

IN THE MATTER OF

PETERSON DRUG COMPANY OF
NORTH CHILI, NEW YORK, INC.FINAL ORDER, OPINION, ETC., IN REGARD TO ALLEGED VIOLATION
OF SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT

Docket 9227. Complaint, Apr. 19, 1989 -- Final Order, Apr. 22, 1992

This final order grants the respondent's motion to withdraw notice of appeal and adopts the initial decision of the administrative law judge, and the order therein, which prohibits boycotts, or threats of boycotts, of pharmacy participation plans.

Appearances

For the Commission: *Karen G. Bokat, John R. Hoagland, Micheal McNeely, Kevin J. Arquit and Daniel P. Ducore.*

For the respondent: *Paul Kelly and Thomas Fink, Davidson, Fink, Cook & Gates, Rochester, N.Y.*

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that the Chain Pharmacy Association of New York State, Inc.; Melville Corporation; Fay's Drug Company, Inc.; Kinney Drugs, Inc.; Peterson Drug Company of North Chili, New York, Inc.; Rite Aid Corporation; and James E. Krahulec have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint stating its charges as follows:

PARAGRAPH 1. Respondent Chain Pharmacy Association of New York State, Inc. ("Chain Association") is a corporation organized, existing and doing business under and by virtue of the

laws of the State of New York, with its principal office located at 17 Elk Street, Albany, New York.

PAR. 2. Respondent Chain Association is an association composed of the following individual member firms: Brooks Drugs Inc., 15 Sabin St., Pawtucket, RI; Carl's Drug Company, Success Drive, Box 203, Rome, NY; CVS, One CVS Drive, Woonsocket, RI; Duane Reade, 4929 Thirtieth Place, Long Island City, NY; Fay's Drug Co., 7245 Henry Clay Blvd., Liverpool, NY; Genovese Drug Stores, 80 Marcus Dr., Melville, NY; Kinney Drugs, Inc., 29 Main St., Gouverneur, NY; The Kroger Co., 1014 Vine St., Cincinnati, OH; Peterson Drug Co., 68 Main St., P.O. Box 166, Oakfield, NY; Revco D.S., Inc., 1925 Enterprise Parkway, Twinsburg, OH; Rite Aid Corp., P.O. Box 3165, Harrisburg, PA; Supermarkets General Corp., 301 Blair Rd., Woodbridge, NJ; Super X Drugs Corp., 1933 Victory Blvd., Staten Island, NY; Walgreen Co., 200 Wilmont Rd., Deerfield, IL. Chain Association's members are engaged in the business of the retail sale of prescription drugs.

PAR. 3. Respondent Fay's Drug Company, Inc. ("Fay's") is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its principal offices located at 7245 Henry Clay Boulevard, Liverpool, New York. In 1986, the retail sale of prescription drugs accounted for a significant portion of the sales of the 110 to 120 pharmacies that respondent Fay's operated in New York State.

PAR. 4. Respondent Kinney Drugs, Inc. ("Kinney") is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its principal offices located at 29 Main Street, Gouverneur, New York. The retail sale of prescription drugs accounts for a significant portion of the sales of the approximately 23 pharmacies that respondent Kinney operates in New York State.

PAR. 5. Respondent Melville Corporation ("Melville") is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its principal offices located at 3000 Westchester Ave., Harrison, New York. CVS (a/k/a CVS Pharmacies or Consumer Value Stores), with principal offices located at One CVS Drive, Woonsocket, Rhode Island, is a division of Melville. In 1986, the retail sale of prescription drugs accounted

for a significant portion of sales of the approximately 115 pharmacies that respondent Melville operated under the CVS name in New York State.

PAR. 6. Respondent Peterson Drug Company of North Chili, New York, Inc. ("Peterson") is a corporation organized, existing and doing business under and by virtue of the laws of the State of New York, with its principal offices located at 68 North Main Street, Oakfield, New York. The retail sale of prescription drugs accounts for a significant portion of the sales of the approximately 18 pharmacies that respondent Peterson operates in New York State.

PAR. 7. Respondent Rite Aid Corporation ("Rite Aid") is a corporation organized, existing and doing business under and by virtue of the laws of the State of Delaware, with its principal offices located at Railroad Ave. and Trindle Road, Shiremanstown, Pennsylvania. In 1986, the retail sale of prescription drugs accounted for a significant portion of the sales of the approximately 260 pharmacies that respondent Rite Aid operated in New York State.

PAR. 8. Respondent James E. Krahulec is an individual and was employed by respondent Rite Aid as Vice-President, Government and Trade Relations in 1986 in respondent Rite Aid's principal offices at Railroad Ave. and Trindle Road, Shiremanstown, Pennsylvania.

PAR. 9. Except to the extent that competition has been restrained as alleged herein, members of respondent Chain Association have been and now are in competition among themselves and with other pharmacy firms and other health care providers in the state of New York.

PAR. 10. Respondents' general businesses or activities, and the acts and practices described below, are in or affect commerce, as "commerce" is defined in the Federal Trade Commission Act, 15 U.S.C. 45.

PAR. 11. Respondent Chain Association is, and has been at all times relevant to this complaint, a corporation organized for the profit of its members within the meaning of Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. 44.

PAR. 12. Customers often receive prescriptions through health benefit programs under which a third-party payer compensates the pharmacy for the prescription according to a predetermined formula. The New York State Employees Prescription Program is a prescrip-

tion drug benefit plan made available by the State of New York to its employees, its retirees, certain other persons, and their dependents. There were approximately 500,000 beneficiaries covered by the Employees Prescription Program in 1986. Since July 1, 1986, The Equitable Life Assurance Society of the United States has insured the Employees Prescription Program, and PAID Prescriptions, Inc., a wholly-owned subsidiary of Medco Containment Services, Inc., has administered it.

PAR. 13. Pharmacies are solicited to participate in the Employees Prescription Program. Pharmacies that participate in the Employees Prescription Program accept as payment in full a reimbursement of the ingredient cost of the drug and a professional fee for dispensing the drug. The Employees Prescription Program provides a formula for determining the reimbursement of the ingredient cost of drugs dispensed.

PAR. 14. Absent collusion between or among pharmacy firms, each pharmacy firm would decide independently whether to participate in the Employees Prescription Program, and the State of New York would enjoy the benefits of competition among pharmacy firms.

PAR. 15. In May 1986, PAID Prescriptions, Inc. formally solicited pharmacy participation in the Employees Prescription Program under terms to become effective on July 1, 1986. Among the proposed terms were changes in the reimbursement level for ingredient costs, an increase in the professional fee, and the offer of additional reimbursement for the use of generic drugs. The proposed terms were intended to reduce the price the State paid for the Employees Prescription Program, and thus minimize costs, and yet to offer reimbursement high enough to attract a sufficient number of participating pharmacies to ensure that Employees Prescription Program beneficiaries would have adequate access to medication.

PAR. 16. In 1986, respondents Melville, Fay's, Kinney, Peterson, and Rite Aid ("respondent pharmacy firms") participated in many prescription drug benefit plans offered by third-party payers, including the Employees Prescription Program as it existed prior to July 1. Each respondent pharmacy firm purchased prescription drugs at a cost which on average was below the Employees Prescription Program's proposed level of reimbursement for ingredient costs. Each respondent pharmacy firm would have suffered a significant

loss of customers had its competitors participated in the Employees Prescription Program at a time when it was not participating.

PAR. 17. Even before PAID formally solicited pharmacy participation in the Employees Prescription Program, New York State began to inform pharmacists' associations of the proposed terms. In or before March 1986, respondent Chain Association became aware of the proposed terms of the Employees Prescription Program, and, in response, communicated to members that the extent to which pharmacies participated in the Employees Prescription Program could affect state officials' consideration of the reimbursement level. Respondent Chain Association held meetings at which some respondent pharmacy firms informed other pharmacy firms that they would not participate in the proposed Employees Prescription Program. Respondent pharmacy firms communicated information regarding their own intentions concerning participation in the Employees Prescription Program to other pharmacy firms. Respondent Chain Association and respondent Krahulec communicated, to Chain Association members and other pharmacy firms, information regarding the intentions of Chain Association members and other pharmacy firms concerning participation in the Employees Prescription Program. Through these exchanges of information and other acts, and through the activities of respondent Chain Association and respondent Krahulec, respondent pharmacy firms and other pharmacy firms agreed to refuse to participate in the Employees Prescription Program at the proposed reimbursement level, for the purpose of increasing the level of reimbursement offered by the State of New York under the Employees Prescription Program.

PAR. 18. Respondents have restrained competition among pharmacy firms by conspiring among themselves and others, or by acting as a combination, to increase the price paid to participating pharmacies under the Employees Prescription Program and to deny to the State the benefits of competition.

PAR. 19. The combination or conspiracy and the acts and practices described above have unreasonably restrained and continue unreasonably to restrain competition among pharmacists and pharmacies in New York, and have injured consumers in the following ways, among others:

A. Price competition among pharmacy firms with respect to third-party prescription benefit plans has been and continues to be reduced;

B. The State of New York was coerced into raising the prices paid to pharmacies under the Employees Prescription Program; and,

C. The State of New York has been and continues to be forced to pay substantial additional sums for prescription drugs provided to Employees Prescription Program beneficiaries, including approximately seven million dollars for the eighteen-month period beginning on July 1, 1986.

PAR. 20. The combination or conspiracy and the acts described above constitute unfair methods of competition in or affecting commerce in violation of Section 5 of the Federal Trade Commission Act. The combination or conspiracy, or the effects thereof, are continuing, will continue, or will recur in the absence of the relief herein requested.

Commissioners Azcuenaga and Machol voted in the negative.

STATEMENT OF COMMISSIONER MACHOL CONCERNING ISSUANCE OF
CHAIN PHARMACY ASSOCIATION COMPLAINT

The case as presented to the Commission was a very complex one, both factually and legally. It alleged a conspiracy among the Chain Pharmacy Association, a number of drugstore chains operating in New York State, and an executive of one of the chains, to coerce the State into raising proposed prescription drug payments to pharmacies under its employee benefit program by threats of refusal to participate in that program.

Each of the pharmacies and pharmacy chains eligible to participate in the program, of course, was free to make its own decision on whether to agree to do so or to threaten to withhold participation. Liability, under the law we administer, would attach only to conspiracy or collusion in reaching such decisions.

Further, the Noerr Pennington line of cases in the Supreme Court teaches us that even commercial enterprises may not be held accountable under the antitrust laws for conspiring or colluding to exercise their right to petition governments, a right protected under the First

Amendment. Though this area of the law is itself complex, it is clear that many of the activities in which the parties engaged in this case were thus protected.

As to the activities alleged in this case which would not be protected by Noerr, the information we received clearly contained no "smoking gun" evidence of conspiracy. We could find the necessary "reason to believe" that a violation had occurred only on the basis of circumstantial evidence. But, in the Matsushita/Monsanto line of Supreme Court cases, we are taught that an inference of conspiracy must be supported by at least some significant evidence of activity which was logically consistent only with conspiracy. That is, if the activity of each member of an alleged conspiracy was wholly consistent with its pursuit of its unilateral self-interest, that inference must fail.

In my view, the inference in this case -- on the information available to support issuance of a complaint -- fails for that reason. I believe -- again on this information -- that it was in the independent interest of each chain pharmacy to threaten to refuse to participate in the program unless prices were raised, because, if the threat had failed to achieve a price increase, the pharmacy could then have reversed itself and participated. The costs of such a strategy were very limited; the potential gains were very large.

It seems clear that the parties to the alleged conspiracy exchanged a good deal of information. It seems very doubtful that it can be established that they conspired with respect to their decisions to threaten non-participation, however, because they did not need to. Their conversations appear to me to have taken place in the context of protected lobbying activity; their actions seem to have been entirely consistent with their individual economic self-interest; and there simply was not sufficient evidence from which I could find reason to believe in the existence of an unlawful conspiracy.¹

¹ Should I have occasion to review this matter following a proceeding before an Administrative Law Judge, I will of course reconsider the factual issues presented solely on the basis of the adjudicative record.

INITIAL DECISION BY

MORTON NEEDELMAN, ADMINISTRATIVE LAW JUDGE

MAY 17, 1991

I. STATEMENT OF THE CASE

The Commission's complaint, which was issued on April 19, 1989, charges a combination or conspiracy in violation of Section 5 of the Federal Trade Commission Act. The complaint centers on an attempt by New York State to reduce the reimbursement received by pharmacies participating in the state's prescription drug plan which benefited some 500,000 public employees, retirees, and their dependents. According to the complaint, the five named pharmacy chains, an executive of one of these chains, a trade association, and unnamed other pharmacy firms had allegedly combined or conspired to refuse to participate in the state's reduced-rate reimbursement initiative. These acts are said to have coerced New York into increasing the reimbursement rate, and to deprive the state of the benefits of competition.

Of the five pharmacy chains named in the complaint -- Fay's, Kinney, Melville (a parent of the CVS chain), Rite Aid, and Peterson -- all but Peterson consented to the entry of a cease and desist order. The one individual named, James E. Krahulec (an officer of Rite Aid), also consented as did the trade association, Chain Pharmacy Association of New York State (CPA). Three other pharmacy chains (Brooks, Carls, and Genovese) consented to the entry of cease and desist orders prior to the issuance of formal complaints. The respondents named in the complaint, and the pre-complaint consenters are treated herein as alleged conspirators.

Peterson vigorously maintains that it has not participated in any illegal combination or conspiracy. Its answer dated May 25, 1989, denies the substantive allegations of the complaint and raises the affirmative defense of the Noerr-Pennington doctrine.

In the prehearing state, both sides were allowed extensive discovery, including a protracted deposition period. Complaint counsel's case-in-chief was heard between December 3 and

December 14, 1990. The defense case was presented during the week of December 17. A motion to receive uncontested rebuttal exhibits was granted on January 16, 1991, and the record was closed for the receipt of all evidence on January 31. During the hearings, complaint counsel and counsel for Peterson were given full opportunity to be heard and to examine and cross-examine the witnesses. The parties filed their main briefs and proposed findings on February 25. Answers to proposed findings and reply briefs were filed on March 18, 1991.

After reviewing all the evidence, as well as proposed findings and briefs submitted by the parties, and based on the entire record, including my observation of the demeanor of witnesses, I make the following findings of fact:¹

¹ Proposed findings not adopted in the form or substance proposed are rejected as either not supported by the entire record or as involving cumulative, immaterial, or irrelevant matters.

The following abbreviations are used throughout in citing to the record:

CX (Complaint counsel's Exhibits)

RX (Respondent's Exhibits)

Testimony is cited by the name of the witness, followed by transcript page as in Rosenberg 1885-87.

The appearances of the witnesses were as follows:

<u>Name</u>	<u>Called By</u>	<u>Testimony Pages</u>
Priscilla E. Feinberg (New York State)	Complaint Counsel ("C.C.")	350-577
Stephen B. Kavanaugh (New York State)	C.C.	581-735
Thomas Hartnett (New York State)	C.C.	801-982
Paul Wutz (Blue Cross of Western New York)	C.C.	989-1078
David T. Painter (FTC Accountant)	C.C.	1082-1498
Leonard J. De Mino (Natl. Ass'n of Chain Drugstores)	Respondent ("Resp.")	1560-1604
John T. Kelley (formerly, Natl. Ass'n of Chain Drugstores)	Resp.	1606-1649

II. FINDINGS OF FACT

A. Identity Of Respondent And The Alleged Conspirators

1. Peterson Drug Company of North Chili, New York, Inc. (hereinafter "Peterson" or "respondent") is a New York corporation with its headquarters located at 68 North Main Street, Oakfield, New York. In 1986, Peterson was the corporate umbrella for 15 affiliated corporations that operated 18 drugstores under the "Peterson" trade-name. Peterson owned four of the stores outright, and it controlled at least 51% of the stock in the affiliated corporations that owned the other 14. The 18 Peterson stores were located in the small Western New York communities of Newfane, Genesco, Williamsville, Akron, Snyder, Chili, Brockport, Bath, North Chili, Albion, Lockport, Wellsville, Chafee, Ontario, Derby, Alden, Perry, and Penfield.²

2. For all practical purposes, Gerald Rosenberg, President of Peterson, represented respondent during the entire course of dealings relevant to this proceeding.³

3. Peterson is the smallest chain named in the Commission's complaint. In 1986, Rite Aid (New York State's largest chain) had about 260 drugstores, CVS approximately 100, Fay's between 110 to 120, and Kinney 23.⁴ Of the other alleged conspirators, Genovese

Walter J. Floss, Jr. (former New York State Senator)	Resp.	1653-1698
Gerald R. Rosenberg (President, Respondent Peterson)	Resp.	1103-1920

² Complaint and Peterson's Answer ¶ 6; Rosenberg 1709-10, 1723, 1755; CX's 16 "I", J, 682A, B, 2070Z-20, Z-21; RX 275. Aspects of the relationship between the Oakfield headquarters and the individual drugstores particularly relevant to this proceeding are treated in Finding 70.

³ Rosenberg 1715-16, 1718-21, 1745-53, 1776-86; CX's 2Z-240-Z-241, 16K, Z-112, 725J-L. Rosenberg is President of each of the affiliated Peterson corporations except for the corporate entity controlling the Newfane store. CX 726B.

⁴ Complaint ¶'s 3-7 and Answers; CX's 9Q, 12J,K, 23M,N, 154A-P, 181A, 2062Z-70.

owned 75 stores, Brooks (a subsidiary of Adams Drugs) about 60 to 70, and Carls 42 or 43.⁵

4. James E. Krahulec is the only individual named in the Commission's complaint. He was Rite Aid's Vice President for Government and Trade Relations (*i.e.*, the company's principal lobbyist)⁶ and played a key role in the conduct challenged by the complaint.⁷

5. Chain Pharmacy Association ("CPA") is a New York State not-for-profit corporation organized in 1984 to advance the common business interests of its pharmacy members by lobbying state legislators and officials. In 1986, the founding members of CPA were 12 pharmaceutical chains doing business in New York State (Peterson, Brooks, Carls, CVS, Rite Aid, Fay's, Genovese, Kinney, SuperRx Drugs, Duane Reade, Revco, and Walgreen) and the pharmacy operations of Supermarkets General and Kroger, two supermarket chains.⁸

6. The members of CPA competed against each other in the sale of pharmaceutical prescriptions, nonprescription drugs, and the myriad nondrug items sold by drugstores.⁹ Peterson's chief competitors in 1986 were Fay's, Rite Aid, and CVS.¹⁰

7. CPA had no staff of its own. Essentially, the work of the association was carried out by its Executive Director, Peter Zimmerman, a retained trade association expert.¹¹ Zimmerman and Krahulec

⁵ CX's 822A, 1212, 1989D, 2249L, 2250"O", 2252"O", P, 2254L-N, 2269G.

⁶ Complaint ¶ 8 and Krahulec Answer; CX's 20H, J, K, U-W, 2194"1".

⁷ See Findings 55-59, 74-81.

⁸ Complaint ¶ 2 and CPA Answer; Kelley 1612, Rosenberg 1715-16; CX's 2"1", J, N, "O", 20U, V, 41E-G, 2199H, 2248Z-26, 2249Z-42, 2252N. Revco owns Carls, but decisions respecting participation in PAID I and other matters relevant to this proceeding were left to the management of the subsid 2251Z-71. Kroger owned SuperRx until December 1986. CX 2266K. Supermarkets General operated pharmacy departments in its "Pathmark" supermarkets as well as its free-standing "Heartland" and "Pharmacy" drugstores. CX's 1305B, 2191Z-264.

⁹ Complaint ¶'s 2 and 9 and Answers; CX's 6Z-2-Z-4, 7V, 18Z-67, 22U, 2060L, 2062Z-21-Z-25, 2189Z-64, Z-65, 2206Z-9, Z-10, 2269G.

¹⁰ CX 2070Z-55.

¹¹ CX's 2H, "1", J, M, 2199G.

of Rite Aid carried the workload for the pharmacists during the events described herein.¹²

8. The object of the alleged conspiracy, PAID I, and its eventual successor PAID II, were third party prescription plans whose implementation involved a stream of interstate commerce flowing from consumers and pharmacists in several states,¹³ to an administrator located in New Jersey,¹⁴ and then back to the pharmacists for reimbursement for the cost of pharmaceuticals manufactured throughout the United States.¹⁵ While most of Peterson's pharmaceuticals were purchased from a New York distributor, its nonprescription business involved a substantial volume of purchases from out-of-state suppliers.¹⁶ Moreover, prescription and nonprescription business are closely linked, and this connection was deeply implicated in the alleged scheme since the pharmacists knew that if PAID I went forward without their participation, they stood to lose both segments of a drugstore's trade.¹⁷ Respondent has not pressed the issues of interstate commerce or the Commission's jurisdiction.¹⁸

B. NYSEPP And The Development Of PAID I

9. New York State in its capacity of employer has ultimate responsibility for a prescription drug program (New York State Employee Prescription Program or "NYSEPP") that is part of the

¹² See Findings 54-59, 74-81.

¹³ Although NYSEPP members are concentrated in New York, the plan also covers state employees and retirees who live outside of New York as well as the out-of-state pharmacies enrolled in the plan in order to serve these out-of-state members. Feinberg 360, Kavanaugh 614.

¹⁴ Feinberg 371-72, Kavanaugh 614.

¹⁵ Feinberg 354, 473-74; CX 2070Z-24. The flow of commerce (or, if you will, the interruption in the flow of commerce) continued as PAID was compensated by the state for administering the plan. Feinberg 459, Kavanaugh 614.

¹⁶ CX 725M.

¹⁷ See Findings 42-52.

¹⁸ Respondent Peterson's Reply To Complaint Counsel's Proposed Findings Of Fact at 327-330 (March 18, 1991).

package of employee and retiree health benefits the state has negotiated with the principal unions.¹⁹

10. In 1986, NYSEPP insured approximately 500,000 public employees, retirees, and their dependents.²⁰

11. The Governor's Office of Employee Relations (OER) was the state agency charged with responsibility for bargaining with the unions over the public employees' health benefits package including NYSEPP, the prescription drug component. OER shared with the state's Department of Civil Service and Budget Department responsibility for designing a NYSEPP program that met the terms of the negotiated health package.²¹ The plan was actually administered by Civil Service.²²

12. NYSEPP in its various configurations (PAID I, PAID II, and their predecessor) was a third party program. Instead of paying the prevailing retail price for a prescription, a state employee or retiree, who was enrolled in the plan, presented a card and was charged only a small co-payment fee. The participating pharmacy submitted the claim to a third party payer (the plan administrator in the case of PAID I) for processing and reimbursement of the cost of pharmaceutical ingredients. In addition, the administrator paid the pharmacies a dispensing or professional fee. The plan administrator, in turn, was reimbursed by an insurer who ultimately looked to the state for payment in the form of the premium expense New York incurred for its employees.²³ The plan was said to have cost the state roughly \$104 million in 1986.²⁴

13. Almost from its inception in 1980, the cost of NYSEPP had grown by leaps and bounds, far exceeding the rise in the medical

¹⁹ Feinberg 358-60.

²⁰ Feinberg 359-60. In addition to state employees, NYSEPP covers participating local (town, county, and school district) employees. Feinberg 359.

²¹ Feinberg 355-58, Kavanaugh 582-84.

²² Kavanaugh 582, 584.

²³ Feinberg 358-59, Kavanaugh 584-85, 589, Wutz 1006, Painter 1405. For its part in this process, the state paid the administrator 50 cents per claim. Feinberg 459, Kavanaugh 614.

²⁴ CX 1763A.

consumer price index. Between 1980 and 1983 alone, the cost to the state for NYSEPP premiums rose from \$25 million to \$90 million with no end in sight.²⁵ These runaway costs were mainly attributable to an aging population of insureds (with a concomitant increase in usage) and rising pharmaceutical prices.²⁶

14. The tripartite division of functions in the administration of NYSEPP between New York State, an insurer, and an administrator, in no way diminished the overriding role of the state as the prime mover for a cost-containment initiative. The premiums that New York as a purchaser of health insurance benefits paid to the insurer on behalf of its public employees was a function of the ingredient reimbursement costs anticipated and actually experienced by the insurer. With these mounting costs in mind, OER began considering potential cost-containment strategies as early as 1984.²⁷

15. The cost-containment initiative eventually adopted by the state centered around the concept of a reduction from Average Wholesale Price ("AWP"). AWP is the wholesale list price for each drug item. It is either suggested by the manufacturer or developed by the publishers of commonly-used industry sources such as the Red Book, Blue Book, or Medispan.²⁸ Although the AWP purports to show the average price which pharmacists are paying, it is universally acknowledged in the industry that drugstores purchase most of their pharmaceuticals at steep discounts off AWP and that these discounts reflect a firm's volume of purchases.²⁹ Peterson, for example, during 1985 and the first half of 1986, believed that it

²⁵ Feinberg 363-64, Kavanaugh 589, 604-05, 668, 682-83, Hartnett 973; CX's 1763A, B, 1785F; RX 254"I".

²⁶ Feinberg 495-98; CX's 1763A, B, 1785, 2262Z-212. Another frequently cited cause of rising prescription prices is the reluctance of doctors to prescribe generic substitutes for branded drugs. CX 1763B.

²⁷ Feinberg 363-64, 457-58, 485, 571-72, Kavanaugh 589, 605, 667-68, Wutz 1006, 1015-16; CX's 732A, 1084A, 1785F, 1868Z-6-Z-13, 2257Z-51, 2262Z-108; RX's 86A, 131A, 134D, 142B, 254"I".

²⁸ Painter 1092-93; CX's 2062Z-115, Z-116, 2069Z-44.

²⁹ Feinberg 372-375, 379, Kavanaugh 604-05, 696, Hartnett 815, Wutz 1022; CX's 6U,V, 1685H, 1759C, 1760A, 2257X,Y, 2268Z-14, Z-15; RX's 97A, 2038, 254Z-31, Z-35.

purchased from its main wholesale supplier at AWP minus 14%.³⁰ Studies had shown that industry-wide the average discount off AWP was 16%, and still larger discounts were available to the big chains.³¹ Thus Fay's purchased pharmaceuticals at approximately AWP minus 21%,³² Brooks at between AWP minus 16% to AWP minus 18%,³³ CVS at about AWP minus 21%,³⁴ Genovese at between AWP minus 16% to AWP minus 22%,³⁵ Kinney at AWP minus 20%,³⁶ and Rite Aid at AWP minus 21%.³⁷ Carls must have acquired pharmaceuticals at comparable discounts since its warehouse was billing its own stores at AWP minus 15%.³⁸

16. PAID I, the cost-containment plan based on a reduction from AWP that was eventually selected by OER and the other state agencies charged with responsibility for NYSEPP, was adopted following an administrative process in which the depth of the state's commitment to cost-containment and its lack of alternatives, prevailed over pharmacist opposition to being singled out as the main target for this economy drive. (Findings 17 to 33.)

17. The experience of NYSEPP's 1980-86 administrator (and joint-underwriter), Blue Cross of Western New York ("BCWNY"), was reviewed. BCWNY, which was well aware of the availability of sharp discounts off AWP, had tried to reduce costs by setting the reimbursement rate at actual acquisition cost plus a \$3.00 dispensing

³⁰ Rosenberg 1766; CX 725D. The rate of discount increased to AWP minus 15% after July 1, 1986. Rosenberg 1887-88; CX's 679A, 725D, 2070S.

³¹ CX's 1084D, 1533A-Z-19, 2257X, Y.

³² Based on Fay's pharmaceutical purchases for NYSEPP prescriptions filled between February 1, 1986, and January 31, 1987. Painter 1433-34; CX's 2203Z-14, Z-15, 2317A-D, 2324.

³³ CX 2252V.

³⁴ CX's 2189Z-219, 2191Z-22, Z-23, Z-94, Z-95, Z-105, Z-106, Z-110, 2268Z-21.

³⁵ CX 's 2247Z-7, Z-23.

³⁶ Based on Kinney's pharmaceutical purchases for NYSEPP prescriptions filled between January 1, 1986, and December 31, 1986. CX's 2318, 2319. See Painter 1433-34 for the calculation made to arrive at the discount off AWP.

³⁷ CX's 2200Z-60-Z-63, Z-113, Z-114, Z-238, Z-239.

³⁸ CX 2251W.

fee. It was virtually impossible, however, for BCWNY to determine actual acquisition costs. The source of this difficulty was made readily apparent on the record which shows that for the purpose of filing claims with BCWNY, Peterson was billed by its wholesale supplier at full AWP although its actual costs were much lower.³⁹ Resigned to the futility of even attempting to monitor such creative bookkeeping, BCWNY eventually departed from the actual acquisition cost formula, and by 1983 settled on a sliding scale reimbursement rate based on discounts off AWP (a tamper-proof benchmark) of 1% to 9% for independents and 12% for chains.⁴⁰ At these discounted reimbursement rates, BCWNY had no difficulty in obtaining a full array of providers as virtually all New York pharmacies participated in NYSEPP.⁴¹

18. OER also surveyed what other employers, both public and private, were doing about cost-containment. Experts were consulted.⁴² An examination of a 1984 U.S. Department of Health and

³⁹ Feinberg 360-61, Kavanaugh 584-85, 676-77, Wutz 994-95, 998-1000, 1003-04, 1014-15, 1022, 1031-32; CX's 359A, 1084D 1372B-G, 2070Z-41, 2261"O", 2261Z-19, Z-20, Z-53, Z-54, 2268Z-20, Z-21. This practice nicely illustrates the fictive quality of full AWP. Peterson's wholesale supplier offered respondent two options in billing: a choice between an invoice showing both the full AWP and the discount, or one with full AWP only, followed later by a separate credit for the discount. The full AWP- separate credit option -- Peterson's choice -- was specifically designed for use when a third party administrator audited the drugstores in search of actual acquisition costs. Rosenberg 1732-33, 1889-91, 1916-17; CX's 1372C, 2070S-Y. Peterson's practice was by no means unique. BCWNY knew that pharmacists and wholesalers "have been joining forces to beat our system" (CX 2267Z-212), but there was little it could do about it. CX's 2267Z-213, Z-214. *See also* CX's 1372B-G.

⁴⁰ Wutz 994-95, 999-1000, 1005-06; CX's 878E, 1372A-G, 1836Z-22, 2267Z-92-Z-108, 2268V; RX 254Z-36. This formula applied to both BCWNY's NYSEPP and non-NYSEPP (*i.e.*, "community") plans. The two plans had a small dispensing fee differential -- 20 cents higher for NYSEPP -- until January 1986. Wutz 993-95, 1005; CX's 878B, E, 942B, 2267Z-132, Z-133.

⁴¹ Feinberg 391, Wutz 1037-38; CX's 2267Z-88, Z-89, Z-114, Z-115, Z-122, Z-123, 2268Z-l.

⁴² Feinberg 376-78, Kavanaugh 696, Wutz 1014-15; CX 1763B; RX 258"l".

Human Services report confirmed the prevalence of large discounts off AWP.⁴³

19. Conceivably New York might have settled on a plan that could have had a more serious impact on retail pharmacists than a reduction in the ingredient reimbursement rate. The state, for example, might have provided prescription coverage for its employees through a single chain, a designated group of preferred providers, or through mandatory use of mail order.⁴⁴ There is no evidence, however, that these alternatives were seriously pursued in 1986.

20. The review described in Findings 17 to 19 led to the conclusions that New York was not doing enough to keep prescription costs in check and that its options for doing more were limited. Determined, nevertheless, to set in motion a cost-containment initiative, OER sent out a "Request For Proposal" ("RFP," in the jargon of the bureaucracy, is a notice that a program is open for bids) on January 22, 1985. The RFP directed that bids should provide for ingredient cost reimbursement at the lesser of 90% of actual acquisition cost or usual and customary charges. The dispensing fee was to be \$2.60 per prescription.⁴⁵

21. In response to this first cost-cutting initiative, PAID Prescription, Inc. ("PAID") a New Jersey-based third party plan administrator (but not insurer) submitted a bid which met the OER target of AWP minus 10%. Based on its limited but successful experience with reduced-rate plans, PAID assumed that a plan of the size of NYSEPP would have no difficulty in attracting an adequate array of participants at the AWP minus 10% rate.⁴⁶ The first RFP, however, was withdrawn in late 1985. As respondent would have it, the RFP was withdrawn because OER, anticipating widespread pharmacy rejection, beat a hasty retreat from the less than AWP formula, thus proving that it was a non-starter. While the record shows that pharmacy opposition was already apparent when the first

⁴³ CX's 1533B, C, 1759E.

⁴⁴ Kavanaugh 684-88, Hartnett 926-27; CX's 1084B, 1989A.

⁴⁵ Kavanaugh 605, 671; CX's 1868A-Z-27, 2260"I"; RX's 258"O", P.

⁴⁶ RX's 257M-"O".

RFP was withdrawn,⁴⁷ there is no evidence that the state had decided at that time to abandon the less than AWP formula. As far as this record will allow, the first RFP was withdrawn because it was proposed on the assumption that the state legislature would pass an enabling law allowing New York to function as its own insurer of NYSEPP. This legislation never passed.⁴⁸

22. The second RFP was announced on December 5, 1985. Unlike the first, no specific reduction from AWP was targeted. Instead, OER said that it was aiming for the control of costs through the use of generic drugs and mail order, but the AWP issue was left open as the RFP merely requested that bidders explore other cost containment possibilities.⁴⁹

23. There were six responses to the second RFP. In this round, the PAID bid was a joint effort of Equitable Life Assurance as the insurer and PAID (Equitable's subcontractor) as the administrator. The PAID-Equitable bid was grounded on AWP minus 5% for both chains and independents. But after the bid was accepted, the reimbursement formula was changed by the state (a combined effort of OER, Civil Service, and Budget) to AWP minus 12% for chains and AWP minus 8% to 2% for independents depending on volume. A professional or dispensing fee of \$2.75 to \$3.00 (depending on the availability of 24-hour service, deliveries, and patient profiles) was to be added to each prescription. The bid also included a generic drug component and a direct mail provision. This essentially was PAID I.⁵⁰

⁴⁷ CX's 2262"I", J; RX's 107A-J.

⁴⁸ Kavanaugh 591-92; CX 2261Q.

⁴⁹ Feinberg 374-75; CX's 1785A-Z-64, 2261Z-27, 2262J.

⁵⁰ Feinberg 376, 378, 389, Kavanaugh 594; CX's 1084A-D, 1562A, 1759A-D, 2257Z-20, Z-21, 22595, 2260R, S, 2261Z-47, 2262Z-07, Z-108; RX's 257Z-6-Z-8. The RFP specifically reserved New York's prerogative of requiring the selected contractor to modify or make additions to its proposal in order to meet the state's specifications. CX 1785G. As it happens, the reimbursement rate adopted by the state was in line with the bid of Empire Blue Cross/Blue Shield, which had recommended AWP minus 12% for chains and a sliding scale for independents. Feinberg 384, 518-19, Kavanaugh 595-96; CX's 1566Z-12, 1836T, 2222C, 2261Z-34, Z-36.

24. The entire state bureaucracy concerned with NYSEPP recommended the selection of Equitable Life Assurance as the insurer, PAID as the administrator, and PAID I as the reimbursement formula. Since the state retained discretion as to the reimbursement formula, the final selection was mainly based on an assessment of the educational and administrative capabilities (*i.e.*, the ability to inform members about the plan, to process "plastic," and to fulfill the mail order component) of the highest-ranked bidders.⁵¹

25. PAID I definitely was not endorsed by the representatives of the pharmacy community. They not only were opposed to its substantive provisions but they also perceived a lack of good faith on the part of the state in the very process by which the PAID I formula was developed and eventually adopted. Although OER had met with pharmacists for the purpose of hearing their grievances against the less than full AWP formula and to consider alternative cost-cutting strategies, the pharmacists felt that their complaints and suggestions had been given short shrift.⁵² Nevertheless, there is no suggestion in the record that the state was not fully apprised of the pharmacists' views.⁵³ They advanced arguments in opposition to PAID I, which had been made at the first intimation that the state might adopt a less than full AWP formula, and which were to be repeated until the demise of this cost-cutting initiative in late June 1986. (Findings 26 to 32.)

26. According to the pharmacists, just as their costs of dispensing drugs were rising, their margins would be unfairly squeezed by the proposed discount off AWP.⁵⁴ While the pharmacists had little in the way of concrete support for their arguments -- Peterson, for example,

⁵¹ Feinberg 363-71, Kavanaugh 594, 596-600, 607, 696; CX's 1084A, 1562A-D, 1563A-D, 1914A-H; RX's 64A-D. The selection of PAID may also have been influenced by the large number of New York pharmacies it already had on line for its non-NYSEPP third party plans. Feinberg 369; RX 64D.

⁵² Hartnett 853-72, Rosenberg 1746-47, 1773-76; CX's 2T, Z-48-Z-53, Z-82, Z-83, Z-265, Z-266, 5Z-11, Z-18, 53B, C, 732A, B, 733A, B, 1876B, C, 2069Z-138, 2261Z-55, Z-66; RX's 6A, B, 106A-C, 108A, B, 183A-C, 198A-K, 203A, B, 315A-C.

⁵³ See Hartnett 978.

⁵⁴ Rosenberg 1752, 1757-60, 1768; CX 1685G.

in 1986 did not know its actual costs for filling a prescription⁵⁵ -- there is no dispute that the confrontation between the state and the pharmacists came down to the issue of how much of the pharmacists' profits, as reflected in their ability to purchase at discounts off AWP, were to be captured by the state.⁵⁶ From New York's perspective the

⁵⁵ Rosenberg 1878-79; CX's 16Z-23, 2070H.

⁵⁶ Feinberg 571-72, Kavanaugh 613, Hartnett 858-59, Wutz 1022; CX 732A; RX 107G. No claim was made by any proponent of the less than full AWP formula that dispensing fees were intended to cover all the costs incurred by a pharmacy in filling a prescription. *See* Feinberg 478-81, 574-76, Kavanaugh 693-95, Wutz 998-99, 1020-23. Although the PAID I dispensing fees (a \$2.75 basic fee and \$3.00 for full service pharmacies) were higher than the schedule used by BCWNY in administering NYSEPP prior to PAID I (Feinberg 389, 574, Wutz 1021; CX's 1685G, H, 1759C, 2261Z-47), it is fair to conclude on this record that the actual cost of dispensing drugs was higher than the amount generally allowed in any third party plan. *See* CX's 16Z-22, Z-23, 2200Z-256-Z-281; RX's 107F, G, 325A-Z-148. There is little, however, in the record to suggest that the level of the dispensing fee was the motivating cause for the pharmacists' anti-PAID I animus, and an argument along these lines would be difficult to sustain given the proof that in the face of competition, pharmacists were willing to waive or discount a comparable amount -- insurance co-payment fees -- in order to retain valuable prescription business. Kavanaugh 609; CX's 7Z-22, Z-23, 11Z-34, Z-35, Z-153-Z-158, 2061Z-82, Z-83, 2062Z-19, Z-20, 2064Z-12, 2069Z-143, 2070Z-14, 2189Z-30, Z-31, Z-212-Z-214, 2196Z-75, Z-76, 22065, T, 2207Z-34, Z-35, 2261Z-21, Z-22; RX 107"I". As indicated in Note 192, *infra*, several of the alleged conspirators believed that there were profits to be made in PAID I notwithstanding low dispensing fees; moreover, even modest profits from this prescription business would have generated very profitable front-end trade. *See* Findings 42-51. Neither the litigants in this case nor anyone involved in the state-pharmacists dispute has made a useful calculation as to how various factors -- discounts off AWP, waiver of co-payment fees, package sizes, dispensing fees, generic drug incentives, volume of prescription business represented by the plan, additional front-end business attributable to a third party plan -- interact on bottom-line drugstore profitability. *See, e.g.* Feinberg 504-05, Kavanaugh 693, Rosenberg 1809-13; CX's 6"O", P, Z-7, Z-12, Z-24, 13Z-37, 16Z-23, 2070Z-54, 2189Z-202, Z-203; *see also* Painter 1478-81. As far as one can tell from this record, even with respect to only one part of this equation -- the cost of pharmaceuticals -- discounts off AWP may just be the starting point of any inquiry since prices at the wholesale level are also influenced by cash payment discounts, large size package reductions, free goods, seasonal specials, rebates, price increase adjustments, and buy-ins. CX's 2260Z-106-Z-111. In short, all that the record shows is that the state wanted the pharmacists to contribute, in the form of a discounted rate for ingredient reimbursement, some part of their profits -- as reflected in the ability of drugstores to purchase at the less than AWP rate -- to

use of a reimbursement formula based on a discount off AWP, not only interjected an incentive for pharmacies to compete against each other in seeking even greater discounts from manufacturers, but it also gave the state a direct stake in the outcome of that competition.⁵⁷

27. The pharmacists expressed deep resentment over being targeted for the state's cost-containment initiative while powerful pharmaceutical manufacturers were left unscathed.⁵⁸ Moreover, from the pharmacists' viewpoint the difference between AWP and their actual costs was a hedge against inflation since it represented a relatively fixed percentage of the increasingly high prices charged by these same manufacturers.⁵⁹

28. The state was challenged by the pharmacists about its proposed distinction between chains and independents as the basis for the PAID I formula.⁶⁰

29. The state was also questioned about the very definition of a "chain" for purposes of the sliding scale reimbursement formula.⁶¹ Despite some uncertainty in this area, the Peterson stores were told as early as May 1986 that they would be treated as independents and thus entitled to compensation at the rate of AWP minus 2%, 5%, and 8% (the sliding scale for independent stores depending on volume) rather than the flat rate of AWP minus 12% for chains.⁶² And while the state may have contributed to pharmacist confusion by vacillating between several definitions of a chain depending upon such consi-

reducing the cost of NYSEPP, and the pharmacists were not especially receptive to this notion. Feinberg 486, 571-72, Kavanaugh 603-07, 613, 622; CX's 732A, B; RX's 107G, 254Q, R, 257Z-7-Z-13, Z-25.

⁵⁷ Kavanaugh 625-26, 632-33, 683-84, 697, 700.

⁵⁸ Feinberg 497-98, Rosenberg 1757-58; CX's 20Z-157, 733A, 2199Z-220, Z-235. In one sense, however, PAID I did target brand name drug manufacturers since it included a generic incentive. See Note 72, *infra*, and 23Z-59, Z-60.

⁵⁹ RX 107G.

⁶⁰ Feinberg 400, 515-16, Rosenberg 1759; CX's 10L, 812, 2303A. Note, however, that Fay's did not believe this distinction was unfair. CX's 9Z-26, Z-27.

⁶¹ Rosenberg 1753; CX's 2Z-26-Z-28, 2069Z-135, 2070Z-56, Z-57, 2199Z-220, Z-235.

⁶² CX's 15X, Y, 711; RX's 260Z-31, Z-32, Z-103, Z-104.

derations as number of stores, common ownership, and the use of central billing,⁶³ there is no evidence that either the state or PAID wavered in its classification of Peterson during the entire relevant time period. To the contrary, by June its status as a series of independents had been specifically confirmed.⁶⁴

30. Going beyond the reimbursement level, PAID I was opposed by the pharmacists because it contained a direct mail component.⁶⁵ As the retail pharmacists would have it, mail-order pharmacy posed a medical danger to patients who, in the absence of a pharmacist to monitor misuse, might possibly ingest conflicting drugs.⁶⁶ To the state officials responsible for meeting the cost of third party plans, the retail pharmacists' argument was a red herring since the plan had installed multiple checks to insure safety.⁶⁷ Besides, mail order sales were essentially confined to "maintenance prescriptions" -- the drugs

⁶³ Feinberg 410, 516-18, 531-32, Rosenberg 1821-24; CX's 2Z-26-Z-28, Z-89, Z-90, 16Z-117, 728A, 733A, 1989A; RX's 260Z-103, Z-104.

⁶⁴ Rosenberg 1824, 1874, 1876; CX's 728A, B, 2070Z-57. Although the record shows that the Peterson stores had been designated as independents in May, 1986, and that this determination had been confirmed prior to June 10 (Feinberg 410), Rosenberg claimed at trial that it was not until June 15 or 16 that he was certain of his status as a series of independents. Rosenberg 1821-24; CX's 16Z-29, 2070Z-57. Under Rosenberg's timetable, it would mean (a) that Peterson was prepared on June 12 to participate in PAID I (if its competitors had done likewise) notwithstanding the possibility that it would have been reimbursed at the chain rate of AWP minus 12% (*see* CX 681A), and (b) on June 18 when the Akron store departed (*see* Finding 69), Rosenberg knew that Peterson would be treated as an independent to be reimbursed at AWP minus 2% to AWP minus 8%. Rosenberg 1876.

⁶⁵ Feinberg 399-400, Kavanaugh 623-24, 689-90, Hartnett 858-59, Rosenberg 1757-58, 1768-69; CX's 1685G, 2199Z-177. A sore point with the pharmacists was the designation of a company affiliated with PAID as the exclusive mail-order distributor. CX's 2092A, 2204Z-238; RX 97B.

⁶⁶ CX's 2Z-3-Z-5. The depth of this concern is suspect since two chains, Fay's and Rite Aid, operated mail-order departments, while another, CVS, had submitted a bid of its own for the NYSEPP mail-order business. CX's 11Z-38, 20Z-39, 1914A, 2189Z-259-Z-324, 2262Z-134, Z-135. *See also* CX 2202Z-132, notes of a CPA meeting, in which CVS reported: "MAIL ORDER: After a long discussion it was decided that the committee could not oppose the concept because of the number of members who are or would be involved with mail order."

⁶⁷ Kavanaugh 709-12, Hartnett 882-83. *See also* CX 1720B.

which doctors prescribed without any time limit in order to stabilize chronic conditions such as arthritis, hypertension, or heart disease.⁶⁸ The pharmacists more or less conceded that the sale of maintenance drugs was a readily identifiable segment of the overall prescription universe, and argued alternatively that loss of this business adversely affected other sales since it reduced the frequency of pharmacy visits.⁶⁹ Despite opposition by pharmacists to mail-order sales, they have participated in NYSEPP plans that had such provisions both before and after PAID I.⁷⁰

31. Another source of pharmacy opposition to the NYSEPP cost-cutting initiative was the prospect that the same approach might be used in Medicaid or other New York State plans, especially EPIC (Elderly Prescription Insurance Council), New York's prescription plan for the elderly.⁷¹

⁶⁸ RX's 97B, 312C. The state's experience both before and after the adoption of the various PAID formulae was that about 10% of all prescriptions were filled through the mail. Feinberg 379-83, Kavanaugh 611; CX's 1718A, 1763D; RX's 95D, 97B.

⁶⁹ Kelley 1618, Rosenberg 1757-58, 1768-69; CX's 16Z-11, 24Z-19, 2199Z-235.

⁷⁰ Feinberg 362, Kavanaugh 623-24. The addition of a mail-order component to the NYSEPP plan underwritten by Blue Cross/Blue Shield had not caused any retailer defections. CX's 1373, 2180, 2267Z-164, 2268P, Q.

⁷¹ Feinberg 500-04, Rosenberg 1769, 1802; CX's 2Z-113, Z-123, Z-124, Z-138, Z-139, 3Z-51, Z-52, 5Z-56, Z-57, Z-60-Z-63, 20Z-10, Z-12, Z-23, Z-36, Z-109, Z-137, Z-173, 24Z-21-Z-24, 492, 681A, 733B, 2070Z-67, Z-68, 2193Z-14, Z-15, 2194Z-40, 2199Z-157, Z-158, Z-235, 2204Z-15, 2250Z-38-Z-41.

32. All in all, there was little in PAID I that the pharmacists liked except for the concept of a generic drug incentive⁷² and a provision for rapid claim reimbursement by the administrator.⁷³

33. The arguments made by the pharmacists did not persuade the state to relax its cost-containment initiative, and on March 7, 1986, OER awarded the NYSEPP contract in the form of PAID I to the PAID-Equitable team.⁷⁴

C. July 1 And The Pressure On The State

34. On March 26, 1986, OER informed CPA that effective July 1, 1986, PAID I would go into effect.⁷⁵ With this starting date in mind, PAID began soliciting pharmacies on May 5, 1986. A formal solicitation was used since this was a new plan, some pharmacy opposition was anticipated, and state officials had to be certain that there were a sufficient number of drugstores on line by the July 1 starting date to service the huge number of NYSEPP members whose

⁷² Generic drug programs are designed to reward pharmacists for steering customers to generics as substitutes for the more expensive but doctor-prescribed branded items whose patents have expired. A generic drug component was supported by the pharmacists. Feinberg 385, Kavanaugh 613, Hartnett 973-74; CX's 2Z-5, 2-39, Z-44, Z-46, 11Z-39, 20Z-32-Z-34, 2194Z-15, 21992-14, Z-15, 2261Z-24, Z-25, 2262Z-71, Z-72; RX's 95L-N. Under PAID I, pharmacies were to be paid 25% of the difference between the costs of the generic and brand name drugs, with a minimum reimbursement of 75 cents. The co-pay was reduced from \$2 for branded to \$1 for generics. Feinberg 384-85, Kavanaugh 611-13; CX's 1084B, C, 1974B. Even with respect to the generic component, the pharmacists were dissatisfied with PAID I. They thought they should receive the generic incentive on all refills and not merely the initial prescription since they had converted the consumer to the use of the substitute. Rosenberg 1816-17; CX 812. Incentives aside, the pharmacists knew that generics were generally more profitable for them than branded drugs. CX's 16Z-9, 18Z-25, Z-26, 2061Z-172, 2196Z-11-Z-13, 2200Z-238, 2201Z-42, Z-43, 2207M, N, X-Z-2, 2267Z-19.

⁷³ CX's 1084C, 1185P, 2254Z-16, Z-11; RX's 107"I", 122B, 254Z-26.

⁷⁴ Kavanaugh 597-600, Hartnett 880; CX's 1563A-D.

⁷⁵ Feinberg 394-95; CX's 380B, C.

non-deferable prescriptions had to be filled.⁷⁶ Moreover, the use of a solicitation procedure was necessary in order to determine which discount off AWP in the sliding scale formula was to apply.⁷⁷

35. Despite the organized pharmacy community's opposition to PAID I, and notwithstanding some uncertainty about having an adequate number of drugstores on line by July 1, the early favorable response of several chains to the solicitation (Findings 36 to 40) eased the pressure of the July 1 starting date as both state and PAID officials believed that countervailing competitive pressures would soon force others to sign up.⁷⁸

36. On May 13, 1986, the Peterson drug store in Akron, New York, informed PAID that it would participate in PAID I.⁷⁹

37. On May 15, PAID was told by Kinney that it intended to participate in PAID I.⁸⁰

38. On May 16, Fay's submitted a notice of its intention to participate in PAID I.⁸¹

39. Carls signed up for PAID I on May 22.⁸²

⁷⁶ Feinberg 391-92, Kavanaugh 603-04, 622, 695, Hartnett 858, 920-21; CX's 2261Z-55, Z-56; RX's 1, 106B, C, 107A-C 257Z-7-Z-16, Z-25, Z-26, Z-126. While some pharmacy opposition had manifested itself prior to the solicitation, the state did not anticipate that participation would be any different from the level achieved under the existing plan administered by BCWNY. Feinberg 394. An indication of what would constitute an adequate panel can be seen from the performance standard in the state's second RFP. If the winning administrator did not have on line 80% of the pharmacies in each New York county, it was subject to financial penalties. Feinberg 390-92, 391, 520, Kavanaugh 602-03; CX's 2257Z-12, Z-13, Z-24, Z-25, 2260N-P, 2261Z-31-Z-33, 2262X; RX's 254Z-55, 260Z-116. After the state changed the reimbursement rate (*see* Finding 82), PAID was still certain that an adequate panel would participate and it did not seek to renegotiate the penalty clause. Feinberg 392; CX's 2257Z-25, Z-26, 2260Z-39-Z-41; RX's 257Z-12, Z-126, Z-127.

⁷⁷ CX's 2257Z-154, 2258Z-12, Z-13; RX's 260Z-7, Z-8.

⁷⁸ Kavanaugh 623, 626-28; RX's 254Z-117, Z-118.

⁷⁹ CX 711.

⁸⁰ CX 491.

⁸¹ CX 368B.

⁸² CX 1147H.

40. By the end of May, about half of all New York chains had enrolled in PAID I,⁸³ and just prior to June 10, approximately 40% of the some 3800 pharmacies in the state had signed up.⁸⁴

41. The significance of this early trend toward participation was made apparent by the tone of a May 27 meeting between OER and the pharmacy community as represented by CPA (Zimmerman), Rite Aid (Krahulec), Peterson (Rosenberg), Fay's, and Kinney. The state officials said that they would not retreat from PAID I, citing in support of their position the encouraging level of participation already achieved and the incongruity of a protest led by firms, some of which had already signed up.⁸⁵ The pharmacists left the May 27 meeting with the impression that not only was the state determined to go forward with PAID I, but that similar reduced-rate formulas for other state-sponsored plans were in the offing if PAID I survived.⁸⁶

D. July 1 And The Pressure On The Pharmacists

42. The intransigence of the state, as shown during the May 27 meeting, must have confirmed for the alleged conspirators the significance of any early signs of participation. Given the size of NYSEPP as well as the pattern of consumer purchases of prescriptions -- consumers tend to return to the same pharmacy for all prescriptions, and they purchase their non-prescription items at the same pharmacy where their prescriptions are being filled -- the

⁸³ CX's 1989C, D, 2260Z-1. See also CX's 1180, 1305A, B, 1306, 2094, 2258Z-29.

⁸⁴ CX's 1079A-C, 2251Z-116, Z-111; RX 259Z-2H.

⁸⁵ Feinberg 401-03, Rosenberg 1112-14; CX's 2Z-92, Z-102, 10M, 14Z-25, 16Z-44-Z-46, 20Z-161, Z-162, Z-164, Z-165, 2069Z-136, Z-137, 2070Z-59, 2257Z-52. Because the pharmacies were enrolling at the rate of 100 to 200 a day, state officials expected that participation would reach the level achieved under the Blue Cross-administered NYSEPP. Feinberg 394, 533, Kavanaugh 617-18. The state officials may also have been heartened by PAID's own first-hand but limited experience with discounts off AWP, which showed that plans based on such formulas had no difficulty in obtaining an adequate panel of pharmacists. Feinberg 392, Kavanaugh 615; CX's 2260J, K, R, S, Y-Z-1, 2262Z-103, Z-104, Z-111-Z-115; RX's 257"O", 258"O"-Q, Z-111-Z-119, 260P.

⁸⁶ CX's 2Z-91, Z-92, Z-105, 5Z-11, Z-18, 733A, B, 2069Z-138.

pharmacists and the state knew that if New York went forward with the plan on July 1, it would have been perilous for any firm to stay out of PAID I (assuming its competitors were in) for fear of loss of not only the substantial NYSEPP prescription business itself ("back-end business" which includes prescription refills), but also the loss of the "front-end" (health, cosmetic and other non-prescription) patronage of some 500,000 NYSEPP members.⁸⁷ Moreover, the prospects for departicipation must not have appeared especially sanguine since pharmacists generally believed that it was in their own self-interest to enroll in high volume third party plans despite low reimbursement rates. (Findings 43 to 51, and 85 to 88.)

43. The direction of the pharmacy business is toward the use of third party plans.⁸⁸ By 1986, these plans accounted for close to 44% of Peterson's prescription business and about 47% of Rite Aid's New York prescription volume.⁸⁹

44. The correlation between prescription and nonprescription business and the relation of both to third party plans was such that Genovese automatically accepted all of these plans except for so-called "capitation" arrangements.⁹⁰ It was Genovese's aim to fill every prescription it could because it operated on a rule-of-thumb that each prescription generated \$15 to \$20 in front-end sales.⁹¹ NYSEPP, which was second only to Medicaid as a source of Genovese's prescription business, accounted for \$7.2 million of that

⁸⁷ Feinberg 511-12, Kavanaugh 623, 627, 628, 703, Rosenberg 1805-06, 1885-87; CX's 2Z-121, Z-122, 6Z-47, Z-84, 16Y-Z-2, 160M, 1127D, 1685H, 2070Z-52-Z-54, Z-88, 2252Z-65(1), Z-66, 2254Q,R, 2260Z-23, Z-24, Z-39, 2261Z-43.

⁸⁸ Painter 1406; CX's 160N, 1127B, 2061Z-224; RX's 11B, 325C.

⁸⁹ CX's 16R, 24Z-13, Z-14, 683A-C, 699A-C. The Peterson percentage is especially impressive given Rosenberg's general distaste for all third party plans. Rosenberg 1712-13; CX 2070Z-53. Third party plans accounted for between 30% to 40% of the prescription business of Brooks, Carls, CVS, Fay's, and Genovese. CX's 6Z-83, 11Z-1, 2061Z-224, 2248H, 2250"O", P, 2252Z-22, Z-33. For Kinney, third party plans offered a significant potential for sales growth. CX's 2061Z-224.

⁹⁰ CX's 2247Z-42, Z-43, Z-46, Z-47, 2248F, 2249Z-7, 2297R. "Capitation" plans pay the pharmacy a fixed amount per patient each month regardless of the number of prescriptions filled. CX's 2247Z-42, Z-43, Z-46, Z-47.

⁹¹ CX's 2247S, T 2248J, 2249Q, Z-7, Z-19.

chain's sales revenues, and in the words of one Genovese official: "You are talking about \$7.2 million a year with respect to this plan. No way can you walk away from 7.2 million."⁹² Thus it was inconceivable that Genovese would be the only pharmacy in its area not participating in a plan that had far fewer members than NYSEPP.⁹³ Genovese further conceded that prior to attending the June 10 "Pharmacy Day" rally (*See Findings 58, 59*), it had assumed that it would be participating in PAID I.⁹⁴

45. Brooks made a calculation that was similar to Genovese's -- for each prescription dollar spent, a customer spent another on non-prescription items.⁹⁵ A company official said that the effect on Brooks would be "devastating"⁹⁶ if it stayed out of PAID I while its competitors participated; reflecting, undoubtedly, the fact that in areas where state employees were concentrated, NYSEPP accounted for about half of Brooks' third party business, and in other areas between 15% and 20%.⁹⁷ This view of the significance of third party plans even carried over to those perceived as having unfavorable ingredient reimbursement rates. As one Brooks official put it:

Well, you have got to look at competition. I mean, this is the whole key in this. If my competitor across the street is in the plan, I may be forced by market conditions to go into it, even though I dislike it and under normal conditions would not go into it.⁹⁸

⁹² CX 2249Z-28; *see also* CX's 1056A, B, 1057, 2249Z-21. The importance of NYSEPP to Genovese can be seen in the effect of even a short delay in its acceptance of the plan. After the demise of PAID I and before it accepted PAID II, Genovese could measure the loss of prescription patronage in the hundreds of customers. CX's 2249Z-67, Z-78, Z-79, Z-250.

⁹³ CX 2249Z-20.

⁹⁴ CX 2249Z-46.

⁹⁵ CX's 2252Z-6, Z-7, 2254Q, R.

⁹⁶ CX 2252Z-71; *see also* CX 2252Z-66.

⁹⁷ CX's 2252Z-33, Z-34. The areas included Albany where Brooks was a major factor. CX's 2252Z-1, Z-2.

⁹⁸ CX's 2252Z-3, Z-4.

46. Because prescriptions generated front-end sales, Fay's participated in third party plans even when it knew that the plans would not cover its variable costs. This policy was adopted in order to increase store traffic and spread costs.⁹⁹ Given the size of NYSEPP, any decision by Fay's not to participate was expected to have an especially adverse effect in Albany and other key markets of this firm.¹⁰⁰ Thus Fay's originally informed PAID that though it was opposed to the less than full AWP formula, it would have to participate in NYSEPP because of the number of consumers at stake.¹⁰¹

47. The position of Carls was uncomplicated. Third party plans, even unprofitable third party plans, brought customers into its store and if their principal competitors (Fay's and Rite Aid) had signed up for PAID I, Carls would have done the same for fear that the same customers would walk out for good.¹⁰² NYSEPP was second only to Medicaid in size and importance for Carls,¹⁰³ and it was inconceivable that this chain would not have participated in a program of this size.¹⁰⁴ Apart from PAID I, Carls had never declined to participate in any third party plan.¹⁰⁵

48. NYSEPP was vital to CVS. This chain filled 4 million prescriptions in New York State in 1985, almost one million of which were for state employees.¹⁰⁶ Moreover, CVS market research had revealed that the average prescription customer spent 40% more on

⁹⁹ CX's 11Z-19-Z-21, 2060Z-23, Z061Z-157-Z-159, 2062Z-3, Z-6-Z-13, Z-136-Z-142, 2069Z-17, Z-18. The only third party plan which Fay's had turned down was a "capitation" plan. CX's 11Z-26, Z-27, 2062Z-14, Z-15 and *see* Note 90, *supra*.

¹⁰⁰ CX's 8Z-17, 11Z-21, Z-30, Z-58, Z-80, Z-81, Z-99, Z-100, 2062Z- 4-Z-6, Z-113, Z-114, 2203Z-28, Z-30, 2322A-C. *See also* Kavanaugh 627.

¹⁰¹ CX 2259Z-40.

¹⁰² CX's 2206Z-9, 2250X, Z-6, Z-82-Z-85, Z-96, Z-97, 2251Z-13, Z-18, Z-29, Z-95-Z-98.

¹⁰³ CX's 2250Z-17-Z-19, Z-24-Z-26, 2251Z-34, Z-36, Z-37, 2291.

¹⁰⁴ CX's 2251Z-53, Z-54.

¹⁰⁵ CX 2206Z-15.

¹⁰⁶ CX's 5Z-67, 6Z-82, Z-83, Z-86, Z-81, 7Z-32, 7-45, Z-46, Z-105.

front-end merchandise than a non-prescription customer and visited the store more than twice as often.¹⁰⁷ Accordingly, CVS knew that if it did not participate in PAID I and its competitors did, this would have a serious direct impact on its market share.¹⁰⁸ Apart from PAID I, CVS had never declined to participate in any third party plan.¹⁰⁹

49. Because of the trend toward third party plans, Kinney viewed participation in these arrangements as contributing significantly toward increasing prescription sales, a goal it had set not only for the drug volume itself, but also for the direct impact of prescription sales on its nonprescription business.¹¹⁰ For all practical purposes Kinney participated in all third party plans,¹¹¹ and the sheer size of NYSEPP -- only Medicaid was larger -- dictated that Kinney had to participate in this plan.¹¹²

50. As late as June 12, and in the midst of the activities in opposition to PAID I, Rosenberg told his stores that Peterson's refusal to participate was contingent on its competitors doing the same. Rosenberg signed the PAID I forms and kept them in his office ready to be submitted if his competitors participated in the plan. Rosenberg knew that any chain participating in PAID I would have a competitive advantage over nonparticipants.¹¹³ The pattern of consumer loyalty described in Finding 42 meant that Peterson would have had

¹⁰⁷ CX's 160K, M, U.

¹⁰⁸ CX's 6Z-44-Z-47. NYSEPP had a special significance for CVS because Albany, where many state employees are located, was its largest market. CX's 2Z-168, 5P, 6Z-2, Z-3, 7U, V. In 1986, CVS accounted for almost 35% of the Albany market, and CVS, Fay's, and Rite Aid together controlled about 60% of pharmacy sales in that area. CX's 6Z-2, Z-3.

¹⁰⁹ CX 2191Z-137.

¹¹⁰ CX's 12Q, R, 2063Z-46, Z-47.

¹¹¹ CX's 12S, 2064P, R.

¹¹² CX's 13Z-2, Z-3, Z-15, Z-75, Z-76, 14Z-23, 2290.

¹¹³ Rosenberg 1805-06, 1885-87; CX 681A. *See also* CX's 2070Z-62, Z-63 for evidence of Rosenberg's apprehension that the major chains might try to "steal a march on their competition," and Rosenberg 1770, 1852, CX's 16Z-74, Z-82, 2070Z-88, Z-89 for his anxiety about possible loss of business in college and prison towns where state employees represented a significant part of the work force.

to sign up for PAID I if its main competitors participated notwithstanding Rosenberg's distaste for "regressive percentage" plans.¹¹⁴ According to Rosenberg, before the prospect of PAID I arose, "we [Peterson] had never been in a situation like this before where there was a potential that we may be non-participators in a plan."¹¹⁵

51. Even Rite Aid, which had threatened the state at an early stage of the PAID I initiative with nonparticipation, and whose Krahulec was instrumental in putting together the combined front of nonparticipation described in Findings 53 to 81, did not rule out participating should its competitors enroll,¹¹⁶ Rite Aid filled 5,000 prescriptions a week under NYSEPP, and an outright decision not to participate would have adversely affected the bottom line profitability of this huge chain.¹¹⁷ Rite Aid, of course, realized that fewer

¹¹⁴ Rosenberg 1885-87; *see also* Rosenberg 1742, 1744, 1805-06; CX's 16Y, Z-1, Z-2, Z-79, Z-80.

¹¹⁵ Rosenberg 1901. *See also* CX's 2070Z-54. The correlation between front-end and back-end business described in Finding 42 was especially important to Peterson because of that chain's large "Love of Pete" gift departments. *See* Rosenberg 1713.

¹¹⁶ In July 1985 and again on May 27, 1986, Rite Aid told OER that it would not participate in any plan that discounted the full AWP rate. Rosenberg 1756, 1759; CX's 2Z-95, Z-174, 2257Z-55; RX's 1, 257Z-47; but *see* CX 812 in which Krahulec said on May 20, 1986, "we may alternately decide to participate" as he contemplates "combined responses" to PAID I. *See also* CX's 23Z-47-42(2), 70C, 2261W, 2323C, D, for evidence that in fact Rite Aid participated in third party plans with reimbursement rates lower than PAID I; indeed, at the very time that Rite Aid made the July 1985 statement it was being reimbursed at AWP-12% in the NYSEPP areas administered by BCWNY. For this very reason, the May 27, 1986, statement did not convince Rosenberg of Rite Aid's commitment to nonparticipation since he knew that the Rite Aid was participating in the BCWNY - administered NYSEPP plan. Rosenberg 1756.

¹¹⁷ CX's 19Z-40, 20Z-11, Z-12, Z-147, 22Z-64, 23Z-49-Z-51, 24Z-20, Z-79, Z-80. Note that even a short delay by Rite Aid in accepting PAID II, the successor to PAID I, meant that the chain was "hit hard" by the loss of business. CX 19Z-141. *See also* CX's 22Z-108, Z-111, Z-145-Z-147, 23Z-92, 2196Z-158, 2201Z-71, Z-73. As indicated in CX 868H third party plans had played a key role in the growth of Rite Aid's prescription business.

customers would be lost if its competitors, too, were not participating in any particular third party plan.¹¹⁸

52. The risk to the alleged conspirators if PAID I was not defeated by July 1 is shown by a June 16 Supermarkets General internal memorandum outlining the prospects for the pharmacy departments of its Pathmark stores should its competitors decide not to participate. Because a "boycott seems to be developing among chain pharmacies" Supermarkets General saw an opportunity to be exploited as it planned to advertise that the Pathmark stores would be accepting PAID I.¹¹⁹ A similar strategy would have been followed by Fay's had it decided to participate while others remained on the sidelines.¹²⁰

*E. The Zimmerman/Krahulec Invitation And
The Pharmacists' Response*

53. Confronted by the prospect that New York was determined to go forward with the July 1 starting date so long as an adequate array of pharmacists seemed likely, Zimmerman of CPA and Krahulec of Rite Aid sent out clear messages to the alleged conspirators that there must be no participation. The contents, the settings, and the means used for sending these messages -- *i.e.*, by exhortations during meetings of the alleged conspirators, by adoption of a "Dear Valued Customer" device for keeping the patronage of state employees while the alleged conspirators did not participate, in response to inquiries from one pharmacist about the intentions of others, by widely circulated memos calling directly and indirectly for nonparticipation -- signaled that joint action was contemplated and invited. (Findings 54 to 81.)

¹¹⁸ CX's 24Z-79, Z-80.

¹¹⁹ CX 1311. *See also* CX's 1307, 1309, 1313.

¹²⁰ CX's 2062Z-44, Z-45. *See also* CX's 24Z-45, Z-46, Z-88, Z-89 for Rite Aid's use of this strategy in 1970 to take business away from competitors who were boycotting Medicaid.

54. Zimmerman knew that if PAID I were to be defeated, it was essential that the pressure of the July 1 deadline be maintained.¹²¹ As early as April 11, 1986, in a memo circulated to "Members of the Chain Pharmacy Association of New York State" (by its terms each member was apprised that all the others had received the same message) he signaled the Pharmacists that the key to their success lay in the vulnerability of the state to nonparticipation --

While this formula [an alternative to PAID I] may be difficult to obtain at this late date, state officials are concerned that participation in this program by pharmacists will be threatened if economic considerations are not adequately addressed.¹²²

55. Early on, Zimmerman also began to play a slightly different variation on the nonparticipation theme. He told Krahulec and other CPA members that if they signed up for PAID I, he would have difficulty lobbying against any attempt by the state to incorporate a reduced rate reimbursement formula in its insurance program for the elderly.¹²³

56. As for Krahulec, he reflected on the prospect of "combined responses" as he reported on May 20, 1986, to Rite Aid officials that "I have already been informed that the independent pharmacists are extremely upset with many aspects of this program and have threatened a boycott."¹²⁴

57. Consistent with his May 20 contemplation of "combined responses" and the receipt of a report respecting the prospects of a boycott, over the next few weeks Krahulec assumed the role he was

¹²¹ CX's 2Z-121, Z-122.

¹²² CX 732B.

¹²³ CX's 2Z-113, Z-123, Z-124. Krahulec had similar concerns about the linkage of the two programs. CX's 20Z-10, Z-11, Z-23. While Zimmerman communicated his thoughts on the anti-PAID I campaign to all CPA members, there can be little question that Krahulec was his main confidant and principal co-strategist. See CX's 2Z-123, Z-238, Z-239, 20Z-23, 21Z-34, Z-35.

¹²⁴ CX 812. Krahulec based his statement on Zimmerman's report that an official of PSSNY (Pharmaceutical Society of the State of New York, the state-wide association of independent pharmacists and umbrella organization for affiliated county associations, CX's 20P, Q, 2243R, S, 2246Z-18, Z-19) had told him that county associations were threatening a boycott. CX's 20Z-139-Z-141.

to play throughout the anti-PAID I campaign -- an aggressive seeker, a convenient depository, and an eager transmitter of information and advice about nonparticipation.¹²⁵

58. The Zimmerman/Krahulec effort to achieve a solid front of nonparticipation intensified as the July 1, 1986, deadline approached. At a June 10 "Pharmacy Day" rally in Albany, Zimmerman again warned the alleged conspirators that the defeat of PAID I, and the effort to keep similar terms out of the state's plan for the elderly, would be jeopardized if any members participated.¹²⁶ A similar message was conveyed in more pointed terms to individual firms. Thus having learned that Carls had signed up to participate in PAID I, Zimmerman cautioned officials of that firm on June 10 or thereabouts that an effective lobbying effort could not be sustained if Carls remained in the plan.¹²⁷

59. For his part, Krahulec weighed in at the "Pharmacy Day" rally with a crucial embellishment on the nonparticipation theme. He discussed with Rosenberg the use of a "Dear Valued Customer" letter, a billing stratagem designed to keep the patronage of state employees while a pharmacy was not participating in PAID I. Rosenberg responded with a request for a copy of the letter.¹²⁸ A representative of Genovese spoke with Krahulec to the same effect

¹²⁵ CX's 12Z-29-Z-31, Z-77, Z-78, 14Z-79-Z-84, 488E, 2066Z-34-Z-36, Z-42 (Krahulec initiates a telephone conference call to Kinney and Genovese in order to determine if these chains intend to participate in PAID I. Kinney tells Krahulec and Genovese that it will not participate), 20Z-66, Z-67, Z-139-Z-141 (Krahulec passes on to Genovese, Zimmerman's report of the boycott being planned by the Westchester and Long Island pharmacists), 20Z-161 (Krahulec learns that Fay's has enrolled in PAID I), 20Z-101, Z-117, Z-118, Z-227, Z-229 (Zimmerman informs Krahulec that chains which had previously signed with PAID I, have canceled), and *see* Findings 59 and 13-81 for Krahulec's use of "Dear Valued Customer" letters and a lawyer's memo as the means for imparting and receiving participation signals. *See also* CX's 14Z-17, Z-78 and Findings 42-52 and 75 for evidence of the mutual interdependence of these firms and the competitive consequences of any uncertainty about each other's intentions respecting participation in a third party plan.

¹²⁶ CX's 2Z-123, Z-124, Z-138, Z-139, 2199Z-102, Z-103, 2249Z-119.

¹²⁷ CX's 2206Z-15-Z-17.

¹²⁸ Rosenberg 1807-08, 1836, 1898-99; CX's 16Z-98, Z-99, Z-102, Z-103, 2070Z-65, Z-75, Z-76.

on or about June 10.¹²⁹ There is also evidence that at the June 10 rally, Krahulec did not confine himself to one-on-one conversations about the "Dear Valued Customer" letter. Kelley, a former Washington-based chain drugstore association lobbyist who attended the June 10 meeting, testified that a reimbursement procedure for nonparticipating pharmacists was the topic of a general discussion.¹³⁰ This proffer by Krahulec of the "Dear Valued Customer" letter, and the requests for the letter that followed, meant that Rite Aid, the largest New York chain, was effectively assured that it need not sign up for PAID I in order to protect its own substantial interest in public employee business.¹³¹ It also meant that Rite Aid, which shared its information with other firms that may have been wavering, had received a clear signal of nonparticipation; for as Krahulec put it, the use of the "Dear Valued Customer" letter was "synonymous" with a decision not to participate.¹³² At the same time, Krahulec's promotion

¹²⁹ CX 2194Z-150, Z-151.

¹³⁰ Kelley 1635-36. At one point, Kelley said that he heard such a discussion (Tr. 1635), and based upon my observation of his demeanor, as well as my review of his testimony for internal inconsistency, I find that his earlier and later attempts (Tr. 1635-36) to hedge on this point are not credible. This discussion about nonparticipation occurred at the 9:15 a.m. meeting on June 10, which Rosenberg attended. Kelley 1634-35. The "Pharmacy Day" rally was actually several meetings. At 9:15 a.m., the CPA members (including Rosenberg), met in the basement of Albany's University Club. CX's 14Z-39, Z-40, 16Z-55, 725J,K, 2069Z-165- Z-167, 2203Z-75. Krahulec spoke at this early meeting. CX 2203Z-77. Later that day, the CPA membership and members of PSSNY, the sponsor of "Pharmacy Day," rallied in a hearing room of the Legislative Office Building where still additional appeals for nonparticipation were made. CX's 2244Z-153-Z-155, 2278A, B. PAID I was also the subject of a June 10 luncheon conversation involving Rosenberg, Owens of Kinney, and Zurek of Carls. CX's 14Z-50, Z-51, Z-127-Z-129, 2206Z-75, 2250Z-131.

¹³¹ Krahulec routinely passed along information about participation in PAID I to the Rite Aid officials who had ultimate responsibility for deciding whether to enroll in the plan. CX's 18Q, 20Z-127, Z-145, Z-242, 2204Z-49. And despite Krahulec's public pronouncements of nonparticipation, Rite Aid kept in reserve the alternative of participation should its competitors waiver. *See* Note 116, *supra*.

¹³² CX's 2194Z-157, Z-158 and *see* Findings 57, 59, 73-81 for evidence that Krahulec played the role of purveyor of information about participation throughout the anti-PAID I campaign.

of the "Dear Valued Customer" approach must have been reassuring to a competitor like Rosenberg who left the "Pharmacy Day" rally with the understanding that Rite Aid itself would not be participating.¹³³ It is also apparent that the other alleged conspirators left Albany on June 10 similarly reassured. (Findings 60 and 61.)

60. Two days after the "Pharmacy Day" rally, Charles Owens, the Kinney representative at the June 10 meeting, told his company officials --

I spent Tuesday, June 10th, in Albany with our chain group.... All chains in our group and many independents have taken the position that we will not participate in the plan as it is structured now.¹³⁴

According to Owens, the basis for his report was the statements of chain representatives who declared on June 10 that they would not participate in PAID I.¹³⁵

61. The exact date is not clear, but sometime between June 10 meeting and June 13, Zurek of Carls reported to his company that "no one else" was participating in PAID I.¹³⁶

62. Although Rosenberg came away from the June 10 meeting with the perception that the combined front of nonparticipation was not rock solid, he recognized that the pharmacists need only hold together for the few weeks remaining before the July 1 starting date. In a June 12 report to the Peterson stores, Rosenberg gave the following account of the June 10 meeting:

There were representatives from many chains -- Rite Aid, Fays, Carls, CVS, Genovese, Brooks and Peterson Drugs. This plan which discount the AWP 12% for chains is so onerous and threatening, that the major chains are up in arms....

To my knowledge, none of the above chains have signed up for the plan, however, moral fibers of their corporate executives will be sorely tested in the next few weeks. I have not sent in any signed contracts as yet, and I can assure we will not be the first. It is my intention to have all the contracts signed and held here in

¹³³ Rosenberg 1901-03; CX 16Z-99.

¹³⁴ CX 492.

¹³⁵ CX's 14Z-64, Z-69. *See also* CX's 14Z-59, 2066Z-33.

¹³⁶ CX's 2206Z-21, Z-22, Z-111.

the office, unless we are forced to commit ourselves to the program because other chains give way.

...So far the O.E.R. has stonewalled the situation, but we believe that if they do not get the signed contracts within the next few weeks, something will crack open....¹³⁷

63. Rosenberg denied that he ever discussed Peterson's participation or nonparticipation with the alleged conspirators. According to his recollection, these subjects never came up on June 10.¹³⁸ As shown in Finding 58, however, there is convincing evidence that Zimmerman spent June 10 urging the CPA members, including Peterson, to adopt a unified position on participation. Contemporaneous or nearly contemporaneous accounts of what occurred on June 10 strongly support the conclusion that Zimmerman's efforts bore fruit. (Findings 60 and 61.) There is also evidence that in response to Zimmerman's exhortations there were explicit avowals of nonparticipation by some firms.¹³⁹ While there is no proof that Rosenberg made such a public pledge, his denial that the subject even came up is contradicted by CX 681A (*See* Finding 62). According to Rosenberg, this June 12 report to his stores merely reflected what he surmised from the large turnout of important and unhappy drugstore executives.¹⁴⁰ But the plain language of the document itself indicates not only that he heard some discussion on June 10 respecting participation, but that what he heard related to a common scheme ("...we [emphasis added] believe that if they do not get the signed contracts within the next few weeks, something will crack open"). Rosenberg

¹³⁷ CX 681A. According to Rosenberg, the report reflected information obtained on June 10. Rosenberg 1798; CX's 2070Z-64, Z-65. *See also* Rosenberg 1803 and CX's 2070Z-62, Z-63, for additional evidence that Rosenberg had doubts about the long-range willingness of the major chains to deny themselves the competitive benefits to be derived from participation in NYSEPP. In general, chains and independents distrust each other and both are skeptical about the other's motives. CX's 2261Z-39-Z-41.

¹³⁸ Rosenberg 1780-86, 1868-69; CX's 16Z-57, Z-58, Z-65, Z-75, Z-76, Z-77-Z-79, Z-86.

¹³⁹ *See* CX's 14Z-40-Z-44, Z-59, Z-61, Z-64, Z-65, Z-69, 2066Z-27, Z-28, Z-33. *See also* CX's 3Z-29-Z-33, Z-48, Z-49 for evidence that nonparticipation was also discussed at CPA meetings prior to June 10.

¹⁴⁰ Rosenberg 1787, 1802-03; CX's 16Z-17, Z-78, 2070Z-62.

himself conceded that prior to June 10 he had made no firm decision as to whether he would participate;¹⁴¹ yet, as disclosed in CX 681A, only two days later he was prepared to commit his stores to nonparticipation so long as the other chains stayed out. In addition, there is no dispute that at the "Pharmacy Day" rally of June 10 Rosenberg discussed with Krahulec the "Dear Valued Customer" letter, an exchange that effectively told Rite Aid that Peterson would not be participating.¹⁴² Moreover, Rosenberg's categorical denial that nonparticipation was discussed on June 10, or for that matter at any other time, must be weighed against the following testimony:

Q. Did you ever have conversations with any persons outside of Peterson's about what the effect of not participating by the firms would be on the terms of the plan?

A. Probably, but I don't remember specifically with whom.

Q. Why do you say probably?

A. Because being a pharmacist, I met with other pharmacists. Everybody was outraged by the plan. And it's common knowledge if you do not have people to participate in a plan, you don't have a plan.¹⁴³

64. Within days of the June 10 rally, the alleged conspirators took steps (Findings 65 to 69) which were unprecedented but fully consonant with the Zimmerman exhortation for departicipation (Finding 58), with the Krahulec advice on how not to participate (Finding 59), and with the perception of the pharmacists (Findings 60 to 62) that a combined front of nonparticipation had been put together in Albany.

65. On June 12, Kinney withdrew from PAID I.¹⁴⁴ Kinney admitted outright that this decision was based on information obtained at the June 1 "Pharmacy Day" meeting.¹⁴⁵

66. Fay's, too, withdrew from PAID I on June 12.¹⁴⁶

¹⁴¹ Rosenberg 1882; CX 2070Z-60.

¹⁴² Rosenberg 1898-99 and Findings 59, 75.

¹⁴³ CX 16Z-81 (Rosenberg Deposition).

¹⁴⁴ CX 1749.

¹⁴⁵ CX's 14Z-74, 488C.

¹⁴⁶ CX 1740.

67. On June 13, Carls withdrew from PAID I.¹⁴⁷

68. By June 17, Rosenberg could confidently report to his Board of Directors that "At this point all major chains have refused to sign [PAID I participation forms]."¹⁴⁸

69. On June 18, Rosenberg first learned that Peterson's Akron store had signed up, and he immediately canceled its participation in PAID I.¹⁴⁹

70. Respondent Peterson went to great lengths in its attempt to establish that its departicipation of the Akron store was somehow different from what Kinney, Fay's, and Carls had done. But these differences relate to how a decision may have been made to participate, not departicipate. To begin with, respondent makes much ado about whether the Akron store had exceeded its authority by participating in the first place. What the record shows is that as a matter of corporate policy, Peterson delegated to each pharmacist-manager discretion in running all aspects of the day-to-day affairs of the 18 pharmacies. Nevertheless, the corporate headquarters kept control since it retained the supervisory reins and determined how much discretion was to be delegated to the affiliates. Under this allocation of authority, during the time period relevant to this proceeding, the pharmacists had been given control over the purchase of pharmaceutical goods, hiring and firing of employees, and broad discretion as to how best to promote the store. Moreover, each store had its own separate contract with third party administrators; submitted its own claims to these administrators; and was paid directly for those claims by the administrators. This contrasts with the method used by major chains, which ordinarily sign one contract for all of their stores and submit the claims collectively with payment going directly to the headquarters of the chain.¹⁵⁰ In actual practice, however, the lines of demarcation between Peterson's putative broad grant of individual store autonomy and the authority retained by the

¹⁴⁷ CX 2005.

¹⁴⁸ CX 679A.

¹⁴⁹ Rosenberg 1831-33; CX's 16Z-88, 1119, 2070Z-72.

¹⁵⁰ Rosenberg 1708-10, 1717-24; CX's 15K, L, 16K, Z-23, Z-24, 716B, 2070Z-73, Z-74, 2268Z-208, Z-212.

Oakfield headquarters were obscure. This is illustrated by respondent's insistence that Rosenberg, acting in his capacity as supervisor of pharmacy operations, was solely responsible for negotiating the contracts with the major pharmaceutical suppliers and third party plan administrators.¹⁵¹ That this claim is inconsistent with respondent's assertion that the stores were to be treated as individual entities under third party plans and were to control purchases as well as making general policy, is shown by the very fact that Akron accepted PAID I without first consulting Rosenberg.¹⁵² But irrespective of whether the Akron store may or may not have exceeded its authority in signing a PAID I participation form, respondent's argument misses the point that the issue here is not how Akron's participation came about, but rather the circumstances surrounding Rosenberg's abrupt and unprecedented decision to departicipate. (As it happens, Rosenberg's explanation for the withdrawal of the Akron store is virtually identical with the explanation given by Carls: the sudden revelation

¹⁵¹ Rosenberg 1717-21, 1724.

¹⁵² Cory, the Akron store manager who had been with Peterson since 1958 and had been signing third party contracts for 20 years, was "confused" by the allocation of authority between him and Rosenberg. CX's 15H, M-Q. One source of this confusion may be found in Rosenberg's own account of his authority which indicates an ambivalent role rather than a hard-and-fast rule ("I took it upon myself to pay somewhat greater attention to third-party prescription programs, which were becoming more prevalent" (Rosenberg 1720)) and "It was not a hard and fast rule" CX 2070Z-73 (Rosenberg Deposition)). Even with respect to the "Akron Incident," according to Rosenberg's version at trial, he simply told the store manager that it would have been "best" to have sent the contract to headquarters. Rosenberg 1832. In further support of this shaky rationalization for departicipation, Rosenberg testified that Cory was not authorized to sign the contract because he was not an officer of Akron at that time. Rosenberg 1832. But Cory, who had been an officer at one time (CX's 15M, N, 2070Z-74), and both as an officer and as an ex-officer apparently enrolled Akron in third party plans without stirring up any great fuss (See CX's 16Z-36, Z-37), had never been told by Rosenberg -- that is, prior to the PAID I incident -- that he no longer had this authority. CX's 15P, Q. Against this background, it is understandable why Rosenberg's policy respecting limitations on the manager's authority had made no lasting impression on Cory. CX 15Z-22.

that the person who signed the participation form was unauthorized to do so.¹⁵³)

71. Respondent also argues that its withdrawal of the Akron store should be considered as simply an extension of its long-standing policy of resisting to the last possible moment all third party plans offering reimbursement at a rate of less than full AWP.¹⁵⁴ In support of this argument, respondent attaches special significance to the contract negotiated with BCWNY during the period 1983-86 for both BCWNY's "community" (*i.e.*, non-NYSEPP) and NYSEPP members. The signing of this agreement followed 2 1/2 years of haggling and threats of law suits between Peterson and BCWNY over reimbursement rates and respondent's status as a chain.¹⁵⁵ If it were classified as a chain, BCWNY would reimburse at a rate of AWP minus 12%. If Peterson were not a chain, the reimbursement rate would be a sliding scale between AWP minus 1% to AWP minus 9%. Peterson finally accepted a compromise rate of AWP minus 3% to minus 11%.¹⁵⁶ This incident tells us nothing about the existence of a scheme to defeat PAID I, and stands simply as additional proof that notwithstanding Peterson's hostility to any third party plan (and especially those premised on a reduction from AWP), it must for competitive reasons eventually accept these plans.¹⁵⁷

¹⁵³ CX Z005. Conspicuously missing from Peterson's explanation of the Akron store's "mistake" is any attempt to account for the ready acceptance of the PAID I formula by Cory, its experienced store manager. CX's 15H, M, N, 2070Z-73, Z-74. Equally odd, is Carls' explanation that it discovered its "mistake" in late May, but only decided to act on it after the June 10 rally. *See* CX 2250Z-86. As in the case of Peterson's Cory, the "unauthorized" Carls' employee had apparently enrolled in other third party plans with no sudden withdrawals upon the discovery of this technical glitch. CX's 2206Z-121, Z-122, 2250Z-80.

¹⁵⁴ Rosenberg 1732-42.

¹⁵⁵ These negotiations followed BCWNY's attempt to eliminate the problems inherent in reimbursement premised on actual acquisition cost. *See* Finding 17.

¹⁵⁶ Wutz 1007-09, 1016, 1038-63, Rosenberg 1732-42, 1912; RX's 23A-35B. BCWNY estimated that Peterson's average reimbursement rate was AWP minus 5.3%. RX 30C.

¹⁵⁷ *See* Findings 42, 43, 50 and Wutz 1074, Rosenberg 1886, 1910; CX's 2070Z-45, 2267Z-124, Z-125, 2268Z-41.

72. With the exception of one "capitation" plan (*See* Note 90), none of the alleged conspirators had ever before withdrawn from a third party plan after they had already enrolled.¹⁵⁸ New York State and the PAID administrators had never before experienced the phenomenon of pharmacies signing up to participate in a plan and then withdrawing a short time later.¹⁵⁹ Even one of the alleged conspirators acknowledged that such withdrawals were unprecedented.¹⁶⁰

73. The Zimmerman/Krahulec campaign for a solid front of nonparticipation did not end with the June 10 "Pharmacy Day," or the departicipation of Fay's, Kinney, Carls, and Peterson that followed. Picking up on Krahulec's "Pharmacy Day" invitation, the alleged conspirators made certain that they were all using the same chosen instrument of nonparticipation -- the Rite Aid "Dear Valued Customer" letter first revealed by Krahulec on "Pharmacy Day." (Findings 74 to 78.)

74. The text of the Rite Aid prototype read as follows:

Dear Valued Customer:

Your prescription drug benefit was changed. According to a notification we received, it is now underwritten by Equitable Insurance and administered by Paid Prescriptions. This change has not altered the value we place on servicing your prescription needs and we would like to continue doing so.

Although we have met and expressed our concerns to the people responsible for your health care, no change was made. This necessitates a change in the procedures for billing. Our Rite Aid pharmacist will complete a billing form for you to obtain reimbursement. Upon mailing the billing form to your union office (Emphasis in original), you will be reimbursed for your expenses.

¹⁵⁸ CX's 11Z-26, Z-27, 488G, 725D, 2063Z-86, Z-87, 2203Z-121, 2206Z-15, Z-125, 2247"O", 2250Z-22, 2297R.

¹⁵⁹ Feinberg 416-17; CX's 2258Z-84, Z-85, Z-102, Z-103, 2259 Z-55, Z-56, Z-91, Z-127-Z-129, 2260Z-19, Z-20, 2262Z-146, Z-147, 2267Z-114, Z-115; RX 259Z-28. In addition to the alleged conspirators, departicipation letters were submitted by Wegmans and several other chains. CX's 2097, 2255Z-87. Wegmans discussed participation and departicipation with Fay's (CX's 2092A, 2255Z-63-Z-65, Z-72, Z-73) but the plans of this chain were not forwarded to Krahulec since Wegman's "is not a member of the group." CX 20Z-227. *See also* CX 2255K.

¹⁶⁰ CX 2203Z-121.

Governor Mario M. Cuomo may be contacted at State Capitol, Albany, NY 12247 (518) 455-2800; and, Thomas F. Hartnett, Director, Governors Office of Employee Relations, State of New York, Agency Building #2, Albany, NY 12223, (518) 474-6988.

We agree this is cumbersome. Please let your officials know you want this changed. If assistance is required, please do not hesitate to let us know.¹⁶¹

75. The common adoption of the "Dear Valued Customer" letter is convincing proof that the alleged conspirators have reached a cozy understanding about nonparticipation for otherwise its use makes no economic sense whatsoever. (Rosenberg's assumption that the other chains would be using the "Dear Valued Customer" letters simply because they would not want to turn customers away,¹⁶² is but a small part of the story.) By the terms of PAID I, if a NYSEPP member had a prescription filled at a participating pharmacy, the consumer merely paid a small co-pay fee. If, however, the same prescription were to be filled at a nonparticipating pharmacy, the member would have to pay up front the store's regular retail price, and eventually would only be reimbursed for the amount that the pharmacy would have received had it participated -- that is, the wholesale price as appropriately reduced from AWP under the PAID I formula.¹⁶³ It was so unlikely that NYSEPP members would have accepted such a disparity in the cost of their drugs that CVS, Fay's, and Rite Aid recognized that they would have lost business if they adopted such a device while their competitors participated in PAID I.¹⁶⁴ As for respondent's contention that the consumer advice contained in the "Dear Valued Customer" letter was readily available in the state's own consumer information pamphlet, this, too, is way off the mark. The "Dear Valued Customer" letter was a devious marketing strategy which promised NYSEPP members "you will be reimbursed for your expenses" but artfully concealed the unfavorable terms of that reimbursement. The New York pamphlet, on the other hand, correctly informed these consumers that if they used any nonparticipating pharmacy they

¹⁶¹ CX 816B.

¹⁶² CX's 16Z-101, Z-102.

¹⁶³ Kavanaugh 631-33; CX 681A; RX 295C.

¹⁶⁴ CX's 23Z-88, 24Z-79, 2187Z-3, Z-4, 2189Z-72, 2203Z-143, Z-144.

would receive the reimbursement amount due to the pharmacy had the pharmacy been a participant. It was for this reason that the state's pamphlet concluded, "This procedure means that when you have a choice, you should use a participating pharmacy"¹⁶⁵, hardly the advice contained in the "Dear Valued Customer" gimmick of the nonparticipating alleged conspirators. Rosenberg, of course, knew that a NYSEPP member who filled a prescription at a nonparticipating Peterson store would only be reimbursed in part, but his version of the "Dear Valued Customer" letter makes no such disclosure.¹⁶⁶ Furthermore, since Peterson's prescription volume was not growing, and competition had already forced price reductions,¹⁶⁷ it is implausible that Rosenberg would have adopted the "Dear Valued Customer" scheme unless he was certain that Peterson would not be confronted by the threat of even more serious price competition in the form of participating drugstores offering to fill NYSEPP prescriptions at no cost except for the small co-pay fee.¹⁶⁸ What's more, the "theory" behind the "Dear Valued Customer" device was that the NYSEPP members who were forced to seek reimbursement on their own would be so inconvenienced -- to say nothing of their out-of-pocket losses -- that they would complain to the state and demand a change in the program.¹⁶⁹ Again, it is inconceivable that the alleged conspirators would risk incurring the ire (and possible irreparable loss) of these valuable prescription customers unless they were certain that no competitors would be offering the hassle-free,

¹⁶⁵ CX 2245Z-198.

¹⁶⁶ Compare Rosenberg 1898 with CX 727B.

¹⁶⁷ CX's 2070Z-35,Z-54. *See also* Rosenberg 1710, 1742-43 for respondent's acknowledgment that its prescription prices must be in the ballpark in order to retain even its loyal customers.

¹⁶⁸ There is no evidence in the record that when the "Dear Valued Customer" letters were adopted that the alleged conspirators knew or could have anticipated that once the program started the state would relent and for the first month or two hold their employees harmless by reimbursing them for the full amount spent even though they used a nonparticipating pharmacy. *See* Kavanaugh 632 and CX's 2249Z-139-Z-142.

¹⁶⁹ Kelley 1635-36. *See also* Hartnett 937; CX's 5Z-75, Z-76.

and largely cost-free drugs that would have been available from PAID I participants.

76. On or about June 12, 1986, Krahulec sent Rosenberg a copy of the "Dear Valued Customer" letter, and later that month they had a telephone conversation about how it was supposed to work.¹⁷⁰ In anticipation of its use on July 1, Rite Aid itself put the "Dear Valued Customer" device in place in its own stores on June 19.¹⁷¹ On June 24, Rosenberg dispatched to the Peterson stores a "Dear Valued Customer" letter modeled after Krahulec's prototype. In a memorandum accompanying the letter, Rosenberg instructed the Peterson stores, first, to collect the regular cash price from the NYSEPP members, and then to tell these customers that they should seek reimbursement from PAID. Consistent with the evidence that the "Dear Valued Customer" device would not have been adopted unless there was an understanding that a solid front of nonparticipation had been put together (Finding 75), Rosenberg reassured his drugstores that they would not be alone. He wrote, "It is a cumbersome procedure, but is essentially what the major chains will be doing come July 1, 1986 if there is no signed contract." The same memorandum also observed that as of June 24, "Rite Aid, CVS, Fays, Carl's, Genovese, Pathmark, Wegman's, Kinney, and Peterson's have not signed up for the program."¹⁷²

77. On June 25, 1986, CVS informed its store that the chain would not be participating in PAID I and a customer letter was on the way.¹⁷³

¹⁷⁰ Rosenberg 1836, 1898-1901; CX's 16Z-99, Z-102, Z-103, 725L, 2070Z-75, Z-76, Z-96, Z-97, 2194Z-144-Z-147, Z-157, Z-158, 2204Z-36, Z-37.

¹⁷¹ CX 818. On the same day or the next, Kinney, Rite Aid, and Genovese held a conference call during which the question of participation in Paid I was discussed. CX 12Z-29-Z-31. During this conference call there was a discussion of how to bill customers if a drugstore did not participate. CX 488E.

¹⁷² CX 727A. *See also* Rosenberg 1835-36, 1897-1901, CX's 727B, 2070Z-75. The "Dear Valued Customer" letter was placed on the pharmacy counter of Peterson's Akron store for distribution to its customers (CX's 2265Z-3, Z-14); in addition, there is evidence that state employees were informed that Peterson would not accept the NYSEPP plastic card. CX 2265Z-19-Z-23, Z-33.

¹⁷³ CX's 122-124B.

78. On June 23, 1986, Kinney informed its drugstores not to accept PAID I cards on July 1. They were instructed to fill prescriptions of state employees for the usual cash amount only and then to give these NYSEPP members receipts "so they can collect from the carrier."¹⁷⁴ On June 26, Kinney further instructed its stores to use an attached "Dear Valued Customer" letter that was identical to the Rite Aid prototype.¹⁷⁵ On or about the same time, similar instructions were transmitted to Genovese, CVS, and Brooks stores.¹⁷⁶

79. With the July 1 starting date of PAID I just a few days off, Krahulec and Zimmerman added still another wrinkle to their campaign for a solid front of nonparticipation. CPA retained a law firm which prepared the following memorandum:

POINTS TO CONSIDER IN CONNECTION WITH
A POSSIBLE PHARMACY PROTEST OF OER PLAN

1. A short (lasting no more than a week) protest in which pharmacies individually and voluntarily decline to enroll in the OER plan as a means of expressing their disapproval of the plan.
2. The sole purpose of the protest to be to send a clear message to the Governor, the Legislature, and the public that the OER plan is unfair to pharmacies and therefore also unfair to state employees.
3. OK to discuss purpose and nature of protest with independent pharmacies' trade association and ask them to discuss it with their members; also OK, either through trade association or directly (by letter or phone call), to invite independent pharmacies to voluntarily and individually protest the OER plan (in the same or a different manner).
4. No pressure on any pharmacy to make the protest (or take any other action) and no retaliation against anyone who chooses not to protest.
5. OK to announce protest to customers; OK -- indeed desirable -- to explain why OER plan is unfair: dispensing fee too low, mail order not safe for patients, AWP minus percentage cuts too deep, etc.
6. Announcement should say that many stores and the CDANYS and independents have been meeting with OER and legislators, trying to see the Governor, held the Albany rally, etc., and that the protest is to underscore and emphasize the same issues as presented at those meetings, etc.

¹⁷⁴ CX 494.

¹⁷⁵ CX's 495A, B.

¹⁷⁶ CX's 122, 123, 124A, 1221, 1222, 2308, 2309, 2310. Carls' "Dear Valued Customer" letter is dated July 1 (CX 2273) but the date of its preparation and transmittal to the drugstores is not clear. *See, e.g.*, CX 2206Z-132.

7. Protest should be widely publicized, for example with a press release which calls on Governor and Legislature not to allow pharmacies to be treated so unfairly.
8. OK to state in press release that, given the onerous terms of the OER plan, many pharmacies declined to participate in the plan quite apart from the protest, and presumably would not participate in the plan even after the protest ended.
9. Announcement and press release should emphasize that pharmacies acted individually and voluntarily to protest OER plan.¹⁷⁷

80. CPA's law firm sent the memo to Krahulec on June 26 with the notation, "Feel free to circulate this letter and attachment to anyone you wish."¹⁷⁸ Every member of CPA eventually was sent a copy, and Krahulec admitted that prior to July 1, he discussed the memorandum with several CPA members.¹⁷⁹ The lawyer who wrote the memo was prepared to repeat its message of a nonparticipation "protest" at a June 27 Lake Placid convention¹⁸⁰ attended by Rosenberg and the other alleged conspirators.¹⁸¹

81. While the lawyer's memo speaks of individual and voluntary action, the actual use to which it was put was just the opposite.

¹⁷⁷ CX's 2204Z-232, Z-233 [Emphasis in original]; see also CX's 20Z-136, 21J-L, Z-37, Z-38, 2204Z-64, Z-65, Z-231, 2263M, Z-23 for Krahulec's role in the preparation of the lawyer's memo. Krahulec, an attorney and pharmacist (CX 20"I"), gingerly avoided the use of the word "boycott" while probing in this "sensitive" area. CX's 20Z-135, Z-136. The reference to "CDANYS" (presumably Chain Drugstores Association of New York State) probably should have read "CPA" for Chain Pharmacy Association. The confusion undoubtedly traces to the law firm's long-standing representation of the National Association of Chain Drugstores (NACDS) and its only recent retention by CPA. See CX 2263L

¹⁷⁸ CX 2204Z-230.

¹⁷⁹ CX's 21Q, Z-95, Z-96, 2204Z-42, Z-70, Z-230. Rosenberg's claim that he never received the document (CX's 16Z-108, Z-109) was not reconciled with his admission that he was on the CPA mailing list and regularly received all CPA mailings. Rosenberg 1749; CX's 16Z-12, Z-13, Z-124, Z-125.

¹⁸⁰ CX's 21Z-37, Z-38. The Lake Placid meeting was the annual convention of PSSNY whose support in the form of a state-wide "stoppage" by the independents was being sought by Zimmerman and Krahulec. CX's 20Z-263, 21Z-6, Z-1, Z-22, Z-23, 2154B, 2204Z-96, 2244Z-49, Z-242, Z-257, 2246Z-146-Z-149, Z-155.

¹⁸¹ CX's 2070Z-79, 2263Z-5-Z-29, Z-52. By the time the lawyer repeated his message on June 27, PAID I had been withdrawn. Feinberg 435-37.

Krahulec forwarded the memo to Adams Drugs (parent of Brooks) on June 26 with a covering letter in which he reported that the chains were indicating their displeasure with PAID I by refusing to sign up for the plan. Krahulec then told Brooks that "the pharmacists' remedy is to refuse to take the contract."¹⁸²

F. *The State Capitulates*

82. With the departicipation of the early enrollees, with those still participating intimating that their commitment was "soft," and without the major chains on board as a leverage for encouraging participation by their competitors, New York caved in on June 26 and abandoned PAID I.¹⁸³ PAID II, the successor plan, set the reimbursement rate at full AWP for independents and AWP minus 5% for chains.¹⁸⁴ After some initial uncertainty, and after first checking with each other about their plans, all the major chains finally accepted PAID II by July 4.¹⁸⁵

¹⁸² CX's 20Z-317-Z-324; *see also* CX's 20Z-269-Z-271, 2204Z-69.

¹⁸³ Feinberg 410-26, 429, 451-52, 468-69. Kavanaugh 618, 630-31, Hartnett 828, 847-49, 929-32, 980-81; CX's 1685G-"I", 2261Z-43, 2262Z-180, Z-181; RX's 254Z-92, Z-117, Z-118. To succeed, PAID I did not need all of the some 4,000 New York pharmacies. The crucial consideration was the availability of pharmacies in areas where state employees were concentrated. Kavanaugh 617. In addition to its own reports of departicipation and the rumors of a less than steadfast commitment by those still enrolled, the state received letters from NYSEPP members forwarding reports of impending departicipation. CX's 1684, 1692B, 1695B, C, 17008, D, 1703B, 1802B, 1803G, 2055B-E; RX's 254Z-68, Z-69, Z-96, Z-97. *See also* Hartnett 982.

¹⁸⁴ Feinberg 431-32, 456; CX 1675A; RX 117A.

¹⁸⁵ CX's 2066Z-42, 2247Z-48, 2270A-D; RX-312A. As could be expected, first in line for PAID II were the independents since they ended up with full AWP. Rosenberg 1845; CX's 16Z-119, Z-121, 2070Z-83, Z-84, 2257Z-128. Once the independents (and firms like Peterson classified as a series of independents under NYSEPP) accepted PAID II (*see* Rosenberg 1845; CX 16Z-119), the chains fell into line (CX's 16Z-121-Z-123, 19Z-172, 24Z-85-Z-87, 2070Z-82-Z-84, 2201Z-61, 2253Z-27, Z-28, 2254Z-89, Z-90), although several (Brooks, CVS, Duane Reed, Fay's, Genovese, Kinney, Carls, and Rite Aid) had contemplated a legal challenge to the two-tier reimbursement schedule retained in PAID II. CX 181A.

83. The cost to the state of the retreat from PAID I has been estimated at approximately \$7 million.¹⁸⁶

G. The Reasonableness Of PAID I

84. Both sides made extravagant claims about the inherent reasonableness or unreasonableness of the PAID I rates of reimbursement. To respondent, it was "a rotten plan."¹⁸⁷ In complaint counsel's view, since PAID I was at least as profitable or even more profitable than other plans that had been accepted (however reluctantly) by respondent and the other alleged conspirators, its rejection is overwhelming proof of concerted action taken contrary to individual self-interest. There is warrant in the record for several factual findings which may lie between the positions of both advocates. (Findings 85 to 88.)

85. New York State was not alone in advancing the notion of reductions from AWP as a cost-containment policy but relatively few third party plans had broken away from the full AWP formula.¹⁸⁸ Those plans which had used reductions from AWP had experienced no dearth of providers. To illustrate, Rite Aid, Fay's, Carls, Genovese, Kinney, and CVS had participated in the BCWNY-administered NYSEPP (*i.e.*, the pre-PAID I program) at a rate of reimbursement that was the same as PAID I.¹⁸⁹ As for Peterson, it eventually accepted a BCWNY-NYSEPP rate that was comparable to the rate it would have received under PAID I.¹⁹⁰

86. Theoretically, a pharmacy firm may go through the exercise of weighing various considerations in evaluating third party plans such as the importance of the plan in a particular locality and its contribution to over-all profits.¹⁹¹ As far as this record will allow,

¹⁸⁶ Feinberg 456-58; CX 1675A.

¹⁸⁷ CX 16Z-80.

¹⁸⁸ Hartnett 914, Painter 1427-28; CX's 732A, 1633C, 1760D, 2262Z-198; RX 107G.

¹⁸⁹ Kavanaugh 696; CX 70C.

¹⁹⁰ See Findings 29, 71.

¹⁹¹ See Rosenberg 1741-42; CX's 6Z-6, Z-24, 2251Z-18, 2252Z-2, Z-9, Z-10, 2254Z-15.

however, none of the alleged conspirators made such a detailed evaluation of PAID I.¹⁹² The absence of these studies may be explained by the universal availability of discounts off AWP (*See* Finding 15) and the facts recited in Findings 42 to 52, which establish that such review is largely unnecessary because of the importance attached to third party plans and the correlation between front-end and back-end business. These considerations mean that even low profit plans are usually accepted, and almost irrespective of profit no firm can afford to stay out of any third party plan if its competitors participate.

87. Any claim that PAID I was destined to fail from the start flies in the face of what actually happened. The plan got off to a good start when Kinney, Carls, Fay's, Peterson's Akron store and many others agreed to participate.¹⁹³

88. Complaint counsel put on an elaborate demonstration of the profitability of the PAID I plan as compared to other third party plans in which Peterson, Brooks, Carls, CVS, Fay's, Genovese, Kinney, and Rite Aid had participated. Fairly summarized, this evidence shows that the alleged conspirators participated in few reduced-rate third party plans, but that each had enrolled in at least one (including NYSEPP as administered by BCWNY) that resulted in gross margin percentages (gross margin divided by total reimbursement) equal to or less than those projected under PAID I.¹⁹⁴ More germane to this case is the uncontroverted proof that drugstores ordinarily do not reject third party plans irrespective of the modest profit levels involved, and that if their competitors had participated, Peterson and

¹⁹² Rosenberg 1812; CX's 5Z-50, 6Z-25, Z-106, 7Z-41, 13Z-1, Z-2, Z-37, 16X, 19Z-39, Z-40, 2070Z-18, Z-52, Z-53, 2189Z-136, 2206Z-118, Z-119, 2207Z-18, Z-19, 2254Z-25. Note, however, that CVS had reached the general conclusion that PAID I would have been profitable (CX 6Z-37), Genovese had no basis for believing it would not be (CX's 2249Z-34, Z-35), and Rite Aid assumed that participation in plans paying AWP minus 12% had been profitable (CX 23Z-19).

¹⁹³ *See* Findings 35-40.

¹⁹⁴ Painter 1089, 1093-1100, 1163, 1300, 1347, 1352-53, 1384-85, 1397-98, 1412-16, 1423-31; CX's 2317A-2319, 2321, 2323A-2327, 2331, 2334-2336. The gross margin of a third party plan is total reimbursement received (sum of the ingredient reimbursement plus dispensing fee) less the cost of the drugs dispensed. Painter 1096.

the other alleged conspirators definitely would have participated, notwithstanding their obvious preference for higher rather than lower profit margins.¹⁹⁵

H. Noerr-Pennington

89. Throughout the period 1985 to mid-1986, the alleged conspirators and other pharmacists were engaged in a vigorous campaign of lobbying to defeat the state's cost-containment initiative as embodied in PAID I. These lobbying activities reach a crescendo at the "Pharmacy Day" rally in Albany on June 10, 1986. And both before and after "Pharmacy Day" there were meetings with state legislators, petitions to the Governor, and the development of a favorable press image for the pharmacists' cause.¹⁹⁶ While the lobbying was successful in generating political pressure,¹⁹⁷ there is no credible evidence that this is what caused the state to cave in on PAID I. All the persuasive evidence is to the contrary. OER and the other NYSEPP administrators anticipated that the pharmacists would marshal support in Albany. But there were countervailing pressures to be considered -- for state officials knew that every increase in payments to the prescription plan must of necessity mean that funds were taken from some other program, which in turn would produce its own political heat. The highest-ranking state official directly involved with NYSEPP testified unequivocally that PAID I was not withdrawn in reaction to the pharmacists' political clout, but rather because state officials believed that they were the victims of a

¹⁹⁵ See Findings 42-51.

¹⁹⁶ Rosenberg 1787-91; CX's 2Z-125, Z-141, Z-142, Z-155, 16Z-55, Z-56, Z-60, Z-61; RX's 149A-C, 165-171A, 185A-187A. Any post-hearing claim that Rite Aid's "Dear Valued Customer" contrivance described in Findings 59, 73-78 was part of this lobbying effort would be contrary to the record. Rosenberg testified: "I didn't send the letter out thinking of it as a lobbying effort." Rosenberg 1897.

¹⁹⁷ Feinberg 433-34, 553, Kavanaugh 625, Hartnett 943-51; RX's 133E, F, 134E-G, 309F-"I".

pharmacy boycott, and irrespective of their beliefs, in fact there were an insufficient number of drugstores on line by July 1.¹⁹⁸

III. DISCUSSION

A major and rapidly escalating expense facing New York State is the cost of the prescription drug component of its employee-retiree health insurance plan. In order to meet this problem, the state, in conjunction with its health plan insurer (Equitable Life Assurance) and the plan's administrator (PAID Prescription, Inc.), announces that as of July 1, 1986, pharmacies will be reimbursed for prescription ingredients at a rate representing a sharp reduction from what the state plan has paid in the past. Since it is well-known that pharmaceuticals are purchased by practically all drugstores at steep discounts from the published Average Wholesale Price (AWP), New York proposes in effect that a portion of the discount be transferred to the state in the form of a reimbursement rate for ingredients of AWP minus 12% for chains and AWP minus 2% to minus 8% (depending on the pharmacy's prescription volume) for independents. This is the so-called PAID I plan, which is at the heart of this case.

The state's proposal outrages the pharmacists who view the plan as an especially arbitrary attack on their profit margins. Led by CPA, their trade association, and Rite Aid, the largest chain in New York, the pharmacists organize an aggressive campaign to defeat PAID I. During the course of the campaign, and as the deadline for its implementation approaches, New York is suddenly confronted with a severe erosion in the number of pharmacies willing to participate in the plan. Because of this pressure, the state knuckles under to the pharmacists' demands, and retreats to PAID II, which eliminates most of the discounts off AWP as the basis for reimbursement. With the defeat of PAID I and the pharmacists' acceptance of PAID II, the prescription component of the New York's health insurance plan goes

¹⁹⁸ Hartnett 801-02, 807-11, 828, 830-31, 851-52, 897-98, 969, 978-80; *see also* Feinberg 415-17, 427-34, 452-54, 553-54. The cause of the state's retreat from PAID I -- an inadequate array of pharmacists -- was in accord with the expectations of Rosenberg who believed that the plan would be changed if not enough providers signed up. Rosenberg 1801; CX 16Z-80. *See also* CX 16Z-97, Z-98.

forward but with a substantially scaled-back cost-containment initiative.

The complaint herein raises the issue of whether there was an agreement or understanding among the pharmacies, including respondent Peterson, which amounted to a combination or conspiracy to boycott New York State in order to defeat PAID I.¹⁹⁹ In addressing this issue, one cannot be oblivious to the obvious: conspirators rarely put their agreements or understandings into writing, and at trial there is bound to be a denial that any explicit oral assurances were given. With these observations in mind, the issue here, as in most conspiracy cases, is whether an inference of an illegal agreement or understanding may fairly be drawn from the conduct of the alleged conspirators. *Norfolk Monument v. Woodlawn*, 394 U.S. 700, 703-04 (1969); *United States v. Paramount Pictures* 334 U.S. 131, 142 (1948); *American Tobacco Co. v. United States*, 328 U.S. 781, 809-10 (1946).

An examination of the context of the state-pharmacists conflict shows that with the announcement of PAID I substantial uncertainties arose for both buyer and sellers. On the buyer's side of this market confrontation, New York State was facing the prospect that with the arrival of July 1, it would have to cope with a serious personnel problem if an insufficient number of pharmacies were not in place to service the non-deferrable prescription needs of its employees and retirees. As it happens, the state could have reasonably anticipated that the interdependence of the pharmacists' decision-making would have lead to an adequate array of pharmacies once several chains had dedicated their acceptance of PAID I soon after the plan was announced. Or to put it somewhat differently, the perceived need of drugstores to participate in third party plans in order to advance or

¹⁹⁹ The complaint charges that the alleged combination or conspiracy constitutes an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act. 15 U.S.C. 45(a)(1) (1988). Unfair methods of competition within the meaning of Section 5 have been held to include the combinations and conspiracies which are among the restraints of trade that violate Section 1 of the Sherman Act. *FTC v. Cement Institute*, 333 U.S. 683, 694 (1948). At no point in this proceeding have complaint counsel contended that an allegation of combination or conspiracy brought under a Section 5 complaint is different from an identical Sherman 1 civil charge.

protect their own economic self-interest would ordinarily have given the state enough participants to get the plan off the ground. From the pharmacists' perspective, there was apprehension that the pressure on the state of the July 1 deadline would be dissipated if they did not maintain a solid front of nonparticipation. There is no dispute that given the well-established pattern followed by consumers in having their prescriptions filled (*i.e.*, consumers tend to return to the same pharmacy for all their drugs, and usually purchase their nonprescription items at the same drugstore where their prescriptions are being filled), Peterson and the other alleged conspirators knew that if their major competitors participated, and New York went forward with the plan, it would have been perilous for any firm to have stayed out of PAID I for fear of permanent loss of not only the substantial NYSEPP business itself, but perhaps even more important, the loss of the lucrative "front-end" (*i.e.*, nonprescription) patronage of some 500,000 consumers. Finally, the pharmacists were concerned that the survival of PAID I might serve as a precedent for any future attempts to reduce prescription reimbursement rates in other state-sponsored health plans.

The antitrust laws are neutral on the merits of these conflicting tensions, and there is no bar to a vigorous campaign aimed at stopping PAID I that took the form of petitioning or lobbying. But neither the Sherman Act nor the Federal Trade Commission Act will tolerate a resolution of this kind of market confrontation by the contrivance of an agreement or understanding to withhold services. I infer just such an agreement or understanding aimed at PAID I from the following:

1. Zimmerman of CPA, Krahulec of Rite Aid, and the other conspirators, including Peterson, knew that if PAID I were to be defeated, the pharmacists had to keep the pressure on the state of the July 1 starting date. This could only be done if a solid front of nonparticipation was maintained. The conspirators were well aware, as explained earlier, that should this objective not be achieved before July 1, the defeat of PAID I would be unlikely since (a) no drugstore (chain or independent) could afford to stay out of the plan if its competitors participated, and (b) in the independent pursuit of their own self-interest, pharmacies tend toward participation in third party

plans, even so-called low-reimbursement third party plans which may adversely affect their prescription profits.

2. Zimmerman and Krahulec conveyed to the conspirators the message that a solid front of nonparticipation prior to July 1 must be achieved in order to defeat PAID I. The contents, the settings, and the instruments used for this communication -- *i.e.*, during a June 10 meeting of the CPA membership, in the proffer of a "Dear Valued Customer" letter, by widely circulated memoranda discussing nonparticipation, and through a lawyer's paper calling for a short "protest" in the form of nonparticipation -- signaled that common action was contemplated and was being solicited.

3. The Zimmerman-Krahulec invitation for nonparticipation before July 1 was acknowledged and tacitly accepted when the conspirators, including Peterson, adopted the "Dear Valued Customer" letter, a tricky and cumbersome billing stratagem designed to retain state employee business while not participating in PAID I. Minimally, each request for the letter effectively told Rite Aid that it had an assurance that the inquiring firm would not join PAID I, or if it had already signed up that it would take steps to departicipate. As the depository of these assurances, Rite Aid could then convey to any chain reliable information about the intent of its competitors, an important consideration in a market characterized by interdependent decision-making. In addition, once Rite Aid received requests for the "Dear Valued Customer" letter, this meant that the state's largest chain was itself assured that it need not sign up for PAID I in order to protect its own substantial interest in public employee business.

4. The main objective of the conspirators was a short-term combination that would hold together until July 1 and thereby not unduly test the underlying distrust the pharmacists may have harbored against each other. But the "Dear Valued Customer" letter also constituted the conspirators' alternative strategy for maintaining the pressure should New York decide to go forward with PAID I after July 1. Since this gimmick would not have worked in markets where there were participating pharmacists, its common adoption clearly contemplated that direct competitors would not be participating while they jointly used a slippery promise of full reimbursement in an effort to retain the patronage of state workers.

5. That the solicitations from Zimmerman and Krahulec were accepted and thereafter were effective in putting a boycott in place is further shown by the sudden and unprecedented withdrawal of several conspirators -- again including Peterson -- from PAID I after first indicating in one form or another that they would participate. These withdrawals came after Zimmerman exhorted the CPA members not to participate, after Krahulec extolled the virtues of his "Dear Valued Customer" letter, and after the conspirators left Albany on June 10 with the impression that a combined front of nonparticipation had been put together.

The pattern of conduct described above comes within the "invitation-acceptance" rubric of *Interstate Circuit v. United States*, 306 U.S. 208 (1939). Interstate, a first-run film exhibitor, demanded on pain of nonrenewal of license agreements that film distributors set a minimum evening admission charge of twenty-five cents for first-run film exhibitors and prohibit outright the subsequent showing of the same films as part of a double feature. Interstate's threat was contained in copies of a single letter that named all eight distributors as addressees. There was no evidence of any direct agreement among the distributors. In due course, however, each distributor acceded to Interstate's demands in several key localities. On these facts, the Supreme Court concluded:

It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it. Each distributor was advised that the others were asked to participate; each knew that cooperation was essential to successful operation of the plan. They knew that the plan, if carried out, would result in a restraint of commerce . . . and knowing it, all participated in the plan.²⁰⁰

On the way to this conclusion, the Supreme Court stressed several factors: (1) an invitation for joint action which created a mutual awareness of the plan; (2) parallel acceptance; (3) deviation from previous business practice; and (4) the interdependence of the decisions. On the last point the Court said:

²⁰⁰ 306 U.S. 208 at 226-27.

Each was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions for any given territory there was risk of a substantial loss of the business and good will of the subsequent-run and independent exhibitors, but that with it there was the prospect of increased profits. There was, therefore, strong motive for concerted action. There was risk, too, that without agreement diversity of action would follow.²⁰¹

The Interstate rationale was followed in *United States v. Foley*, 598 F.2d 1323 (4th Cir. 1979), *cert denied*, 444 U.S. 1043 (1980), where an inference of conspiracy was allowed on facts similar to the instant case. Foley, a Washington area real estate broker, invited his competitors to dinner and announced that he did not care what his guests were going to do, he was about to raise his commission rate from 6% to 7%. Testimony as to what followed the host's announcement was in conflict but apparently there was a general discussion of the subject, some firms may have expressly indicated their agreement with Foley, while others at least gave that impression. After the dinner, the 7% rate began to appear, and those who stayed at 6% were reminded that no firm could maintain the 7% rate unless all held the line. Citing to the Interstate principle of invitation and acceptance, the Fourth Circuit found on these facts "ample evidence to permit the finding of a conspiracy." *Id.* at 1331.

Each element of Interstate as expounded in *Foley* is present in this case: invitations from Zimmerman and Krahulec, acceptance by the alleged conspirators, deviation from past business behavior, and a context in which no firm would have made a decision not to participate unless it was convinced that its competitors would do the same.

It is of no moment that Peterson may not have participated from the outset in all phases of this conspiracy. *American Medical Assoc. et al.*, 94 FTC 701, 1000 n.38, *aff'd*, 638 F.2d 443 (2d Cir. 1980), *aff'd by an equally divided Court*, 455 U.S. 676 (1982). While the record indicates that the opening gambits -- the notion of sending out an invitation to form a solid front of nonparticipation prior to and after July 1 -- originated with Zimmerman of CPA and Krahulec of Rite Aid, and that these two carried the brunt of the work, Peterson was no innocent bystander patiently waiting in the wings for the

²⁰¹ *Id.* at 222.

larger chains to take action. Rosenberg of Peterson sought out Krahulec, and in effect acknowledged his acceptance of an Interstate invitation to boycott by (1) asking for the "Dear Valued Customer" letter, Krahulec's method for retaining state employee business while simultaneously putting into place a boycott of New York's PAID I plan, and (2) canceling the already-filed participation notice of his Akron store.

Notwithstanding the continued viability of Interstate and its progeny, it is axiomatic that cases involving the invitation/acceptance concept must now pass muster under *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574 (1986).²⁰² What the court said in *Matsushita* is that the permissible range of inferences from ambiguous evidence (especially if the motive to conspire is questionable) is limited by two considerations: "conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of conspiracy" and there must be evidence "that tends to exclude the possibility that the alleged conspirators acted independently." *Id.*, at 588. While this language may bring a summary dismissal to a conspiracy case grounded solely on uniform or even parallel conduct, it does not mean that an inference of conspiracy is no longer proper merely because a respondent is able to concoct some far-fetched scenario of independent action. Again in the language of *Matsushita*, the issue is whether "the inference of conspiracy is reasonable in light of competing inferences." *Ibid.* As respondent would have it, this "competing inference" derives from the proposition that since nothing was to be gained from an early decision to participate in PAID I, Peterson in its own self-interest did no more than take the rational independent course of awaiting the outcome of the legitimate lobbying campaign which was under way. This argument nicely overlooks several points. To begin with, plenty was to be gained by a joint decision prior to July 1 not to participate. In this respect, unlike *Matsushita*, there is no question here of motive to conspire; "motive" simply being another way of saying that before an agreement can be inferred, it must be demonstrated that joint activity

²⁰² *Wilk v. American Medical Ass'n* (Wilk II), 895 F. 2d 352, 312 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 513 (1990).

would be economically effective for otherwise there would be no point in putting together a combination. All the conspirators, including respondent, wanted to defeat the state's cost-cutting and competition-inducing initiative embodied in PAID I, and there can be no real dispute that the most effective way of doing so would be for the pharmacies to cancel already filed notices of participation or to withhold new notices of participation before July 1, and thereby force the state to increase the reimbursement rate. In contrast, the conspiratorial conduct alleged in *Matsushita* -- an agreement to maintain high prices in Japan in order to subsidize predatory low prices in the United States -- was not only lacking the essential ingredient of motive (*i.e.*, because of the speculation surrounding the effectiveness of predatory pricing), but the Supreme Court was also apprehensive about the anticompetitive side effects of an alleged conspiracy based mainly on evidence of rebates and price-cutting.

Second, Peterson did not sit idly by waiting for July 1. It took the unusual step of canceling a previously filed notice of participation after receiving the Zimmerman/Krahulec invitations to joint action and then indicating Peterson's acceptance by requesting the "Dear Valued Customer" letter. Moreover, this conduct occurred in a setting in which it was not in Peterson's self-interest to departicipate or not sign up additional stores unless it was convinced that its competitors would do the same.

Third, the "Dear Valued Customer" letter was not only a mechanism for signaling that a solid front of nonparticipation had been put together prior to July 1, but its common adoption contemplated that the conspiracy would continue as nonparticipating competitors put into place this device for use after July 1 as a way of keeping the prescription business of state workers.

Fourth, on the facts of this record it is implausible that a bloc of pharmacists would have departicipated or not participated in the absence of a tacit agreement. The well-established pattern in the industry is that drug stores usually sign up for third party plans and even if a particular pharmacy may disapprove of a discounted reimbursement formula it cannot allow participating competitors to garner crucial front-end business. In sharp contrast to this norm, New York State was suddenly confronted with the unexpected -- pharmacies did not sign up and those that had, departicipated after an

association meeting. This highly suspicious conduct, in the context of an intensely interdependent market and the existence of a strong motive to conspire, at least puts one on the alert for any combination-facilitating contrivances. In point of fact, no elaborate mechanism was required: all that was needed was an exchange of signals respecting nonparticipation as the way to maintain the pressure of the July 1 starting date. These signals were provided by the Zimmerman exhortation to joint action and by Krahulec's hawking of the "Dear Valued Customer" letter. That these signals fulfilled their intended roles is shown by the unprecedented withdrawals from PAID I and the contemporaneous accounts of the June 10 meeting which reveal that the conspirators left Albany with the belief that their competitors would not be participating. It is this sequence of events which places the conduct of the pharmacists squarely back within the four corners of Interstate.

In sum, Matsushita does not say that an inference of conspiracy, reasonably drawn from the record facts, is somehow held in suspense while an endless search proceeds for a rational non-conspiratorial business explanation. Nor does Matsushita require that such an inference yield to strained arguments about the plausibility of possible independent decision making.²⁰³ As it happens, both sides to this litigation vastly overloaded the record by their interpretation of Matsushita as inviting a sort of speculative gamesmanship as to what may or may not have happened in the absence of an agreement. Thus Peterson's alternative scenario -- essentially, a recitation of an incident, unchallenged in the complaint, of its delay in accepting another reduced-rate third party plan -- begs the question as to whether there was an implicit understanding directed at the early demise of PAID I. By the same token, since there is compelling evidence respecting Peterson's actual intent to participate in PAID I had its competitors done so, little was added to the record by the elaborate comparisons to other third party plans which so engaged complaint counsel.

²⁰³ See, e.g., *City of Long Beach v. Standard Oil Co. of California*, 872 F. 2d 1401, 1407 (9th Cir. 1989), amended, 866 F. 2d 246 (1989), *cert. denied*, 110 S. Ct. 1126 (1990).

As for respondent's argument that the other, legal activities engaged in by Peterson and the other conspirators somehow immunizes the illegal agreement, the Supreme Court has held that Noerr-Pennington protection applies only to petitioning, and this limited immunity is not transferrable to a commercial boycott notwithstanding the fact that both lawful lobbying and unlawful boycotting may have been directed at the same goal.²⁰⁴ In other words, an implicit agreement to withhold services in order to obtain an economic advantage does not become petitioning by reason of the fact that the agreement was consummated during a campaign which clearly included lobbying aspects. *FTC v. Superior Court Trial Lawyers Ass'n*, 110 S.Ct. 768, 776-78 (1990); *Allied Tube & Conduit Corp. v. Indian Head Inc.*, 486 U.S. 492, 503-04 (1988). *Superior Court Trial Lawyers Ass'n* is particularly germane given the similarity in the legal tactics (lobbying, demonstrations, and publicity) used by both pharmacists and the lawyers for the indigent as part of their public campaigns to put pressure on the government.²⁰⁵ But just as the lawyer's explicit agreement to boycott was isolated from these protected activities and quickly disposed of by the Supreme Court, I see no reason for reaching a different result here merely because the pharmacists' agreement to boycott happens to be implicit yet properly inferred from the record. In the same vein, an illegal boycott does not become legal lobbying by the simple expedient of saying that the lobbying would not have been credible unless the conspirators found some way of putting together a solid front of nonparticipation. Under Noerr-Pennington, lobbying means petitioning in its various forms;

²⁰⁴ The doctrine is found in *Eastern R. Conf. v. Noerr Motors*, 365 U.S. 127 (1961) (a publicity campaign by railroads aimed at securing legislation harmful to the trucking industry did not violate the Sherman Act); and *United Mine Workers of America v. Pennington*, 381 U.S. 657 (1965) (lobbying campaign by the union and large coal operators intended to persuade the Secretary of Labor to establish wage rates that would impact adversely on small mines did not violate the Sherman Act). The constitutional basis of Noerr-Pennington, *i.e.*, the right of citizens to exercise free speech and inform the government, was affirmed in *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972).

²⁰⁵ See *Superior Court Trial Lawyers Assoc. et. al.*, 101 FTC 510, 534-543 (1984) (ALJ opinion).

it does not encompass an agreement to withhold services in order to make the petitioning effective.

Having found that there was an implicit agreement or understanding to boycott, there can be no issue of actual effects on price or the reasonableness of New York's PAID I proposal. An agreement to boycott is a naked restraint on price and output and thus constitutes a *per se* violation of the Sherman Act and the Federal Trade Commission Act. *FTC v. Superior Court Trial Lawyers Ass'n*, 110 S.Ct. 768, 774-75 (1990); *United States v. General Motors*, 384 U.S. 127, 145-48 (1966); *Klor's v. Broadway-Hale Stores*, 359 U.S. 207, 212 (1959).

Finally, the order herein goes beyond what the Commission has accepted in related consent decrees in that it prohibits respondent from soliciting any information from its competitors about their intentions respecting participation in third party plans. This is a permissible extension in a fully litigated case in which it has been demonstrated that such relief is appropriate fencing-in and reasonably related to the practices proven on the record. *FTC v. National Lead Co.*, 352 U.S. 419 (1957); *FTC v. Ruberoid Co.*, 343 U.S. 470 (1952); *Siegel Co. v. FTC*, 327 U.S. 608 (1946). What has not been demonstrated is the need for, or for that matter the feasibility of, the expansive order advocated by complaint counsel. As complaint counsel would have it, respondent would be prevented from attending meetings it "expects or reasonably could expect" might relate to some discussion about participation in third party plans. Going one step further, under complaint counsel's proposed order even if respondent could not have anticipated that any hanky-panky would come up at a meeting, it nevertheless would be liable if some competitor took to the floor and happened to discuss participation. The antitrust laws of the United States do not require that the prudent businessman, on pain of incurring civil penalties, read tea leaves, or keep his fingers crossed about what his competitors may say.

IV. CONCLUSIONS

1. The Federal Trade Commission has jurisdiction over the subject matter of this proceeding and over respondent Peterson.

2. The acts and practices charged in the complaint took place in commerce and affected commerce within the meaning of the Federal Trade Commission Act.

3. Respondent Peterson joined in and participated in a conspiracy to boycott New York State's Employee Prescription Program for the purpose of increasing the reimbursement paid to pharmacies under the program.

4. The conduct of respondent Peterson described above constitutes an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

Accordingly, the following order will be issued:

ORDER

I.

For purposes of the order, the following definitions shall apply:

A. "*Peterson*" means Peterson Drug Company of North Chili, New York, Inc., its directors, officers, agents, employees, divisions, subsidiaries, successors and assigns;

B. "*Third party payer*" means any person or entity that provides a program or plan pursuant to which such a person or entity agrees to pay for prescriptions dispensed by pharmacies to individuals described in such plan or program as eligible for such coverage ("covered persons"), and includes, but is not limited to, health insurance companies; prepaid hospital, medical, or other health service plans, such as Blue Cross and Blue Shield plans; health maintenance organizations; preferred provider organizations; prescription service administrative organizations; and health benefit programs for government employees, retirees or dependents;

C. "*Participation agreement*" means any existing or proposed agreement, oral or written, in which a third-party payer agrees to reimburse a pharmacy for the dispensing of prescription drugs to covered persons, and the pharmacy agrees to accept such payment from the third-party payer for such prescriptions dispensed during the term of the agreement;

D. "*Pharmacy firm*" means any partnership, sole proprietorship or corporation, including all of its subsidiaries, affiliates, divisions and joint ventures, that owns, controls or operates one or more pharmacies, including the directors, officers, employees, and agents of such partnership, sole proprietorship or corporation as well as the directors, officers, employees, and agents of such partnership's, sole proprietorship's or corporation's subsidiaries, affiliates, divisions and joint ventures, but excludes any partnership, sole proprietorship or corporation, including all of its subsidiaries, affiliates, divisions and joint ventures, which own, are owned by, control or are under common control with Peterson. The words "subsidiary," "affiliate," and "joint venture" refer to any firm in which there is partial (10% or more) or total ownership or control between corporations.

II.

It is ordered, That Peterson, directly, indirectly or through any corporate or other device, in or in connection with its activities in or affecting commerce, as "commerce" is defined in Section 4 of the Federal Trade Commission Act, shall forthwith cease and desist from:

A. Agreeing or combining, attempting to agree or combine, or taking any action in furtherance of any agreement or combination, advocating an agreement, or organizing or cooperating with any pharmacy firm(s) to (1) boycott, refuse to enter into, withdraw from, or not participate in, any participation agreement or (2) threaten to boycott, threaten to refuse to enter into, threaten to withdraw from, or threaten not to participate in, any participation agreement;

B. For a period of ten (10) years after the date this order becomes final, stating or communicating in any way to any pharmacy firm the intention or decision of Peterson with respect to entering into, refusing to enter into, threatening to refuse to enter into, participating in, threatening to withdraw from, or withdrawing from any existing or proposed participation agreement into which Peterson and the other pharmacy firm have entered, could enter or are considering entering;

C. For a period of eight (8) years after the date this order becomes final, advising any pharmacy firm with respect to entering into,

refusing to enter into, participating in, or withdrawing from any existing or proposed participation agreement into which Peterson and the other pharmacy firm have entered, could enter or are considering entering;

D. For a period of ten (10) years after the date this order becomes final, communicating in any way to or soliciting from any pharmacy firm any information concerning any pharmacy firm's intention or decision with respect to entering into, threatening to refuse to enter into, refusing to enter into, participating in, threatening to withdraw from, or withdrawing from any existing or proposed participation agreement.

Provided that, nothing in this order shall prevent Peterson from:

(1) Exercising rights permitted under the First Amendment to the United States Constitution to petition any federal or state government executive agency or legislative body concerning legislation, rules or procedures, or to participate in any federal or state administrative or judicial proceeding;

(2) Subcontracting, preparing joint bids, or otherwise jointly undertaking with pharmacy firms to provide prescription drug services under a participation agreement if requested to do so in writing by the third party payer;

(3) Communicating to the public truthful, nondeceptive statements concerning any existing or proposed participation agreement.

III.

It is further ordered, That Peterson:

A. Provide a copy of this order within thirty (30) days after the date of this order becomes final to each officer, director, employee pharmacist, and each employee whose responsibilities include recommending or deciding whether to enter into any participation agreement, and each employee who regularly attends meetings on Peterson's behalf that include representatives of other pharmacies; and

B. For a period of five (5) years after the date this order becomes final, provide each new director and each employee who enters a

position described in paragraph A a copy of the order within ten (10) days of the date the employee or director assumes the new position.

IV.

It is further ordered, That Peterson:

A. File a verified, written report with the Commission within ninety (90) days after the date this order becomes final, and annually thereafter for five (5) years on the anniversary of the date this order becomes final, and at such other times as the Commission may, by written notice to Peterson require, setting forth in detail the manner and form in which it has complied and is complying with this order;

B. For a period of five (5) years after the date this order becomes final, maintain and make available to Commission staff for inspection and copying upon reasonable notice all documents generated by Peterson or that come into Peterson's possession, custody, or control regardless of source, that embody, discuss or refer to the decision or upon which Peterson relies in deciding whether to enter into any participation agreement in which Peterson participates, has participated, or has considered participating; and

C. Notify the Commission at least thirty (30) days prior to any proposed change in Peterson such as, assignment or sale resulting in the emergence of a successor corporation or association, change of name, change of address, dissolution, the creation, sale or dissolution of a subsidiary, or any other change that may affect compliance with this order.

ORDER GRANTING MOTION TO WITHDRAW APPEAL AND ADOPTING INITIAL DECISION

On June 7, 1991, respondent Peterson Drug Company of North Chili, New York, Inc. ("Peterson") filed a timely Notice of Intention to Appeal from the Initial Decision rendered in this matter by

Administrative Law Judge Morton Needleman.¹ Peterson thereafter sought, and was granted, an extension of time until August 6, 1991 to perfect its appeal by filing an appeal brief.

Rather than filing an appeal brief on the appointed day, Peterson filed a Motion to Withdraw Notice of Intention to Appeal. *Motion to Withdraw Notice of Intention to Appeal*, Dkt. No. 9227, ¶3 (Aug. 6, 1991). In its Motion, Peterson stated that, while "[n]othing in this motion . . . should be construed as an admission . . . to any portion of the Initial Decision," it consents to the entry of the order contained in the Initial Decision. The Motion notes as well that complaint counsel in this matter has been informed of Peterson's decision and does not oppose it.

Under Section 3.51(a) of the Commission's Rules of Practice, 16 CFR 3.51(a) (1991), the Initial Decision becomes the decision of the Commission 30 days after it is served on the parties, or 30 days after the filing of a timely notice of appeal, whichever is later, unless the appeal is perfected by the filing of an appeal brief.²

Because Peterson was granted an extension of time within which to perfect its appeal, more than 30 days have elapsed since the notice of intention to appeal was filed. Rule 3.51(a) does not expressly address this situation, and the Commission has therefore determined to clarify the date on which the Initial Decision becomes the decision of the Commission. The Commission has determined that Rule 3.51(a) should not apply retroactively under the circumstances which obtain here.³ Rather, the Commission has determined that the case

¹ The Commission's complaint in this matter, issued on April 19, 1989, named six corporations and one individual as respondents. During the subsequent course of the proceeding the other respondents entered into consent agreements, leaving Peterson as the only respondent subject to the Initial Decision.

² This result can also be forestalled if the Commission places the matter on its docket for review *sua sponte*, or issues an order which otherwise stays the effective date of the Initial Decision.

³ To accord Rule 3.51(a) retroactive effect in this matter would create the curious situation in which the Initial Decision would have become the decision of the Commission on July 8, 1991, although that result could not have been known until Peterson abandoned its appeal by filing its Motion on August 6. The task of determining when compliance obligations arose would be problematic, to say the least.

should not be placed in its own docket for review, and that the Initial Decision should become effective as the decision of the Commission upon service of this order to all concerned. The precedential significance of all or any part of this decision in future Commission proceedings will depend entirely on the persuasive weight the Commission determines that it should bear in such proceedings.⁴ Therefore,

It is ordered, That respondent's Motion to Withdraw Notice of Appeal be, and it hereby is, granted; and

It is further ordered, That the Initial Decision of the Administrative Law Judge in this matter, and the order therein, shall become the decision and order of the Commission effective upon completion of service of this order upon the parties.

⁴ Cf. *BASF Wyandotte Corp.*, 100 FTC 261, 430 (1982).

IN THE MATTER OF

SUN COMPANY, INC., ET AL.

CONSENT ORDER, ETC., IN REGARD TO ALLEGED VIOLATION OF
SEC. 5 OF THE FEDERAL TRADE COMMISSION ACT*Docket C-3381. Complaint, May 6, 1992--Decision, May 6, 1992*

This consent order prohibits, among other things, Sunoco from making any representation concerning the superiority of Ultra octane gasoline in providing engine power or acceleration for any automobile, unless the respondents possess competent and reliable scientific evidence to substantiate the claims.

Appearances

For the Commission: *Joel Winston and Marianna R. Watts.*

For the respondents: *Richard B. Herzog, Pepper, Hamilton & Scheetz, Washington, D.C.*

COMPLAINT

The Federal Trade Commission, having reason to believe that respondents Sun Company, Inc., and Sun Refining and Marketing Company, corporations, hereinafter sometimes referred to as respondents, have violated the provisions of the Federal Trade Commission Act, and it appearing to the Commission that a proceeding by it would be in the public interest, hereby issues its complaint stating its charges as follows:

PARAGRAPH 1. Respondent Sun Company, Inc. is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Pennsylvania. Respondent's office and principal place of business is located at 100 Matsonford Road, Radnor, PA.

Respondent Sun Refining and Marketing Company is a corporation organized, existing, and doing business under and by virtue of the laws of the State of Pennsylvania. Respondent's office