Antitrust, Vol. 33, No. 2, Spring 2019.

Don't Ditch Antitrust's Role in Product Hopping: A Response to Pace and Adam

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WE APPRECIATE JACK E. PACE III and Kevin C. Adam's *Understanding and Un-Tying Product-Hopping Litigation, Part II: A Reply to Carrier and Shadowen*, which replies to our piece, *A Non-Coercive Economic Approach to Product-Hopping* in the Fall 2018 issue of ANTITRUST. We have two main points in response.

First, Pace and Adam propose that antitrust liability for product hopping be limited to "deceptive" reformulations and offer "sham" innovation as an example of deception. We responded to the sham-based and deception-based proposals in our initial piece. Neither is supported by any cogent rationale. Both suffer from the critiques we leveled (and offered in greater detail elsewhere[1]) against the approach offered by Judge Douglas Ginsburg and former FTC Commissioner Joshua Wright.[2] The deception-based proposal: (1) refuses to acknowledge evidence that the failure to scrutinize product hops deters innovations as brand firms withhold advances from the market to use later in a product hop; (2) refuses to acknowledge that consumer gains from generic competition in the pharmaceutical industry are enormous; and (3) denies the economic significance of the "price disconnect," by which the person who chooses the drug does not pay and the person who pays does not choose.[3]

Second, Pace and Adam mischaracterize our position. We never "argue[d] . . . that *all transitions* from old products to new products (both hard and soft switches) should be illegal, except in isolated instances in which the branded pharmaceutical manufacturer takes extreme steps to assist its generic competitors."[4] Nor did we ever state—or even imply—that "antitrust scrutiny is appropriate for *all* product reformulations, even where no customers were coerced, because of the 'price disconnect' in pharmaceutical sales."[5] Nor does it consider our cabining of the "product-hopping" term or application of a "no-economic sense" test to claim that under our test, "every new version of brand-name medicine would run the risk of treble damages antitrust liability . . . unless it qualified for a safe harbor"[6] outside the brand's control.

Instead, we explicitly limited our definition of "product hopping" to the brand firm's combination of (1) "reformulating a product in a way that makes a generic version of the original not substitutable, and (2) encouraging doctors to write prescriptions for the reformulated rather than the original product, i.e., switching the prescription base from the original to the reformulated product." In other words, any reformulation that can stand on its own two feet—one made to open new markets or increase competition with non-generic rivals—does not even count as product hopping.[7]

Pace and Adam also misunderstand our safe harbors. As a general point, the safe harbors are *more* generous to the brand firm than the current state of the law, which does not offer any such havens from liability. Pace and Adam are correct that under the first safe harbor, the brand firm does not control the timing of the generic's application filing. But a brand manufacturer will proceed with a genuine innovation regardless of when the generic enters the market. After all, the rationality of such a reformulation is not dependent on blocking the generic. Supporting this is the empirical evidence that 80 percent of reformulations are made at a time when generic entry is not expected.[8]

The second safe harbor lies entirely within the control of the brand firm, which can introduce its reformulation after the generic enters the market. Pace and Adam somehow claim that this *safe harbor* would *expand* antitrust liability. That does not make sense. Nor do the authors consider that if a product reformulation provides a real innovation, and its introduction is not intended to impair generic competition, the brand firm is not unduly burdened by waiting until after generic entry to introduce the product. The brand needs to introduce the reformulated product before generic entry only if it does not provide a real innovation and its purpose is to impair generics.

Finally, Pace and Adam do not address our explanation of why the no-economic sense test is *more* deferential to brand manufacturers than the rule of reason in being conducted *ex ante*, being based on objective economic evidence, and not

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punishing conduct that has *more significant* anticompetitive effects as long as there is a reason for the reformulation that is not rooted in blocking generic entry.

In short, Pace and Adam's response offers a framework that essentially immunizes product hopping from antitrust scrutiny and mischaracterizes our position. When a brand firm undertakes a reformulation that only makes sense by harming generic rivals, thereby increasing costs to consumers without offsetting innovation benefits, antitrust liability is appropriate. ■

[1] Michael A. Carrier & Steve D. Shadowen, *A Non-Coercive Economic Approach to Product Hopping*, ANTITRUST, Fall 2018, at 104.

[2] *See* Jack E. Pace III & Kevin C. Adam, Doryx, Namenda*, and Coercion: Understanding and Un-Tying Product-Hopping Litigation*, ANTITRUST, Summer 2018, at 24, 28; Joshua D. Wright & Judge Douglas H. Ginsburg, Comment of U.S. Federal Trade Commissioner Joshua D. Wright and Judge Douglas H. Ginsburg on the Canadian Competition Bureau's Draft Updated Intellectual Property Enforcement Guidelines (Aug. 2015), https://www.ftc.gov/public-statements/2015/08/comment-commissioner-joshua-d-wright-judge-douglas-h-ginsburg-canadian.

[3] Pace and Adam believe they have dispensed with the price disconnect (which has been acknowledged for the past 50 years) because (1) drug companies engage in television advertising and (2) pharmacy benefit managers (PBMs) "extract billions of dollars in rebates from pharmaceutical manufacturers in exchange for favorable formulary placement." But the first explanation ignores advertising's role in encouraging consumers to demand drugs from price-insensitive doctors. And the second is merely a form of the "Cellophane Fallacy," (*see* United States v. E.I. du Pont de Nemours, 351 U.S. 377 (1956)), assuming that antitrust enforcers need not worry about conduct that deprives consumers of the typical 80 to 90 percent discounts from generic entry because PBMs, based on competition within the therapeutic class, are able to extract, say, 20 percent discounts from brand drugs.

[4] Pace & Adam, *supra* note 2, at 114.

[5] *Id.* at 115.

[6] *Id.* at 119.

[7] Our explanation that product hopping "does not include any instance in which the manufacturer promotes the original and reformulated products equally, without encouraging doctors to switch to the reformulated product" does not, as Pace and Adam suggest, impose "an 'equal' promotion requirement." Rather, it provides a counterexample to the behavior that our test targets: a brand's "switching the prescription base from the original to the reformulated product."

[8] *See* Steve Shadowen, Keith B. Leffler & Joseph T. Lukens, *Anticompetitive Product Changes in the Pharmaceutical Industry*, 41 RUTGERS L.J. 1, 27 (2009).