



VIEWPOINT:

French Competition Council vs. GSK France: who is the predator?

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An eCCP Publication

June 2007

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French Competition Council vs. GSK France: who is the predator?¹**By****Axel Schultz & Jeremy de Douhet²**

On 14 March 2007 the French Competition Council issued a decision³ imposing a EUR 10 million fine on GlaxoSmithKline France (GSK France) for predatory pricing. The investigation was the result of a complaint by a generic manufacturer, Flavelab, and resulted in the first ever predatory pricing decision by the French Competition Council.

This decision is remarkable in several aspects. Firstly, the alleged predatory pricing did not take place in the market in which GSK was found to be holding a dominant position, but in another, allegedly related market. Secondly, in order to find a dominant position on the related market, the Competition Council adopted a very narrow product market definition, equal to ATC level 5. Thirdly, the accusation of predation was not based on GSK's cost of production, but on the internal transfer price between GSK France and another subsidiary of the parent company GSK plc.

According to the decision, GSK France engaged in 1999 and 2000 in a predatory pricing strategy in the market for second generation injectable cephalosprines sold to hospitals. This market comprised GSK France's product "Zinnat" and Lilly France's product "Kefadol", as well as generic versions (the Zinnat market). Both GSK and Lilly had a turnover of just over EUR 1 million on this market. Hence, the decision found that GSK did not hold a dominant position. However, the Competition Council found that GSK was dominant in the market for injectable aciclovir sold to hospitals, a market equal to ATC level 5, where GSK sold its product "Zovirax" (the Zovirax market).

According to the Decision, the predation consisted of GSK France selling Zinnat to hospitals at a price below cost for the period between 1999 and 2000. The market concerned by the alleged predation (second generation injectable cephalosprines sold to hospitals) is relatively small (value below EUR 3 million) compared to other markets in which GSK France is active and compared to the overall sales of medicines to hospitals in France. But the Competition Council found that the predation was part of a wider intimidation strategy aimed at discouraging generic manufacturers from entering other hospital medicine markets where GSK France was active. The theory was that by using a predation strategy on one market (i.e. the Zinnat market), GSK was building an aggressive reputation and sending signals to generic manufacturers of what it was capable of doing in order to deter generic entry elsewhere (i.e. the Zovirax market where the

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³ *Décision no 07-D-09 du 14 mars 2007 relative à des pratiques mises en œuvre par le laboratoire GlaxoSmithKline France* ("the Decision").

patents were due to expire shortly). Moreover, the Council argued that once the generic competitor Flavelab exited the Zinnat market in 2001, GSK allegedly raised its prices in the following two years, allowing it to re-coup a large part of the losses from the predatory 1999 and 2000 sales.

Market definition and dominance

One of the noteworthy features of this decision is the narrow product market definition adopted by the Competition Council. The Decision comes to the conclusion that GSK France's Zinnat did not hold a dominant position on the market for second generation injectable cephalosprines sold to hospitals. By contrast, the decision found that GSK France's Zovirax constituted a market by itself on which it necessarily held a dominant position.

The subject of market definition in the pharmaceutical sector has been hotly debated over the past few years, with diverging results. In merger control decisions, the European Commission usually uses ATC level 3 as a starting point and sometimes uses ATC level 4 in its decisions. Equally, in its 2005 AstraZeneca decision, the market definition used by the Commission corresponded to ATC level 4. Going even further, the Hellenic Competition Committee concluded in a 2001 interim decision⁴ that each molecule concerned constituted a separate product market. By contrast, albeit in a parallel trade context, the European Court of First Instance in Case T-168/01 found that it was "*not manifestly incorrect*"⁵ to define a wider market comprising all pharmaceuticals that can be traded lucratively.

Thus, past cases have defined the relevant product market more narrowly than ATC level 3. However, it is rare for it to be defined at ATC level 5. By doing so, the Competition Council excluded, for instance, competing products at ATC level 4 that were used for the same indications but with a different formulation (tablets and creams, instead of injectable as Zovirax). It may well be that these products are ultimately no substitute for Zovirax, but the Decision goes into no detail when disregarding them. It simply states that these products are not in injectable form.

Dominance and abuse in different markets

Another interesting aspect of this Decision is that the abuse takes place in a market other than the one over which GSK was dominant. There have been cases with similar set-ups. However, one requirement has always been that the two markets have "associative links". The Council found that such "associative links" as set out in *Tetra Pack*⁶ existed between the Zinnat and Zovirax markets. In particular, the Council noted that on both markets the customers (i.e. hospitals) and the supplier (i.e. GSK) were identical, that both were competitive and not regulated markets and that GSK had itself

⁴ Decision of 3 August 2001,

⁵ Case T-168/01, *GSK v. Commission*, judgment of 27 September 2006.

⁶ Case T-83/91, *Tetra Pack v. Commission*, judgment of 6 October 1994, on appeal Case C-333-94, judgment of 14 November 1996.

connected the two markets by granting rebates to hospitals for bundled sales of Zinnat and Zovirax.

However, a comparison with the facts in the *Tetra Pak* decision shows that the “associated links” in that case were much stronger than here. First, Tetra Pak held 78% of the overall market in packaging in both aseptic and non-aseptic cartons, i.e. seven times higher than its closest competitor, which would confer unquestionably a dominant position even on that wider market. By contrast, GSK France’s share on an overall hospital market would be in the range of 6%. Moreover, Tetra Pak held market shares of 48% on the non-aseptic carton market and 52% on the non-aseptic machine market.⁷ The Court of First Instance confirmed that such market shares could be considered even on their own as demonstrating the existence of a dominant position.⁸ By contrast, the decision states explicitly that GSK France did not hold a dominant position on the Zinnat market. Further, both the aseptic and non-aseptic machines and cartons at issue in *Tetra Pak* were used for packaging the same liquid products, principally dairy products and fruit juice. By contrast, Zinnat and Zovirax are certainly not used to treat the same illnesses (unless one would argue that ultimately all medicines treat human diseases – which would be a fairly wide perspective). Finally, the two main players in *Tetra Pak* operated in both aseptic and non-aseptic markets and a third player on the non-aseptic market had been trying to enter the aseptic market. By contrast, only GSK France was active on both the Zinnat and Zovirax markets, with a different set of generic companies active on each market.

This comparison shows that the “associative links” in *Tetra Pak* were considerably stronger than in this case. Thus it seems questionable whether the Competition Council could validly rely on the *Tetra Pak* test to find that GSK France’s dominant position on the Zovirax market could be abused on the Zinnat market.

Transfer prices as basis for AKZO test

Predatory pricing refers to practices which entail the setting of prices at a level so low that competitors cannot compete. The Competition Council relied on the test set out in the *AKZO* judgment of the European Court of Justice.⁹ Accordingly, the Council adopted the cost test and concluded that the sale prices charged by GSK France for injectable Zinnat were below cost.

However, the Competition Council did something unprecedented. Instead of looking at the real costs of production of the products involved, it used the internal transfer price as the basis for the AKZO test. The Council found that GSK France purchased the product in question from another GSK subsidiary and then re-sold it in France at a price below the cost at which it had purchased it. The Competition Council

⁷ The dominant position which was abused by Tetra Pak existed on the aseptic carton market, not the non-aseptic markets.

⁸ Case T-83/91, paragraph 119.

⁹ Case C-62/86, *AKZO Chemie BV v. Commission* [1991] ECR I-3359.

found that the fact that GSK France sold the product at a price below the cost at which it had purchased it was in itself sufficient to prove the existence of anti-competitive predatory pricing.

This is a surprising approach. GSK France argued that although the price may have been set below the internal transfer price, i.e. the price it paid the other GSK subsidiary, the sales were made above the average variable cost of the GSK subsidiary which manufactured the product, i.e. the cost of production at group level. The Council rejected this argument on the basis that it could not be applied when the acquirer (GSK France) was an autonomous entity able to fix its own prices and operate on the market. The Council therefore concluded that GSK France's purchase prices were relevant for the purpose of the analysis and that they were deemed to be made pursuant to market prices. The Council laconically stated that "*the qualification of transfer price does not lead to any particular consequence in competition law since this price corresponds to a real merchant transaction.*"

The Decision seems to overlook that intra-company sales are not normally "*real merchant transactions.*" It makes a difference if a product is bought on the open merchant market or from a group subsidiary. In fact, competition law generally recognises the notion of a single economic entity, according to which, for the purposes of competition law, the behavior of the entire group as such has to be assessed. Clearly, neither Article 81 EC nor its French equivalent Article L. 420-1 of the French Commercial Code apply to intra-group agreements. It is not clear why this notion should not be true for Article 82 EC and Article L. 420-2 of the French Commercial Code. It seems plausible that the price between two subsidiaries within a group of companies does not necessarily reflect the real cost of the product, and is therefore not comparable to a price from a "real" supplier. Internal transfer pricing is typically a very technical procedure often reflecting other aims, such as fiscal results or group accounting. Finally, the Decision argues that OECD rules require transactions between subsidiaries be carried out at arm's length, in particular in cases where the entities involved have pricing autonomy. This does however not seem to be the case here. The Decision does not rebut credibly GSK's argument that GSK France is a price-taker rather than equal-footed price negotiator.

Strategy of predation

In addition to the cost test, the Competition Council assessed GSK's predation strategy. To that end it defined three possible predation strategies:

- Financial predation where the victim depends on external financing and the dominant company intends to dissuade financial investors through predatory pricing resulting in losses for the victim and ultimately withdrawal of financing with the victim ultimately exiting the market;
- Predation by "signaling" to potential competitors that it is not profitable to enter the relevant market due to the low prices practiced by the incumbent;

- Predation by creating a reputation for being aggressive with the aim of deterring competitors from coming onto the market.

The Competition Council was clearly influenced by the conviction that GSK adopted an aggressive policy to delay or hinder generic competition. Although the predation policy focused on a relatively small market, the Council considered that GSK's predatory policy was part of an overall intimidation strategy aimed at sending a "signal" deterring generic manufacturers from entering the hospital medicine market at large. The Council concluded that this strategy led to Flavelab's exit from the market in which the predatory pricing took place (but on which GSK was not dominant, i.e. the Zinnat market) and deterred generic entry into other markets where GSK's patents would soon expire (i.e. the Zovirax market).

The Decision's conviction of GSK's aggressiveness is surprising in light of the fact that only 43 contracts at prices below transfer price had been concluded in 1999 and 2000 between GSK France and French hospitals. In comparison, there exist more than 4000 hospitals in France. Also, in each case where the sales had been made below the transfer price, GSK France had obtained retroactive rebates from the GSK group so that it did not make a financial loss on these sales for fiscal purposes. But the decision uses this fact only to conclude that GSK France had pricing autonomy.

Meeting the competition

The Competition Council also rejected GSK France's argument that it only tried to react to a generic competitor entering the market with low prices and to meet this competition. The reason for the rejection is that GSK's average sales prices were below those offered by the generic company Flavelab. Again, this is a novel approach to predation. The AKZO test does not ask whether the price of the dominant company is higher, lower or equal to the one charged by the other company; the only question is whether the price charged by the dominant company is below costs, which was not the case here when looking at the production costs at GSK group level.

Re-couping

The Competition Council also found that GSK France was able to raise its prices in the two years following the predation, thereby allowing it to re-coup a large part of the losses from the predatory 1999 and 2000 sales. GSK argued that the price rise in 2001 had nothing to do with recouping, but was actually the result of a legitimate attempt at avoiding the predatory pricing allegations. In 2000 Flavelab had launched a request for interim measures against GSK France's low prices. GSK France was therefore aware of the allegations against it, and argued that it had chosen to raise its prices in order to avoid the predatory pricing claims. In fact, it seems likely that had it not raised prices in 2001, the predation claims would have covered a longer period beyond 2000, but now that it had raised prices, the Competition Council instead found this price rise demonstrated that GSK was able to recoup losses.

Elimination of a competitor

The Competition Council found that the behavior had led not only to the exit from the relevant market of the generic producer Flavelab, but also to the deterrence of generic entry by others on other markets. The Decision does not however explain fully the causal link between Flavelab's exit from the Zinnat market and GSK's pricing, nor between GSK's behavior and the non-entry of other generic manufacturers on other markets.

Competition policy should be concerned with predatory pricing only when it excludes equally efficient competitors, not less efficient competitors. By contrast, the decision states that GSK "*could not ignore that Flavelab, with only two years of existence, was a generic producer with a fragile financial background.*" Does this mean that the test of predatory pricing should have a subjective element depending on the financial strength of the smaller company? Such a subjective element would be rather difficult to apply, in particular *ex ante* when the dominant company has to decide which prices it will charge.

Conclusion and context

From a French perspective, this decision is important as it is the first involving predatory pricing by a single dominant company. In previous decisions, the Council has however referred to the *AKZO* jurisprudence and applied "eviction price" or "predatory price" arguments in cases involving the attempt by cartels to push competitors off the market.¹⁰

From a legal perspective, this decision is interesting as it uses a new approach to the old *AKZO* test, in particular the use of transfer prices as proxy of production costs and the application of the "associative links" test.

However, the real impact for research-based pharmaceutical companies of this decision lies in the context of lifecycle management and post-patent pricing strategies. Typically prices come under pressure once the patent expires. Does this decision mean that pharmaceutical companies have to keep their prices up and accept that their market share collapses, or can they meet the competition? If so at what price?

Intervention by the Competition Council was certainly motivated by a desire to encourage generic entry. As such, this decision is yet another manifestation that attention is (slowly) moving away from parallel trade on to generic competition. The Commission's decision against AstraZeneca's use of SPCs to delay generic entry and the decision by the Italian antitrust authority against Merck Italy are to be seen in that

¹⁰ See, in particular, cases 94-MC-10 dated 14 September 1994 and 97-D-39 dated 17 June 1997.

context. In the latter case,¹¹ Merck's SPC for an antibiotic compound had expired in most European countries except Italy. An Italian generic company wanted to produce this compound in Italy and export it to other EU countries where the SPC had expired. However Merck refused to grant a license under the SPC. The Italian Antitrust Authority found that Merck had a dominant position over the compound in question (the product market definition corresponded to ATC level 4) and found that Merck had infringed Article 82 EC in that the refusal to grant a license impeded generic entry in countries where SPC had expired.

In the U.S. the FTC is hotly pursuing so-called reverse payments. In a number of cases, generic companies challenged in court the validity of patents or even launched a generic version of a molecule still under protection. In some cases the ensuing dispute lead to settlements which included payments from the brand manufacturer to the generic company for non-entry. The FTC views such reverse payments as deliberate strategies to delay generic entry in violation of antitrust laws. The FTC's decision against Schering-Plough was overruled by the Court of Appeals (and the Supreme Court refused to hear the appeal). The FTC was, however, successful in blocking a settlement between Sanofi/BMS and Apotex whereby Apotex had agreed not to market a generic Plavix (whose patent expires in 2012) in return for \$40 million. Shortly after the settlement collapsed, Apotex launched its generic version of Plavix.

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¹¹ Case A364 - MERCK-PRINCIPI ATTIVI, decision of 21 March 2007.