IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

NATCHITOCHES PARISH HOSPITAL SERVICE DISTRICT and JM SMITH CORPORATION d/b/a SMITH DRUG COMPANY on behalf of themselves and all others similarly situated, Plaintiffs, v. TYCO INTERNATIONAL, LTD.; TYCO INTERNATIONAL (US) INC.; TYCO HEALTHCARE GROUP LP; THE KENDALL HEALTHCARE PRODUCTS COMPANY, Defendants.	§	Civil Action No. 05-12024 PBS **JURY TRIAL DEMANDED**

TYCO INTERNATIONAL (US) INC., TYCO HEALTHCARE GROUP LP, AND THE KENDALL HEALTHCARE PRODUCTS COMPANY'S MOTION TO EXCLUDE THE EXPERT REPORT AND OPINIONS OF PROFESSOR EINER ELHAUGE

[REDACTED VERSION]

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I. INTRODUCTION

From the outset of this action, Plaintiffs have maintained that evidence regarding the impact of the challenged Covidien contracts on individual class members is irrelevant.[1] Over two years ago, Covidien sought discovery from hospitals to determine whether the challenged share-of-purchase discounts or sole-source contracts constrained real purchasers from buying from Covidien's rivals. Plaintiffs, however, argued that this evidence was unnecessary, because their liability expert, Einer Elhauge, could use the available sales data to show that the challenged contracts had the "practical effect" of foreclosing competition. Plaintiffs successfully blocked hospital discovery, other than the single deposition of Natchitoches hospital itself, which ironically repudiated all of Plaintiffs' claims of coerced purchasing behavior.

In lieu of direct evidence from purchasers about the impact of the challenged contracts, Plaintiffs rely entirely on the proposed opinions and testimony of Prof. Elhauge to carry their burden of demonstrating anticompetitive economic foreclosure. Their case rests completely on his ability to prove that share-of-purchase discounts and sole-source contracts forced customers to buy from Covidien who would otherwise have bought from its rivals. Without such proof, Plaintiffs have no evidence that their theory of the case is viable.

Not surprisingly, the econometric and empirical analyses supposedly establishing and quantifying the foreclosure of Covidien's rivals' are the centerpiece of Prof. Elhauge's expert report. Indeed, the amount of foreclosure he computes translates *directly* into the number of dollars that Plaintiffs' damages expert claims are owed to the class. Yet, despite the critical importance of these computations, Plaintiffs chose to engage a flatly unqualified law professor to

[1] "Plaintiffs" are Natchitoches Parish Hospital Service District and JM Smith Corp. d/b/a Smith Drug Co.; "Covidien" means Tyco International (US) Inc., Covidien (formerly Tyco Healthcare Group LP), and The Kendall Healthcare Products Company.

perform the work of a sophisticated economist. Prof. Elhauge is not a credentialed (nor even trained) economist. His economics education is limited to two introductory classes usually given to college freshmen, and one law school course. As Prof. Elhauge himself admitted, he is not an econometrician. Prof. Elhauge's complete lack of expertise, standing alone, is fatal to his bid to present the jury with the complex analyses he has tried to perform and to the admissibility of his opinions about the alleged economic effects of the challenged contracts.

But not only is Prof. Elhauge unqualified, his analyses contain numerous crucial mistakes that a trained economist would not have made, and his results are hopelessly infected with these errors. Prof. Elhauge's "simultaneous comparisons," which purportedly prove Covidien's rivals' inability to sell as successfully to customers "burdened" by the challenged contracts, contain numerous layers of selection bias. Put simply, Prof. Elhauge assigns customers that like Covidien's containers to what he calls the "burdened" group and those who have demonstrated a preference for rivals to the "unburdened" group, then he cries foul when those who prefer Covidien's products buy more of them than those who do not. Worse yet, when a "burdened" customer chooses to ignore Covidien's allegedly exclusionary contracts by buying from a rival (such as when a member of a sole-source Covidien GPO decides to buy entirely from Daniels or Becton Dickinson), Prof. Elhauge reassigns this buyer to the "unburdened" category, thereby recasting acts that directly contradict his theories as helpful data points. These transparently self-serving data manipulations ignore the requirements of good science.

Prof. Elhauge claims to have accounted for the selection bias in his simultaneous comparisons (which even he cannot fully deny exists) by performing "longitudinal comparisons," including various regressions on the sales to buyers over time. But a Nobel-Prize winning econometrician looking at those regressions has deemed them wholly unsound, because

they ignore over 90% of the relevant data and contain other serious errors.

In addition to these defects, the entire premise of Prof. Elhauge's opinions -- that discounting practices can be condemned with no price/cost analysis -- conflicts with controlling legal authority and the majority of antitrust scholarship. Indeed, the First Circuit and other courts have held that imposing liability for above-cost, share-of-purchase discounts would be inimical to American antitrust law and policy. This is a separate and additional reason to exclude Prof. Elhauge's testimony, because it shows that he is committed to proffering improper legal advocacy rather than independent expert evaluation.

Prof. Elhauge's lack of relevant expertise and the serious errors that pervade his analyses render his opinions not only unreliable, but wholly misleading and useless for testing the alleged economic effects of Covidien's contracts. The unavoidable conclusion is that Prof. Elhauge's proposed opinions and testimony are irremediably flawed and will lead to reversible error if presented to the jury. Rule 702 of the Federal Rules of Evidence and the standards established in *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993), compel this Court to exclude his report, opinions and proposed trial testimony.

II. LEGAL STANDARDS

The standards mandating exclusion of Prof. Elhauge's report and testimony are straightforward. Because statements by a witness qualified by a court as an expert can carry great weight with the jury, "[e]xpert evidence can be both powerful and quite misleading…" *Daubert*, 509 U.S. at 595; *United States v. Monteiro*, 407 F. Supp. 2d 351, 358 (D. Mass. 2006) (Saris, J.) ("Simply put, expert testimony may be assigned talismanic significance in the eyes of lay jurors, and, therefore, the district courts must take care to weigh the value of such evidence against its potential to mislead or confuse") (citation omitted). Under Federal Rule of Evidence

702, this Court acts as the gatekeeper to ensure that proposed expert testimony "is not only relevant, but reliable" and that it "is sufficiently tied to the facts of the case [such] that it will aid the jury in resolving a factual dispute." *Daubert,* 509 U.S. at 589, 591 (internal citation omitted); *Bogosian v. Mercedes-Benz of N. Am., Inc.*, 104 F.3d 472, 476 (1st Cir. 1997) (a court must "ascertain whether the testimony is helpful to the trier of fact, *i.e.*, whether it rests on a reliable foundation and is relevant to the facts of the case"). Accordingly, before allowing expert testimony to be heard, a court must take great care to assure that (1) the putative witness is expertly qualified to opine on the relevant subject matter; (2) the reasoning and methodology underlying the proposed testimony is scientifically valid; and (3) the proposed testimony actually "fits" the contours of the case and can be properly applied to the facts in issue. *See Daubert*, 509 U.S. at 592-93; *Monteiro*, 407 F. Supp. 2d at 357-58. This requires the Court to "evaluate the methods, analysis, and principles relied upon" by the putative expert to "ensure that the opinion comports with applicable professional standards outside the courtroom and that it 'will have a reliable basis in the knowledge and experience of [the] discipline.'" *Watkins v. Telsmith, Inc.*, 121 F.3d 984, 991 (5th Cir. 1997) (citing *Daubert*, 509 U.S. at 592). "Because the admissibility of all expert testimony is governed by the principles of Rule 104(a), the proponents of the expert testimony must establish these matters by a preponderance of the evidence." *Monteiro*, 407 F. Supp. 2d at 356 (citation and internal quotation marks omitted).

III. ARGUMENT

A. Prof. Elhauge is not an Expert in the Relevant Discipline

By training and professional experience, Prof. Elhauge is a lawyer and a law professor, *not an economist*. He graduated from college with a degree in biochemical sciences. (Ex. A at

13:11-14.)[2] He went to law school a year later. (*Id.* at 14:3-9.) He currently teaches antitrust, contracts, corporations and a few other subjects at the Harvard Law School. (Exhibit A to 12/18/07 Elhauge Expert Report ("Elhauge") (Docket No. 133).) Prof. Elhauge holds no academic degree in economics. (Ex. A at 15:12-20.) His formal education on the topic consists of two entry-level courses. (*Id.* at 14:14-15:11.) Other than a class on antitrust law, the only graduate course he took that touched on economics was a law school course on the economic analysis of legal issues. (*Id.* at 15:21-16:10.) Prof. Elhauge has also never taught a class in economics or statistical modeling. (*Id.* at 17:12-18:7.) Moreover, in Prof. Elhauge's words, "an econometrician is somebody who specializes in developing methodologies for statistical analysis of economic problems," and he concededly is "not [] an econometrician." (*Id.* at 9:1-16.)

This Court must evaluate Prof. Elhauge's lack of expertise in the specific context of the analyses he proposes to present to the jury. *Berry v. City of Detroit,* 25 F.3d 1342, 1351 (6th Cir. 1994) (Judge must consider an expert's qualifications not "in the abstract, but whether those qualifications provide a foundation for a witness to answer a specific question."); *Whiting v. Boston Edison Co.*, 891 F. Supp. 12, 24 (D. Mass. 1995) ("[A] witness must be qualified in the *specific* subject for which his testimony is offered.") (emphasis in original). Despite Prof. Elhauge's lack of training in econometrics or statistical modeling, his report contains complex data analyses that purport to measure precisely the degree to which the challenged Covidien practices impacted purchasing in the sharps container market. First, Prof. Elhauge tries to measure Covidien's rivals' ability to sell to customers who made purchases under Covidien's share-of-purchase discounts, sole-source contracts, both types of contracts or either type (the

[2] All references to an exhibit ("Ex.") refer to the lettered exhibits attached to the concurrently filed Declaration of Jeffrey M. Gutkin.

"simultaneous comparisons"). (Elhauge ¶¶ 179-85.)[3] Prof. Elhauge claims that these analyses show that Covidien's rivals "do significantly worse when [Covidien's] exclusionary contracts are present than they do at unburdened buyers" and measure how much worse they do. (*Id.* ¶ 183.) He also claims to analyze the impact of the challenged contracts on buyers over time by applying a statistical regression model (the "longitudinal comparisons").

These analyses require expertise in econometrics and statistical analysis that Prof. Elhauge plainly lacks. His training as a lawyer and his career of commenting on the antitrust laws simply has nothing to do with how one properly populates a "control group" and "treatment group" for the purpose of conducting statistically reliable comparisons. Similarly, Prof. Elhauge has no business presenting regression analyses to the jury. Being a lawyer does not make one an expert in whether a "linear" or "logarithmic" regression is the right approach for analyzing a data set. (Elhauge ¶ 190.) Neither can two college courses in economics supply a legally sustainable basis for the expertise needed to present the following information to a jury:

> The coefficients that result from the regression are in natural logarithms. To convert them to percentage terms, one must raise the constant *e* to the coefficient and subtract 1. The logarithmic regression ln y = c +bx + ε, where x is a dummy variable indicating the burdened/unburdened segments, is equivalent to y = exp(c)exp(bx)exp(ε). When x goes from 0 to 1, the rival's market share, y, is multiplied by exp(b). Then, because exp(0) equals 1, one must subtract 1 to get the percentage change in the rivals market share as their restricted status goes from 0 to 1.

(Elhauge ¶ 191 n. 416.) As this passage makes plain, Prof. Elhauge purports to opine on complex economic and statistical matters with no training or basis whatsoever to claim sufficient

[3] Although Plaintiffs' complaint references package or "bundled" discounts, Prof. Elhauge has neither estimated how much of the market received those discounts nor does he claim to analyze what effect, if any, those practices had on Covidien's rivals. Additionally, Prof. Ordover has shown that an insignificant portion of the sharps container market received any form of package discount, and Prof. Elhauge has never disputed these estimates. (1/18/08 Ordover Expert Report ("Ordover") ¶ 110 (Docket No. 132, Exhibit A).)

expertise for doing so. Prof. Elhauge's lack of any economics credentials, standing alone, renders him unfit for presentation to the jury as an economics expert. *See Bogosian*, 104 F.3d at 477. His almost total lack of training in economics also marshals against permitting his opinions to reach a jury. It seems "beyond doubt" that a testifying expert "should have achieved a meaningful threshold of expertise" in the given area. *Prado Alvarez v. R.J. Reynolds Tobacco Co., Inc.*, 405 F.3d 36, 40 (1st Cir. 2005).

Plaintiffs also have never shown that Prof. Elhauge has sufficient professional experience to qualify as an expert on statistical modeling. *Ankuda v. R.N. Fish & Son, Inc.*, 535 F. Supp. 2d 170, 174 (D. Me. 2008) ("[I]f the expert witness is relying solely or primarily on experience, then the witness must explain how that experience leads to the conclusion reached, why that experience is a sufficient basis for the opinion, and how that experience is reliably applied to the facts.") (citation omitted). Prof. Elhauge's time as a professor and an expert witness does not make him an authority on econometrics. *Tokio Marine & Fire Ins. Co., Ltd. v. Grove Mfg. Co.*, 958 F.2d 1169, 1175 n.3 (1st Cir. 1992) ("The fact that a person spends substantially all of her time consulting with attorneys and testifying in trials is not a disqualification, but it is not an automatic qualification guaranteeing admission of expert testimony.").

Even if Prof. Elhauge's distinguished career as a legal scholar and professor qualifies him as expert in antitrust law, this is neither sufficient nor germane. Expert testimony on the state of antitrust law would plainly intrude on the domain of the court and be inadmissible. Additionally, courts in this Circuit often find accomplished experts in related disciplines insufficiently qualified if they do not have particular expertise in the relevant subject matter. *See, e.g.*, *Bogosian*, 104 F.3d at 477 ("master mechanic" without a degree or training in engineering cannot opine on design defects); *Tokio Marine*, 958 F.2d at 1174-75 ("professional witness" with

license in civil engineering and experience investigating over 60 crane accidents not qualified because he "conceded that he was not an expert in crane maintenance nor in crane operation").[4] Prof. Elhauge's is not qualified to perform regressions and other technical statistical analyses.

In short, Prof. Elhauge lacks the requisite economic expertise to present his foreclosure analyses to the jury. The Court should exclude his opinions.

B. Prof. Elhauge's "Foreclosure" Analyses are Deeply Flawed

As described above, Prof. Elhauge's principal attempt to validate his theories with actual evidence are his empirical comparisons of Covidien's rivals' performance in the portions of the market "burdened" and "unburdened" by the challenged practices.[5] Plaintiffs not only elected to forego marshalling evidence from individual purchasers regarding how these practices affected their buying decisions, but aggressively and successfully blocked Covidien from obtaining such evidence. (*See* 10/30/2006 Order Denying Class Member Discovery.) Therefore, Plaintiffs' only supposedly empirical evidence that the challenged practices allowed Covidien to make sales it would not have made in the but-for world are Prof. Elhauge's comparisons.[6] The validity of

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[4] *Polaino v. Bayer Corp.*, 122 F. Supp. 2d 63, 67-69 (D. Mass. 2000) (excluding highly qualified chemist who lacked the training or experience to opine on design flaws causing release of chemical fumes); *Sutera v. The Perrier Group of Am. Inc.*, 986 F. Supp. 655, 667 (D. Mass. 1997) (Saris, J.) (excluding oncologist and hematologist with considerable experience in diagnosis and treatment, but inadequate expertise in epidemiology, toxicology, biostatistics or risk-assessment, from opining as to leukemia's causes); *see also Shreve v. Sears, Roebuck & Co.*, 166 F. Supp. 2d 378, 391 (D. Md. 2001) ("[t]he fact that a proposed witness is an expert in one area, does not *ipso facto* qualify him to testify as an expert in all related areas.").

[5] Although Prof. Elhauge uses a variety of terms, this brief will use "burdened" to refer to any purchasers that Prof. Elhauge claims are affected by the challenged contracts.

[6] As Covidien has previously noted, the one class member from which it was allowed to take discovery, Natchitoches, confirmed that it felt free to buy from any sharps container vendor, despite its GPO contracts, and that it selected Covidien based on safety. (Ex. D at 22:14-25:8, 67:1-69:10) (Crowder Depo.) It is worth noting that in the related Daniels competitor litigation, *Daniels Sharpsmart, Inc., v. Tyco Int'l (US) Inc., et al*, No. 5:05-CV-169 (DF) (E.D. Tex.), in which Covidien and Daniels both deposed hospitals, *the hospitals uniformly testified that GPO contracts do not prevent them from buying sharps containers from their preferred suppliers.* With the Court's permission, Covidien will submit relevant excerpts from these deposition transcripts, which unequivocally contradict Professor Elhauge's opinions here.

these comparisons is critical to Plaintiffs' case, because they form a vital input for the damages calculations of Dr. Singer, which cannot be performed without these comparisons. (*See, e.g.*, 12/18/07 Singer Expert Report ¶¶ 57-58 & Table 11 (Docket No. 136) (incorporating the results of Elhauge Exhibit 9).) Prof. Elhauge claims that these comparisons show that Covidien's discounts and contracts had a substantial negative impact on the sales of competitors. (Elhauge ¶ 179; Ex. A at 136:6-137:3) ("My [foreclosure] analysis was based more on statistics of what they were actually able to do in the unburdened and burdened portions of the market."). However, as described in detail in the accompanying declarations of Drs. Janusz A. Ordover ("Ordover Decl.") and Daniel McFadden ("McFadden Decl."), these analyses are corrupted by elementary design and implementation errors. Consequently, the analyses lack reliability and cannot be presented to the jury or relied upon by Dr. Singer.

1. Selectivity bias pervades the "Simultaneous Comparisons"

As described above, in his "Simultaneous Comparisons," Prof. Elhauge claims to demonstrate that rivals enjoy substantially greater sales in the portion of the sharps container market "unburdened" by Covidien's challenged practices. (Elhauge ¶¶ 179-87; Exhibits 5-16.) As the Nobel-Prize winning economist James Heckman observed, one of the most common flaws of an inexpert economic analysis is the introduction of self-selection or "selectivity" bias.[7] Imagine a scientific experiment to test whether a speed reading class causes people to read more. To conduct this experiment, a researcher must have a "control group" and a "treatment group" that differ *only* in that one group takes the class and the other does not. If taking the class is the only material difference between the two groups, the researcher can reliably conclude that a statistically significant difference in the reading habits of the two groups results from the class.

[7] (*See e.g.*, Ex. E (http://nobelprize.org/nobel_prizes/economics/laureates/2000/public.html).)

If, however, other differences between the two groups exist, for example, if those who choose to take the class are avid readers and those in the supposed control group (who do not take the class) are not, the experiment will be plagued by selectivity bias and its results will be meaningless. That is, a finding that the class attendees read more than the non-attendees will not in any way demonstrate that the class actually encouraged reading.[8] This is the essence of the problem with Prof. Elhauge's simultaneous comparisons.

Courts routinely exclude analyses infected with selection bias. *See, e.g.*, *Bouchard v. Am. Home Prods. Corp.*, 213 F. Supp. 2d 802, 810 (N.D. Ohio 2002) (holding that an article "overly tainted with selection bias" "may not form the basis of [an expert's] opinion"); *Valentine v. Pioneer Chlor Alkali Co., Inc.*, 921 F. Supp. 666, 676-77 (D. Nev. 1996) (rejecting study where "[t]he probability of selection bias is too high to be overlooked").[9] As described below, exclusion is plainly warranted here.

The selectivity bias in Prof. Elhauge's simultaneous comparisons is flagrant and rampant. As an initial matter, buyers are assigned to one of the "burdened" groups when they choose to buy from Covidien either under a share-of-purchase discount or sole-source contract and are assigned to the "unburdened" group if they opt not buy under such a contract. (Ordover Decl. ¶¶ 13-16.) Plainly, customers who prefer Covidien and choose to buy most or all of their needs from Covidien will very likely choose to use a share-of-purchase discount to obtain the best

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[8] "Selectivity concerns the presence of some characteristic of the treatment (or control) group that is both associated with receipt of the treatment and associated with the outcome so as to lead to a false attribution of causality regarding treatment and outcomes." (Ex. G at 447 (Johnston and DiNardo, Econometric Methods) (citations and internal quotations omitted).)

[9] *Whiting*, 891 F. Supp. at 21 n.44 (Court gives no weight to study marred by self-selection and other biases.); *Allgood v. General Motors Corp.*, No. 102CV1077DFHT AB, 2006 WL 2669337, at *9-11 (S.D. Ind. Sept. 18, 2006) (finding expert's "methodology…was not sufficiently reliable to satisfy the demands of *Daubert* and Rule 702 due to selection bias and therefore cannot be admitted").

available prices, if they can access such a discount. Conversely, customers who prefer a rival and who do not purchase enough Covidien products to qualify for a discount will not commit to such a contract. Therefore, customers who do not prefer Covidien's products will self-select into the "unburdened" group, which, conveniently, is the group Prof. Elhauge wants to show buys more from rivals to support his liability theory and to increase the alleged damages to the class.[10]

Prof. Elhauge tacitly admits this selection bias exists as to share-of-purchase discounts, but claims that it is absent for the sole-source contract comparisons because customers do not choose to join a GPO based on their preference for a particular sharps container vendor. (Elhauge ¶ 198.) This argument is specious. Buyers are not assigned to the burdened group because they have chosen to *belong* to a sole-source GPO. They are treated as burdened only if they actually buy through a sole-source contract. (Ordover Decl. ¶¶ 26.) Thus, Prof. Elhauge would assign a member of a Covidien sole-source GPO that buys 100% of its sharps container needs from Stericycle to the *unburdened* group. Such a buyer is a perfect counter-example to Prof. Elhauge's theory that sole-source contracts cause buyers to choose Covidien. Yet Prof. Elhauge's manipulation of the data twists that buyer's decision to ignore the supposedly exclusionary contract into a data point supporting his opinions.

To properly conduct this analysis, Prof. Elhauge needed to assign all buyers who had *access* to the challenged contracts to the burdened group, not just those who *freely elected* to buy through the contracts. A simple example vividly illustrates this point. Imagine that in a group of 100 hospitals that belong to no GPO and have no access to the challenged contracts, 50 choose to

[10] Note that even if Covidien's discounting practices were the uniform volume discounts of which Prof. Elhauge approves, his comparisons would yield the exact same results -- buyers that agree to purchase a large volume from Covidien would undoubtedly purchase significantly more from it, and relatively less from its rivals, than hospitals that decline volume discount programs. As such, his approach would find a large "gap" even under contracts that, according to Prof. Elhauge, are procompetitive.

buy from Covidien and 50 from rivals. Now imagine that these 100 buyers form a GPO and contract to receive share-of-purchase discounts from Covidien, but *assume, arguendo, that the contract has no impact at all on their purchasing*. Accordingly, the same 50 hospitals continue to buy from Covidien under the new GPO contract and the same 50 buy off contract from rivals. Prof. Elhauge's valueless simultaneous comparisons would "prove" that 100% of the difference between these two groups is caused by the contract, because all Covidien's buyers would be placed in the burdened group and all the rivals' buyers would be categorized as unburdened. (Ordover Decl. ¶¶ 17-18 & Exhibits 1-3.) Obviously, this comparison is intellectually bankrupt because its outcome is preordained by the formulation of the test groups themselves. But this is precisely the meaningless experiment Prof. Elhauge proposes to present to the jury here. Note too that if Prof. Elhauge had designed the experiment to compare buyers with *access* to the challenged contracts to those *without access* in this hypothetical, he would have correctly concluded that the contract had no impact, because he would find 50 Covidien buyers and 50 rival buyers in each of those groups.

As if this were not enough, the bias Prof. Elhauge's gerrymandered test groups creates is further compounded by his reassignment of buyers from the burdened group to the unburdened group whenever they contradict his theories. (Ordover Decl. ¶¶ 19-22, 27.) In another naked ploy to increase the "gap" between the two groups (and the damages Covidien allegedly owes), whenever a hospital buying under one of the challenged contracts elects to switch to a rival and, thus, ceases to buy under the challenged contracts, Prof. Elhauge reassigns that buyer to the unburdened group.[11] (*Id.*) Again, he does not do this solely when the buyer loses *access* to the

[11] Prof. Elhauge responds that he did not reclassify hospitals according to their purchasing patterns, but only according to their contract status. (Elhauge ¶¶ 86-87.) This is a distinction without a difference. With a share commitment contract, the hospital's purchasing pattern

contracts (such as if its GPO stops offering share-purchase discounts and becomes multi-source), but when the buyer makes a choice to ignore the challenged contracts and buy from a rival.

The fallacy and self-serving bias of this reassignment tactic is obvious. The supposed purpose of the simultaneous comparisons is to determine the extent to which the challenged contracts cause hospitals to forego purchases they would have made from rivals. But whenever a "burdened" hospital demonstrates that the challenged contracts do not prevent it from switching entirely to a rival, Prof. Elhauge purges that buyer from the burdened category. By reclassifying hospitals, Prof. Elhauge guarantees the result he is looking for, turns flatly contrary data into supportive data and violates the basic tenets of valid research design. (Elhauge ¶ 87.)[12]

These multiple sources of selectivity bias render Prof. Elhauge's analyses meaningless. Indeed, because of the basic design errors in his wholly unscientific comparisons, Prof. Elhauge cannot reliably claim that *any* of the difference between the share of Covidien's rivals in the burdened and unburdened groups is attributable to the challenged GPO contracts as opposed to legitimate preferences for Covidien's products and prices. (Ordover Decl. ¶ 16.) In other words, the simultaneous comparisons will be literally useless to the jury. Given Prof. Elhauge's dramatic, but utterly fallacious, analyses regarding the impact of Covidien's contracts, allowing them to be presented to the jury would create an intolerable risk of prejudice to Covidien.

Prof. Elhauge's responses to these critiques are unavailing. For example, he argues that

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determines the hospital's contract status. If a hospitals ceases to purchase at its committed share-of-purchase level (*e.g.*, if its utilization of Covidien products falls below 80%), it will lose its committed contract status and Prof. Elhauge will reassign it. Thus, reclassifying a hospital when it changes contracts also reclassifies a hospital when it decides to convert to a rival.

[12] As explained below and in the McFadden Decl., Prof. Elhauge's failure to control for differences in the *prices* offered to the "burdened" and "unburdened" groups is another important flaw in the simultaneous comparisons. Professor cannot speak to how much of the alleged difference in purchasing results from the unremarkable, and not remotely anticompetitive, fact that buyers offered less attractive Covidien pricing buy less from Covidien and more from its rivals.

his "longitudinal comparisons" of Novation members and of buyers that "have switched their status over time" are not skewed by selection bias. (Elhauge ¶¶ 195-96.) As explained below, that is untrue, and, in any event, Prof. Elhauge's longitudinal comparisons suffer from additional defects. Prof. Elhauge devotes most of his rebuttal to the demonstrably false claim that Dr. Ordover "used comparisons that are essentially identical to mine in methodology" in the *Masimo* case. (2/15/08 Elhauge Reply Expert Report ("Elhauge Rep") ¶¶ 84-85 (Docket No. 135).) In that case, plaintiff Masimo Corporation hired Prof. Elhauge and Prof. Jeffery MacKie-Mason to testify during a re-trial on damages. Only Prof. MacKie-Mason testified, however, because the court perceived that Prof. Elhauge had little to say regarding damages, and was proffered in large part to give improper legal instruction. (Ex. H at 46:11-15, 56:12-17, 64:24-25, 65:7-8) (*Masimo v. Tyco*, 10/5/2006 Tr.) (Court states that Prof. Elhauge is being offered in part to provide legal instruction to the jury, and "he can't do that"). At trial, Prof. MacKie-Mason, made the exact same mistake that Prof. Elhauge makes here -- he began his "comparisons" after hospitals had already revealed their purchasing preferences, classifying hospitals that signed discount contracts with Covidien as "restricted" and those that declined to commit as "unrestricted." (Ex. I at 48:12-22, 135:9-24, 143:15-22, 146:8-18) (*Masimo v. Tyco*, 10/18/2006 Tr.) Also, just as Prof. Elhauge does here, he augmented this selection bias by reclassifying hospitals from "restricted" to "unrestricted" if they stopped purchasing enough from Covidien. (*Id.* at 140:1-10.)

At trial and in his expert report, Dr. Ordover described how this approach diverged from his own methodology (which was based on hospitals' *access* to discounts, not their use of them), and explained how Prof. MacKie-Mason's approach injected selectivity bias into his conclusions. (*See* Ex. J at 11:11-17, 65:4-20, 70:12-22, 71:8-20, 77:12-21, 79:7-15) (*Masimo v. Tyco*, 10/19/2006 Tr.) After considering this testimony, the Masimo court rejected Prof.

MacKie-Mason's flawed methodology -- *the exact same methodology Prof. Elhauge advances here* -- and accepted Dr. Ordover's methodology in its entirety. (Ex. K at 1) (*Masimo v Tyco*, Min. Order.) Thus, Prof. Elhauge's methodology is not only inconsistent with Dr. Ordover's prior methods, but it has already been rejected by a federal court.

In sum, Prof. Elhauge's flawed methodology renders his simultaneous comparisons unreliable and thoroughly inadmissible.

2. Prof. Elhauge's "Longitudinal Analyses" are also improperly executed and lend no support to his theories

Prof. Elhauge's "longitudinal analyses" purport to show that Covidien's rivals performed better among Novation members after the end of Covidien's sole-source contract and that regression analyses verify the impact of the challenged contracts on rivals generally. (Elhauge ¶¶ 188-92.) Neither of these analyses withstands scrutiny.

First, Prof. Elhauge's impressionistic look at rivals' growth after the Novation sole-source contract ended ignores a vital point. Covidien's rivals began steadily gaining share among Novation members in October 2004, *almost a year before the sole-source contract ended.* (*See* Elhauge Exhibit 17.) In fact, a mathematical analysis of the month-on-month growth of rivals over the entire period covered by the data shows that there was *no statistically significant change in rivals' growth rates* after the sole-source contract ended. (McFadden Decl. ¶¶ 21.) If anything, this growth trend, which began while the allegedly exclusionary contract was in effect and did not accelerate when it ended, contradicts Prof. Elhauge.

Turning to the regressions, as Dr. McFadden, explains, Prof. Elhauge violates two elementary and critically important econometric principles by: (1) disregarding huge amounts of relevant data and (2) failing to control for several important factors, chief among them being relative pricing. (McFadden Decl. ¶¶ 15, 16, 23, 24.) These "fundamental technical and

statistical errors invalidate [Prof. Elhauge's] conclusions and render them of no probative value in support of his claims that certain contractual forms have an exclusionary impact." (*Id.* ¶ 33.)

First, Prof. Elhauge's choice to run his regressions in "logarithmic" rather than "linear" form forced him to disregard over a whopping 90% of the available sales data. (*Id.* ¶ 24.)[13] Importantly, excluding this data is not just a violation of abstract econometric theory; it substantially biases the regression results in Plaintiffs' favor. (*Id.*) If Prof. Elhauge had run a linear regression that incorporated all the relevant data, he would have seen that, for two of his eight regressions, the rivals actually captured a *greater* percentage of the sales in the allegedly burdened group. (*Id.* Tbl. 2.) As to the other six regressions, looking at all the data diminishes the supposed impact of the challenged contracts on burdened buyers *by over 90%*.[14] (*Id.*) Prof. Elhauge's unjustifiable exclusion of the great bulk of the relevant facts, therefore, entirely invalidates his regression results, as any properly trained econometrician would have recognized. (*Id.* ¶¶24, 27.)

Second, Prof. Elhauge's regressions fail to control for various salient factors, including, most importantly, container pricing. [redacted] It is neither surprising, nor evidence of anticompetitive conduct, that buyer's receiving less attractive prices from Covidien tend to buy more from rivals than those getting lower prices. Yet, Prof. Elhauge

[13] As Dr. McFadden explains, the regression Prof. Elhauge devised necessarily ignores all the sales data in which buyers purchase exclusively from Covidien. (McFadden Decl. ¶ 23.) Prof. Elhauge justifies his use of a logarithmic regression by arguing that it better represents his assumption that the change in a rival's share would be influenced by its starting share. (Elhauge ¶ 190.) This explanation in no way excuses throwing out huge amounts of plainly relevant data.

[14] As the remainder of this section and Dr. McFadden's declaration make clear, simply correcting for Prof. Elhauge's data dumping error does not, by any means, make the results of his regression analyses reliable. (McFadden Decl. ¶¶ 26–27.)

does not even attempt to control for price or to segregate the effect of the price hike from the alleged effect of the contract change itself, which any "valid economic study" would have done. (McFadden Decl. ¶7.) Prof. Elhauge simply ignores the pricing data.

Third, Prof. Elhauge's claim that no selection bias affects his regressions concerning buyers who "have switched their status over time" is false. (Elhauge ¶ 195.) His analyses of those buyers' purchases still largely depend on whether the buyer *chooses* to use the challenged contracts, not whether they have *access* to them. Accordingly, selection bias also pollutes these results for the reasons already discussed. (Ordover Decl. ¶¶ 30-31; Ordover ¶¶ 122-23.)[15]

For these reasons, Prof. Elhauge's longitudinal comparisons are no more reliable (or less flawed) than his simultaneous comparisons, and they too cannot be allowed to reach the jury.

C. Prof. Elhauge's theories conflict with both antitrust law and scholarship

Even if Prof. Elhauge's statistical analyses were not rife with error, his testimony would still be improper, because the theories underlying his opinions are incompatible with the weight of antitrust jurisprudence and scholarship. Prof. Elhauge intends to tell the jury that Covidien's discount contracts, although entirely voluntary, anticompetitively exclude rivals. He claims that buyers are reluctant to shift a portion of their sharps container purchases to a competitor because they would have to give up their discounts for Covidien's sharps containers. Allegedly, by offering discounts where buyers who buy more pay less (a common business practice), Covidien makes it more difficult for competitors to win business and "forecloses" competition.

While true exclusive dealing contracts may be assumed to exclude competitors (at least for some period of time), the voluntary share-of-purchase discounts at issue here cannot be

[15] Dr. McFadden also points out that Prof. Elhauge's other attempt at regression analyses (to prove that sharps container sales are impacted by economies of scale) is also incorrectly performed. (Elhauge ¶ 96; McFadden Decl. ¶¶ 30-32.)

presumed to foreclose anyone unless they are shown to be below an appropriate measure of costs. Because it is one of the principal aims of the antitrust laws to encourage vigorous price competition, courts have repeatedly required evidence of below-cost pricing before condemning discounting arrangements. *See, e.g.*, *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 229-30, 233-37 (1st Cir. 1983) (individually-tailored volume discounts not anticompetitive if they exceed incremental and average costs).[16] Prof. Elhauge, on the other hand, baldly concludes that Covidien's discounts foreclosed competition without showing whether those discounts were below (or even anywhere near) Covidien's cost.[17] (Ex. A at 188:2-7 ("I haven't opined that the discounts were below costs or reached such a conclusion.").) He also never attempts to show that Covidien's actual rivals could not profitably compete for the "foreclosed" business simply by lowering their own prices. (*Id.* at 136:6-137:3.)

Indeed, Prof. Elhauge apparently does not believe that Covidien's rivals should be required to compete aggressively to win business. In a statement that perfectly encapsulates why his perspective is harmful to competition and consumers, Prof. Elhauge protests in his reply report that "Professor Ordover would require rivals to lower their prices below their usual levels to offset the [discounts] imposed by Tyco." (Elhauge Rep. ¶ 73.) This criticism is extraordinary. A firm forcing its rivals to lower their prices is the essence of competition. Condemning this is an utter inversion of antitrust principles.

In addition to being irreconcilable with antitrust case law, Prof. Elhauge's theories are

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[16] *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1058-63 (8th Cir. 2000) (above-cost market share discounts are not "in any way exclusive" or anticompetitive when consumers are not obligated "to refrain from purchasing from competitors in order to receive the discount" and are "free to walk away from [the] discounts at any time"), *cert. denied*, 531 U.S. 979 (2000); *see also Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223, 231 (1993) (discounts not anticompetitive if above an appropriate measure of costs).

[17] In fact, Plaintiffs allege that Covidien's prices were "well above the marginal cost for its Sharps Containers." (Compl. ¶ 26 (Docket No. 1).)

also at loggerheads with the leading scholarship in this area, which follows the majority of courts in holding that antitrust liability cannot be imposed without a carefully conducted price/cost analysis.[18] In fact, several esteemed legal scholars, including the preeminent Herbert Hovenkamp, have condemned Prof. Elhauge's point of view. *See* Herbert Hovenkamp, *Recurring Issues in Antitrust Enforcement*, 2006 Utah L. Rev. 841, 843-44, 863 nn.14, 28 (2006) (stating that Prof. Elhauge's theories on anticompetitive discounting, while "popular with plaintiffs' lawyers" would establish standards that "[a] federal court could never apply [without] chilling procompetitive behavior")[19] Similarly, the staff of the recently convened Antitrust Modernization Commission found that single-product, share-of-purchase discounts were hardly even worth reviewing because "[p]ure loyalty discounts are generally lawful in the same manner that above-cost pricing is generally lawful." (Ex. M at 39 n.155) (AMC Memo.)

Prof. Elhauge is not a neutral expert. He is a lawyer by training and a plaintiff's advocate by choice. (Ex. A at 25:9-20, 26:10-27:8.)[20] At bottom, Prof. Elhauge seeks to present

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[18] (*See, e.g.*, Ex. N ¶ 749, 146 ("when a discount is offered on a single product (whether a quantity or market share discount) the discount should be lawful if the price after all discounts are taken into account exceeds the defendant's marginal cost or average variable cost") (Areeda and Hovenkamp, *Antitrust Law*)); Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 Emory L. J. 423, 482-83 (2006) ("plaintiffs should not be permitted to bypass a cost/revenue analysis…[i]f the plaintiff could respond to the defendant's bundled discount by dropping its own price profitably, then there would be neither 'forcing' nor 'foreclosure.'"); Thomas A. Lambert, *Evaluating Bundled Discounts,* 89 Minn. L. Rev. 1688, 1694-95 (June 2005) ("[a]n above-cost single-product volume discount may always be matched by an equally efficient competitor"); (Ex. B at 28-29 (Hovenkamp article on exclusionary pricing) (with single-product discounts conditioned on exclusivity or market share discounts, "an equally efficient rival should be able to steal the sale as long as the fully discounted price is above cost").)

[19] *See, e.g.*, Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 Yale J. on Reg. 169, 197-202 (Summer 2006) (criticizing Prof. Elhauge's theories on exclusionary conduct and concluding that his proposals do "not appear to be based on sound economic theory or empirical evidence"); Lambert, *supra* note 19, at 1706-17 (calling Prof. Elhauge's "restrictive approach" to evaluating discounts "inconsistent with the very goal of antitrust law").

[20] Prof. Elhauge began his work in the healthcare arena as a paid consultant to the Medical Device Manufacturers' Association -- a trade group of small businesses that are bitterly opposed to the GPO industry. (*See* Ex. F (http://www.medicaldevices.org/public/issues/gpo.asp).) He

Plaintiffs' closing arguments from the witness stand, but to cloak that advocacy in the ostensible neutrality of an expert in economics.[21] Other courts have remonstrated him for this tactic.[22]

Allowing Prof. Elhauge's misguided theories into the courtroom would invite the jury into legal error. As Justice (then Judge) Breyer cautioned in *Barry Wright*, "the consequence of a mistake here is not simply to force a firm to forego legitimate business activity it wishes to pursue; rather, it is to penalize a procompetitive price cut, perhaps the most desirable activity (from an antitrust perspective) that can take place in a concentrated industry where prices typically exceed costs." 724 F.2d at 235. This Court should follow the First Circuit and others by rejecting Prof. Elhauge's attack on Covidien's discounting programs.

IV. CONCLUSION

For all the above reasons, Covidien respectfully requests that the Court exclude the reports, opinions and testimony of Prof. Einer Elhauge.

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Respectfully submitted,

/s/ *James Donato*

James Donato (SBN: 146140)
COOLEY GODWARD KRONISH LLP
101 California Street, 5th Floor
San Francisco, CA 94111
Telephone: (415) 693-2000
e-Mail: jdonato@cooley.com

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has appeared before Congress to protest the purported evils of GPOs. (Ex. A at 39:5-9, 39:24-40:5, 40:20-41:14.) He has been retained by every plaintiff, or nearly every plaintiff, that has challenged GPO practices and discounts in the last five years. He has never concluded that a medical device manufacturer did not engage in anticompetitive conduct. (*Id.* at 33:22-34:2.)

[21] *Tokio Marine,* 958 F.2d at 1175 n.3 (citation omitted) ("Experts also run the risk of becoming 'nothing more than an advocate of policy before the jury.'"); *Viterbo v. Dow Chem. Co.*, 646 F. Supp. 1420, 1425-26 (E.D. Tex. 1986) (when an expert loses her objectivity, "any resulting testimony would be unfairly prejudicial and misleading" and should be excluded).

[22] *See The Pinal Creek Group v. Newmont Mining Corp.*, 352 F. Supp. 2d 1037, 1046 (D. Ariz. 2005) (excluding Prof. Elhauge's opinions on governing law and federal antitrust law); (Ex. L at 62:22-64:19 (*Applied Med. v. Johnson & Johnson*, 8/22/2006 Tr.) (court forced to issue corrective statement during Prof. Elhauge's testimony telling the jury to follow the legal instructions of the court, not the expert witness); Ex. H at 46:11-15, 56:12-17; *see also Salas v. Carpenter*, 980 F.2d 299, 305 (5th Cir. 1992) ("the trial judge ought to insist that a proffered expert bring to the jury more than the lawyers can offer in argument") (citation omitted).)

COOLEY GODWARD KRONISH LLP
Donald K. Stern (BBO: 479420)
The Prudential Tower
800 Boylston Street, 46th Floor
Boston, MA 02199
Telephone: (617) 937-2300
e-Mail: dstern@cooley.com

TYCO HEALTHCARE GROUP LP
John M. Griffin (BBO:549061)
Marc A. Polk (BBO: 631765)
15 Hampshire Street
Mansfield, MA 02048
Telephone: (508) 261-8480
e-Mail: john.griffin@tycohealthcare.com
e-Mail: marc.polk@tycohealthcare.com

COOLEY GODWARD KRONISH LLP
Linda Callison (SBN: 167785)
Margaret Branick-Abilla (SBN: 223600)
Five Palo Alto Square
3000 El Camino Real
Palo Alto, CA 94306
Telephone: (650) 843-5000
e-Mail: lcallison@cooley.com
e-Mail: mbranickabilla@cooley.com

GIBSON DUNN & CRUTCHER LLP
Christopher D. Dusseault (SBN: 177557)
333 South Grand Ave.
Los Angeles, CA 90071-3197
Telephone: (213) 229-7000
e-Mail: CDusseault@gibsondunn.com

Attorneys for Defendants
TYCO INTERNATIONAL (US) INC.;
TYCO HEALTHCARE GROUP LP;
THE KENDALL HEALTHCARE
PRODUCTS COMPANY

CERTIFICATE OF SERVICE

I hereby certify that the foregoing was filed through the ECF system will be sent electronically to the registered participants as identified on the Notice of Electronic Filing (NEF) and copies will be sent to those indicated as non-registered participants on October 17, 2008

/s/ *James Donato*
James Donato

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