack the demand necessary to take advantage of such manufacturer discounts before the products expire. Dec. ¶ 12. In these situations, the regionals' lack of scale results in higher unit costs.[44] Many regional wholesalers do not carry a full line of pharmaceuticals because they do not have the volume of customers necessary to justify offering SKUs that individual customers order in low numbers. Dec. ¶ 9; Dec. ¶ 3.

The fringe typically does not have the technology that customers demand: specialized software, standardized reports, advanced electronic ordering systems and electronic order confirmation.[45] Moreover, splitting sales among regional wholesalers is too expensive and

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[44] Regional wholesalers have not succeeded in bidding jointly on national accounts and lack the structure to do so. To bid jointly for a national account, regional wholesalers need uniform services, a centralized office for handling customers' questions and complaints, common product codes, and a common ordering, invoicing, and billing system; they have none of these. Dec. ¶ 3; Dec. ¶ 10; Dec. ¶ 9. Some areas of the country have no regional wholesaler, so it would be impossible to form a group of regional wholesalers to serve all of the country. ¶ 3; Dec. ¶¶ 10, 13.

[45] ¶ 6; Dec. ¶ 9 ; Dec. ¶ 10; Dec. ¶ 10 ¶ 9 Dec. ¶¶ 8, 11 ; Dec. ¶ 4; Dec. ¶ 10; Dec. ¶ 8 ; *accord* PX at (1987 industry report: " "). Existing associations of regional wholesalers cannot integrate data from component wholesalers. Dec. ¶ 6.

inconvenient for many customers. For example,

Dec. ¶ 9.[46] Many regional wholesalers are unable to cover the geographic areas required by customers, especially GPOs and retail chains.[47]

Because the regional firms have higher costs, they are incapable of effectively challenging the prices of the national firms. This cost disadvantage means that they are likely to follow rather than to challenge a post-acquisition price increase.

Dec. ¶ 15. Others confirm that they too would go along with a price increase.

¶ 7; ¶ 11; *see* Dec. ¶ 23

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[46] Dec. ¶¶ 10
Dec. ¶ 10
Dec. ¶ 5 Dec. ¶ 14.

[47] Dec. ¶ 2; Dec. ¶ 2;
Dec. ¶ 3. Customers confirm that regional wholesalers cannot serve them.
Dec. ¶ 6; Dec. ¶ 8, 11 ;
Dec. ¶ 7; Dec. ¶ 9.

If the merged firms increased prices post-merger, many customers would pay higher prices, rather than switch to lesser service offerings from regional firms.[48]

3. *Expansion by the Fringe Will Not Defeat Anticompetitive Conduct.*

Regional firms confirm that they will not expand sufficiently to undercut a post-acquisition price increase by the nationals. Dec. ¶ 13; Dec. ¶ 10; Dec. ¶ 8; Dec. ¶ 7. " ." Dec. ¶ 5.

Most regionals lack the capital to open new distribution centers or acquire existing wholesalers. Dec. ¶ 10; Dec. ¶ 8. Those that could expand would do so by acquisition,[49] and would merely cannibalize the sales of another regional. Dec. ¶ 13; Dec. ¶ 7. Dec. ¶ 8.

The opportunities for success from expansion are not promising. FoxMeyer tried it in 1994 and failed miserably. FoxMeyer, then the nation's fifth largest drug wholesaler, attempted to expand rapidly and add information systems offerings. Although it invested over three years to upgrade its technology, it was unable to get the information systems to work, Tr. 51-52, Tr. 160-61, lost customers rapidly and wound up in bankruptcy -- and was acquired by McKesson. Many other firms have also exited the business in recent years, while

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[48] Dec. ¶ 15; Dec. ¶¶ 16-18; Dec. ¶ 9; Dec. ¶ 11; Dec. ¶ 7; Dec. ¶ 11.

[49] However, " ." Dec. ¶ 6.

none have entered.

Small expansions, by contrast, are unlikely to be sufficient to allow regionals to match the nationals' cost structure, and thus would not constrain their behavior. Any firm seeking to expand by acquisition in an effort to match Cardinal's and McKesson's cost structure will find the pickings slim indeed. One defendant's investment banker noted that

PX at ; *accord* Dec. ¶ 6.

4. *The Market is Insulated From Entry.*

If entry is difficult, the merged entity can raise prices without attracting new competition. *American Stores*, 697 F. Supp. at 1131; *see FTC v. Procter & Gamble Co.*, 386 U.S. 568, 579 (1966). The ultimate issue is whether entry is so easy that it "would likely avert [the] anticompetitive effects" resulting from the proposed acquisition. *Staples*, 970 F. Supp. at 1086, *quoting Baker Hughes*, 908 F.2d at 989. Entry is considered "easy" if it would be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects" of a proposed transaction. *Merger Guidelines* § 3.0, at 16-17.

plainly believes that entry is not easy:

PX at .

The *Guidelines*' approach is to determine if a new entrant is likely to emerge and to have a significant market impact within two years. *Merger Guidelines* § 3, at 16-18. In order for new entry to be likely, the sales opportunities available to a new entrant must be sufficient to enable the entering firm to operate at a large enough scale to make entry profitable. *Merger Guidelines*, § 3.3, at 18.

No new firm has entered the market for almost two decades. That fact speaks volumes. *De novo* entry as a local or regional wholesaler would involve substantial sunk costs in inventory and information systems.[50] A firm that incurred those sunk costs would then face incumbents with lower variable costs since, as defendants argued before the Commission, their greater size post-merger will enhance their already significant ability to obtain drugs at lower costs than can smaller wholesalers. It is unlikely that a firm would incur those sunk costs if it would be unable to match the variable costs of the incumbents, since the incumbent could cut price and drive out the entrant. Moreover, local *de novo* entry would only establish a firm with the constraining ability of the existing fringe; if the fringe today cannot constrain, there is no reason to suspect that an entrant could constrain these incumbents.[51]

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[50] Courts often look to the history of entry in assessing the likelihood of future entry. *See Staples*, 970 F. Supp. at 1087 (recent trend of exit, not entry); *United Tote,* 768 F. Supp. at 1076, 1080-82 (lack of entry supported finding of barriers); *American Stores*, 697 F. Supp. at 1131-32; *FTC v. Illinois Cereal Mills, Inc.*, 691 F. Supp. 1131, 1144-45 (N.D. Ill. 1988), *aff'd*, *sub nom. FTC v. Elders Grain,* 868 F.2d 901 (7th Cir. 1989).

[51] Industry analysts confirm the substantial barriers to entry into drug wholesaling. PX at (

); PX at (

); PX at (

Entry at a national level would be even more impractical. It would cost $500 million to $1.2 billion to build, equip and stock a network of 20 distribution centers, and hundreds of millions more to develop proprietary information systems that customers would find to be alternatives.[52] That amount likely exceeds the operating income of *all four merging firms* in 1996 ($562 million). McKesson, Cardinal, Bergen, AmeriSource Forms 10-K (1997). It is not surprising that there has been no new entry since 1981.

5. *Defendants' Asserted Efficiencies Cannot Save these Transactions.*

The defendants argued before the Commission that the proposed acquisitions would result in significant efficiencies. The Supreme Court has stated that "possible economies cannot be used as a defense to illegality" in Section 7 merger cases. *Procter & Gamble*, 386 U.S. at 580; *see also Philadelphia Nat'l Bank*, 374 U.S. at 371; *Phillipsburg Nat'l Bank*, 399 U.S. at 367-68. Many courts, including this one, have followed the Supreme Court's undisturbed precedent.[53] Other courts have nevertheless held that in appropriate circumstances, a defendant can rebut the presumption that a merger "would substantially lessen competition" by proving "substantial

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[52] Even individual distribution centers cost millions of dollars. *See* PX at ; PX

[53] As Judge Gesell wrote: "Any federal judge considering regulatory aims such as those laid down by Congress in Section 7 of the Clayton Act should hesitate before grafting onto the Act an untried economic theory such as the wealth-maximization and efficiency-through-acquisition doctrine expounded by [defendants] . . . . To be sure, efficiencies that benefit consumers were recognized [by Congress] as desirable but they were to be developed by dominant concerns using their brains, not their money by buying out troubling competitors. The Court has no authority to move in a direction neither the Congress nor the Supreme Court has accepted." *Coca-Cola*, 641 F. Supp. at 1141.

efficiencies that benefit competition and, hence consumers," *University Health*, 938 F.2d at 1222; *see Rockford Mem. Corp.*, 717 F. Supp. at 1288-92; just as the antitrust agencies consider pro-competitive efficiencies in evaluating a merger's likely competitive effect. *Merger Guidelines* § 4.0, at 18-20. All courts, however, agree that the ultimate issue under Section 7 is whether a proposed merger is likely to lessen competition substantially in any line of commerce in any section of the country, and if it is determined that a merger would have such an impact, proven efficiencies, however great, "will not insulate the merger from a Section 7 challenge." *University Health*, 938 F.2d at 1222 n.29.

Should the parties make efficiency claims in this Court, the Commission will demonstrate that these claims are factually unsupported, not specific to these mergers (since similar cost savings could be obtained through other means that do not threaten competition), and "arise from anticompetitive reductions in output or service." *Merger Guidelines* § 4.0, at 18-20.

These two acquisitions differ from most others in this industry, which combined wholesalers in different regions to create national competitors. There was little head-to-head competition. Here the principal efficiency claim -- that they will have cost savings resulting from the consolidation and closing of distribution centers -- is instead the very anticompetitive effect flowing from the transaction. Eliminating excess capacity that the defendants recognize is driving down price will not benefit consumers. An alleged efficiency that simply serves to mask competitive harm cannot be recognized by the courts. *See Alliant Techsystems*, 808 F. Supp. at 23 (elimination of "inefficiencies" of competitive bid were not cognizable). Many commentators agree that these savings should not be recognized. *See* Hovenkamp § 12.2b, n. 24 ("the qualifying efficiency cannot be elimination of the cost of competing, or virtually all mergers to monopoly would qualify for the defense"); IV P. Areeda & D. Turner, *Antitrust Law* ¶ 957 (1980)

(elimination of procurement efficiencies not cognizable).

III. THE FACTS OF THIS CASE DEMONSTRATE THE NEED FOR PRELIMINARY INJUNCTIVE RELIEF.

Where, as here, the Commission has demonstrated a likelihood of success on the merits, defendants face a difficult task of "justifying anything less than a full stop injunction." *PPG*, 798 F.2d at 1506; *Staples*, 970 F. Supp. At 1091. The strong presumption in favor of a preliminary injunction can be overcome only if: (1) significant equities compel that the transaction be permitted; (2) a less drastic remedy would preserve the Commission's ability to obtain eventual relief; and (3) a less drastic remedy would check interim competitive harm. 798 F.2d at 1506-07.

Injunctive relief is plainly appropriate here. One of the principal reasons for enjoining potentially illegal acquisitions stems from the historic difficulty of effectively splitting a combined operation into viable entities after the acquisition is consummated. This is particularly true in cases like this one where the defendants have testified that they will immediately begin to close down distribution facilities if the mergers are consummated. Defendants plan to close 55 of their 99 distribution centers following the mergers. *See* p. 26 n.32 above. The ineffectiveness of divestiture as a remedy, and the need for injunctive relief to maintain the status quo, was demonstrated so frequently that by 1966 it became the subject of judicial notice by the Supreme Court in *FTC v. Dean Foods Co.*, 384 U.S. 597, 606 n.5 (1966).

Section 13(b) manifests congressional recognition of the enforcement problem. *Weyerhaeuser*, 665 F.2d at 1081 n.20. As the court noted in *FTC v. Rhinechem Corp.*, 459 F. Supp. 785, 790 (N.D. Ill. 1978):

> Section 13(b) in part reflects Congress' dissatisfaction with the efficacy of divestiture as a remedy in antitrust cases. To achieve its goal of facilitating successful governmental intervention before the eggs are even cracked, thereby relieving the government from the necessity of trying to unscramble them at some later date, Congress rendered the

traditional equity requirements inapplicable in a Section 13(b) suit.

As this Court recently noted in *Staples*, another compelling reason to halt illegal acquisitions before they occur is to prevent the interim harm to competition that would result even if a suitable divestiture remedy could be devised. 970 F. Supp. at 1091. As the District Court for the Northern District of Ohio stated in enjoining two acquisitions in 1984, "later remedies cannot remove retroactively the harm that has already occurred. Courts should, therefore, prohibit consummation of a merger pursuant to Section 13(b) where serious questions are raised about its legality." *Bass Bros.*, 1984-1 Trade Cas. (CCH) at 68,622.

Conclusion

These transactions must be enjoined. Drug wholesaling services constitutes a relevant product market; the nation is a relevant geographic market; and the proposed transactions would create a duopoly in which each firm will dwarf the remaining fringe. Anticompetitive effects -- the power to raise prices to consumers -- are presumed where a merger gives a firm such a dominant market position. *Philadelphia Nat'l Bank*, 374 U.S. at 364; *Phillipsburg Nat'l Bank*, 399 U.S. at 366; *PPG*, 798 F.2d at 1506. Here that presumption is confirmed by the defendants' own documents, which show that the very purpose of these acquisitions is to bring more "pricing rationality" to the market, and by the absence of meaningful competition to the merged firms after the mergers.

For the above stated reasons, the Court should grant the Commission's motion for preliminary injunctions against both proposed mergers.

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Respectfully submitted,

Melvin H. Orlans
Attorney
Office of the General Counsel
Federal Trade Commission
Washington, D.C. 20580
(202) 326-2475

Michael E. Antalics
Richard G. Parker
Richard Liebeskind
Attorneys
Bureau of Competition
Federal Trade Commission
Washington, D.C. 20580
(202) 326-2821

Attorneys for Plaintiff