IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT
Nos. 96-1891, 96-1892, 96-1922 and 96-1923

BROKERAGE CONCEPTS, INC.,
Appellee/Cross-Appellant,

v.

U.S. HEALTHCARE, INC.; CORPORATE HEALTH ADMINISTRATORS, INC.; UNITED STATES HEALTH CARE SYSTEMS OF PENNSYLVANIA, INC., d/b/a THE HEALTH MAINTENANCE ORGANIZATION OF PENNSYLVANIA; RICHARD WOLFSON; SCOTT MURPHY; and WILLIAM BROWNSTEIN,
Appellants/Cross-Appellees.

On Appeal From A Final Judgment Of The United States District Court For The Eastern District Of Pennsylvania
(Honorable Clarence C. Newcomer, District Judge)

OPENING BRIEF FOR DEFENDANTS/APPELLANTS/CROSS-APPELLEES

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STATEMENT OF SUBJECT-MATTER AND APPELLATE JURISDICTION

The district court had jurisdiction under 28 U.S.C. §§ 1331, 1337, and 1367, and 18 U.S.C. § 1964. This Court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES, PRESERVATION, AND STANDARD OF REVIEW

1. **Whether plaintiff's claim that a reciprocal-dealing arrangement — which at most caused plaintiff to lose a single customer — was "tying" that violated the Sherman Act, 15 U.S.C. § 1, fails as a matter of law because, among other things, plaintiff failed to show market power in any properly defined market**. Defendants raised this issue in their Rule 50 Motions for Judgment as a Matter of Law (JA 175-176, 3014-3016), which the district court denied (Add. A20-A24, A27, A28, A31). Review of denial of a Rule 50 motion is plenary. *Doe* v. *SEPTA*, 72 F.3d 1133, 1137 (3d Cir. 1995), cert. denied, 117 S. Ct. 51 (1996).

2. **Whether plaintiff's claim that defendants' insistence on a reciprocal-dealing arrangement violated the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1964, fails as a matter of law because there was no proof of any predicate criminal acts and because plaintiff's customer, not plaintiff, was the "victim" of the alleged crimes.** Defendants raised this issue in their Rule 50 Motions (JA 168-171, 176-177, 223-226, 3016-3019), which the district court denied (Add. A10-A17, A24-A25, A27, A28, A31). Review is plenary. *Doe* v. *SEPTA*, 72 F.3d at 1137.

3. **Whether, as a matter of law, defendants' insistence on a reciprocal-dealing arrangement could constitute "wrongful means" and tortiously interfere with plaintiff's prospective contractual relations.** Defendants raised this issue in their Rule 50 Motions (JA 171-172, 177-178, 226-227, 3019-3020), which the district court denied (Add. A17-A19, A24-A25, A27, A28, A31). Review is plenary. *Doe* v. *SEPTA*, 72 F.3d at 1137.

4. **Whether the damages awards can stand.**

A. **Whether the award of compensatory damages should be reversed because it exceeded the maximum amount supported by the evidence.** Defendants raised this issue in their Renewed Motion for Judgment as a Matter of Law following the verdict (JA 3020). The district court denied the motion (Add. A31). The standard of review of a compensatory damages award for sufficient evidence is whether the district court

abused its discretion in not awarding a new trial. *Cooper Dist. Co.* v. *Amana Refrigeration, Inc.*, 63 F.3d 262, 277 (3d Cir. 1995).

B. **Whether the award of punitive damages should be vacated because it was unsupported by evidence of outrageous conduct.** Defendants raised this issue following the verdict in their Renewed Motion for Judgment as a Matter of Law (JA 3020), which the district court denied (Add. A31). This issue presents the question of law whether sufficient evidence in the record supports the punitive damage award. Review of that issue is plenary. *Berroyer* v. *Hertz*, 672 F.2d 334, 339 (3d Cir. 1982).

5. **Whether the erroneous admission of evidence on the crucial issues of market power and alleged coercion requires judgment for defendants or a new trial.** Defendants preserved these issues by filing motions in limine (JA 97-98, 125-127, 164-166), which were denied (Add. A2, A5-A6, A8), and by making objections at trial, which were overruled. JA 1493, 1567, 260-262, 435-436, 471-477, 483. Review of evidentiary decisions is for abuse of discretion, unless the issue involves a question of law, in which case review is plenary. *Duquesne Light Co.* v. *Westinghouse Elec. Corp.*, 66 F.3d 604, 613 (3d Cir. 1995); *In re Paoli R.R. Yard PCB Litig.*, 35 F.3d 717, 749 (3d Cir. 1994), cert. denied, 115 S. Ct. 1253 (1995).

STATEMENT OF RELATED CASES AND PROCEEDINGS

The only related matters are defendants' fee-award appeals, which have not yet been assigned a docket number by the Court. On December 10, 1996, the district court awarded BCI attorneys' fees and expenses totaling $910,489.62. Add. A68.

STATEMENT OF THE CASE

U.S. Healthcare, through its subsidiaries, offers Health Maintenance Organizations ("HMOs") in many States, including Pennsylvania and New Jersey. Corporate Health Administrators ("CHA"), a wholly owned subsidiary of U.S. Healthcare, provides third-party administration ("TPA") services. Brokerage Concepts, Inc. ("BCI"), also provides TPA services. BCI sued U.S. Healthcare, CHA, and other corporate and individual defendants affiliated with or employed by U.S. Healthcare. BCI alleged a violation of the Sherman Act, a violation of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and tortious interference with contractual

relations. After a 17-day trial, the jury returned a verdict for BCI on all counts, awarding $200,000 in compensatory damages and a total of $1,000,000 in punitive damages.[1]

STATEMENT OF FACTS

1. Many U.S. Healthcare HMO members participate in the U.S. Healthcare prescription purchase program. JA 581. Under that program, a member is responsible only for a small copayment with each prescription purchase. JA 583-584. Each member designates one pharmacy at which he or she will purchase prescription drugs. JA 582-584. Members change their pharmacy designation merely by filling out a form. JA 584. In addition to paying for actual purchases, U.S. Healthcare pays the pharmacies that serve the prescription purchase plan a set monthly amount based on the number of U.S. Healthcare members designating that pharmacy, without regard to the actual purchases of drugs from that pharmacy. JA 585.

2. In 1991, I Got It At Gary's ("Gary's") operated four discount retail stores with pharmacy departments in suburban Philadelphia. JA 1377. Gary's offered its employees two options for their health insurance coverage: a Blue Cross/Blue Shield plan and a U.S. Healthcare HMO. JA 2201. Robin Risler, a co-owner of Gary's, ran its Human Resources Department. JA 331-334. Her assistant, Sandra Chen, thought that Gary's might save money by switching to self-insurance. JA 428-429. By self-insuring, Gary's would pay all the medical claims of its employees up to a set limit, and would purchase insurance to cover amounts above the limit. JA 277. Gary's would need to hire a third-party administrator ("TPA") to process the claims. JA 277-278. Gary's decided to self-insure in 1991, terminating its contracts with U.S. Healthcare and Blue Cross/Blue Shield. JA 430. Based on the recommendation of its controller, Mitchell Abrams, Gary's evaluated and hired BCI on an annual basis as a TPA. JA 429-431.

3. In August 1993, Gary's opened its fifth store, in Abington, Pennsylvania. JA 496. Gary's applied for the admission of that new store to U.S. Healthcare's pharmacy network. JA 497. Defendant Richard Wolfson, director of U.S. Healthcare's pharmacy program, advised defendant William Brownstein, the regional pharmacy

[1] Although the district court ordered plaintiff to elect among its antitrust, RICO, and tort remedies (Add. A43-A52), plaintiff has never complied with that order. This brief demonstrates that *all* of plaintiff's causes of action are infirm.

director for Pennsylvania, not to process the application. JA 623-624. Wolfson felt that Gary's had terminated U.S. Healthcare's contract in an unprofessional manner in 1991, and that there was therefore no reason why U.S. Healthcare should provide new business for Gary's. JA 615-616.

4. In September 1993, Brownstein audited generic drug use at Gary's Eagleville store. JA 1845. The audit measured the pharmacy's compliance with the requirement of the provider agreement that generic drugs be used whenever possible to contain costs. JA 926. The audit revealed that Gary's used generic drugs far less than the network average and inadequately documented decisions not to use them. JA 945. Brownstein passed the audit results to the Quality Assessment Committee, which referred the audit to the Peer Review Committee. JA 1698, 1715. The Peer Review Committee voted to impose a three-month freeze on Gary's Eagleville location. JA 942-946. When a store is "frozen," only new U.S. Healthcare members may not designate it as their location for buying drugs. JA 627.

At the end of the freeze period, U.S. Healthcare conducted another audit of the Eagleville store. JA 946. Because Gary's had shown improvement in its use of generic drugs, and had promised to make an effort to improve its use and documentation at all locations, the Peer Review Committee voted to remove the freeze in late February 1994. JA 644-649.

5. Gary Wolf — co-owner and President of Gary's — set up a meeting with U.S. Healthcare on December 1, 1993. JA 893-897. Among the issues discussed at the meeting were Gary's generic use and admission of the Abington store to U.S. Healthcare's provider network. JA 923-925, 501. At the meeting, U.S. Healthcare requested and received permission to bid on Gary's TPA business for the next annual contract period. JA 635. Wolfson commented that "we like to do business with people who do business with us." JA 502.

Gary Wolf then instructed his sister, Robin Risler, to "take a look at" the TPA services offered by CHA, the U.S. Healthcare subsidiary. JA 342. He told her to accept CHA's bid if it was equal to or better than BCI's. JA 341-345. Risler resented her brother's intrusion into her responsibility, and initially was disposed against CHA. JA 345, 374. After she retained an insurance broker to help her evaluate the competing proposals and had discussions with CHA, however, her attitude became positive. JA 375.

In early January 1994, Gary's sent a letter to U.S. Healthcare promising to provide full consideration to CHA's bid. JA 2475. Defendant Scott Murphy, an executive in CHA's marketing department, relayed that fact to Wolfson. JA 638. Wolfson then instructed Brownstein to enroll the Abington location. JA 638, 641-643.

Although Chen and Abrams had some input in deciding which TPA to hire, Risler made the ultimate decision. JA 463-464. After evaluating proposals from BCI, CHA, and a third bidder, Risler chose CHA because it offered better medical management and more services for about the same price. JA 391-397, 419. Risler felt that she had full control over the decision, and her decision surprised Wolf. JA 418, 421-422.[2]

Risler informed BCI that she would not renew the annual terminable-at-will contract with BCI, and Gary's began using CHA for its TPA needs in August 1994, the next annual contract period. JA 241, 266, 286-288. In May 1996, Drug Emporium, a large pharmacy chain, acquired Gary's. JA 1744. As a result, Gary's terminated its contract with CHA effective May 31, 1996. JA 1744, 2986.

6. At trial, BCI presented no expert economic testimony. Instead, BCI presented as its principal "expert" testimony — over objection — a telephone survey of a small number of pharmacies, apparently designed to show the importance of membership in the U.S. Healthcare network. JA 1493-1561. Defendants presented expert economic testimony that linkage of network membership and purchase of TPA services was normal business behavior and not anticompetitive. JA 1805-1806, 1810-1811. Nevertheless, the jury, after hearing instructions that invited it to substitute its own notions of proper business behavior for the economic concepts of the antitrust laws (see pp. 24-25, *infra*), determined that the linkage of network membership and TPA services constituted an antitrust violation, several crimes, and a tort. Judge Newcomer declined to disturb the verdict but refused to enter an injunction against defendants. Add. A31, A53-A67.

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[2] Although 3 BCI employees related hearsay conversations in which Risler allegedly indicated that she had no choice but to accept the CHA bid, that evidence was admitted (over objection) only to prove her state of mind, not to prove the underlying facts. See pp. 47-49, *infra*.

SUMMARY OF ARGUMENT

According to plaintiff, to *sell* more prescription drugs, Gary's agreed to *buy* TPA services from defendants. That allegation, even if true, is the natural and normal business conduct of reciprocal dealing, not tying. Reciprocal dealing is generally procompetitive and may be unlawful *only* "if the user's purchasing power is sufficiently substantial and its use results in substantial foreclosure of competition in the other weaker product market." *W.L. Gore & Assocs., Inc.* v. *Carlisle Corp.*, 529 F.2d 614, 624 (3d Cir. 1976).

BCI failed to show that U.S. Healthcare had purchasing power — market power — in a properly defined market. The only "product market" BCI proffered was "U.S. Healthcare members with prescription drug benefits in the areas surrounding * * * Gary's pharmacies in suburban Philadelphia." That single-brand "market," in which U.S. Healthcare necessarily has a 100% "market share," fails as a matter of law because it ignores the ability of Gary's to sell prescription drugs (and other products) to persons other than U.S. Healthcare subscribers. BCI also failed to prove a proper geographic market. In any reasonably defined market, U.S. Healthcare had a market share of at most 25%, which is too small to confer market power.

BCI cannot prevail under the rule of reason because it showed no harm to *competition* for the provision and administration of health benefits. BCI's failure to retain a single account is not harm to competition, but its inevitable result. U.S. Healthcare's lack of market power also defeats BCI's rule-of-reason claim. And, because the jury instructions on the rule of reason relieved BCI of the need to show *any* harm to competition, a new trial, at least, is necessary.

BCI's RICO claims also fail as a matter of law. Gary's, not BCI, was the only possible victim of the "crimes" BCI alleged. BCI therefore lacked RICO standing. Nor did BCI prove any crimes. Defendants are not the sort of "rating" services to which the Pennsylvania commercial bribery statute applies. Defendants' business bargaining was not extortion because defendants had every right to bargain for reciprocal benefits in exchange for admitting or retaining Gary's in the U.S. Healthcare pharmacy network. Defendants' conduct was not mail or wire fraud because the scheme BCI alleged — one in which defendants *hid* their true purpose of inducing Gary's to send its TPA business to CHA — could only *defeat* that alleged purpose. BCI's Travel Act allegation must fall with

the other predicate-act allegations. And the trial court erroneously submitted an "aiding and abetting" theory to the jury. Furthermore, the errors on the antitrust claims contaminated the RICO instructions.

The tortious-interference award likewise should be reversed. BCI did not show that defendants used "wrongful means" to compete with BCI. Reciprocal-dealing arrangements comport with the public policy of the antitrust laws — indeed, are procompetitive — except in a few well-delineated circumstances not present here. The health-care policy of Pennsylvania likewise *favors* an HMO's ability to select freely among providers such as pharmacies, in stark contrast to the policy of States that have "Any Willing Provider" laws. Furthermore, the jury instructions erroneously described "wrongful means," disregarding the competitive setting of this case.

If the Court reaches questions of damages, the compensatory damages should be reduced and the punitive damages reversed. The compensatory award exceeded the maximum permissible recovery in light of the sale of Gary's to Drug Emporium on May 31, 1996. And defendants' actions were not outrageous and did not justify punitive damages.

Evidentiary errors also justify reversal. The district court permitted BCI's expert to present a biased, hearsay survey lacking the guarantees of trustworthiness required by *Daubert* v. *Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993), and *Pittsburgh Press Club* v. *United States*, 579 F.2d 751, 755 (3d Cir. 1978). The court also misconstrued Federal Rule of Evidence 803(3) by admitting critical "state-of-mind" hearsay not just for state of mind but *for the truth of the underlying facts asserted.* The erroneously admitted hearsay evidence was BCI's *only* "proof" that Gary's was "coerced" rather than (as the hearsay declarant herself insisted at trial) having selected CHA on the merits. Finally, the district court erroneously admitted prejudicial opinion testimony about whether U.S. Healthcare's generic-use policy complied with Pennsylvania law.

The judgment below, including the award of attorneys' fees, should be reversed.

ARGUMENT

"We like to do business with people who do business with us." That mundane expression of the practice of reciprocal dealing articulates the *quid pro quo* that lies at the heart of a healthy and properly functioning marketplace. This "natural and normal" business conduct (*United States* v. *Morgan*, 118 F. Supp. 621, 633 (S.D.N.Y. 1953) (Medina, J.)) is well within the mainstream of commercial practice. The trial court, however, permitted the phrase "we like to do business with people who do business with us" to become a mantra of evil, signifying bribery, extortion, wire fraud, a *per se* antitrust violation, and a malicious tort.

This case involves hard bargaining between two businesses. Hard bargaining, however, is not a crime and is not subject to punishment. Gary's, the "victim" of the conduct at issue, is not the plaintiff here. Rather, the plaintiff is a spurned competitor who prefers the outcome in a courtroom to the outcome in the marketplace. This familiar paradigm of suits by one competitor against another, when the supposed consumer victims of the alleged anticompetitive conduct are *not* suing, has rightly caused great skepticism among antitrust experts. See, *e.g.*, Easterbrook, *The Limits of Antitrust*, 63 Texas L. Rev. 1, 18, 35 (1984) ("[w]hen a business rival brings suit, it is often safe to infer that the arrangement is beneficial to consumers"; "the lure of damages * * * induces plaintiffs to challenge conduct that is procompetitive"); Baumol & Ordover, *Use of Antitrust to Subvert Competition*, 28 J.L. & Econ. 247 (1985); Snyder & Kauper, *Misuse of the Antitrust Laws: The Competitor Plaintiff*, 90 Mich. L. Rev. 551 (1991).

BCI has litigated this case as if all reciprocal dealing were illegal, but in reality the overwhelming majority of reciprocal-dealing arrangements are procompetitive and lawful. See, *e.g.*, Liebeler, *The Emperor's New Clothes: Why Is Reciprocity Anticompetitive?*, 44 St. John's L. Rev. 545, 545 (1970) (reciprocity "may be positively beneficial to the competitive process, even though, like most aspects of competition, it may discomfort some competitors"). Only a small minority of reciprocal-dealing arrangements — those involving substantial market power and market foreclosure — may violate the law. No effort was made below to sift carefully the few such arrangements that may be anticompetitive from the many that are not, and an examination of BCI's causes of action reveals that none of them is sustainable as a matter of law.

I. DEFENDANTS' RECIPROCAL-DEALING ARRANGEMENT DID NOT VIOLATE THE SHERMAN ACT

BCI's primary claim is that defendants violated the antitrust laws through illegal tying. BCI contends that the alleged tie is illegal both *per se* and under the rule of reason. But the transaction between U.S. Healthcare and Gary's was reciprocal dealing, not tying. Reciprocal dealing poses much less threat to competition than tying. And, even if the practice involved in this case were subject to the law governing tying, BCI's claims still would fail as a matter of law.

A. The Reciprocal-Dealing Arrangement Was Not a *Per Se* Antitrust Violation

Reciprocal dealing should not be judged under the modified *per se* rule applicable to tying. Even if that test is employed, however, BCI has failed to demonstrate the most crucial requirement — U.S. Healthcare's market power in a properly defined market. No *per se* tying claim can succeed without such a showing. *Town Sound & Custom Tops, Inc.* v. *Chrysler Motors Corp.*, 959 F.2d 468, 477 (3d Cir.) (en banc), cert. denied, 506 U.S. 868 (1992). BCI's attempt to meet this requirement by arguing that U.S. Healthcare has power in the "market" consisting of its own subscribers fails as a matter of law. The geographic market BCI proposed was also contorted and unsound. In any relevant market, U.S. Healthcare has no market power.

1. *Reciprocal Dealing Is Not Subject To* Per Se *Condemnation*

BCI's theory is that U.S. Healthcare "tied" participation in its pharmacy program to purchasing TPA services from CHA, its subsidiary. The tying claim posits that U.S. Healthcare "sold" Gary's the ability to participate in the network, but only if Gary's also bought CHA's TPA services. The flaw in that theory is that it is analytically misleading to conceive of the contract between U.S. Healthcare and Gary's as a "sale" of the ability to participate in the network. No money flowed to U.S. Healthcare from Gary's as a result of that transaction. At bottom, the provider contract between U.S. Healthcare and Gary's allowed U.S. Healthcare members to *purchase* prescription drugs *from* Gary's. Money routinely flowed *from* U.S. Healthcare *to* Gary's in exchange for prescription drugs. The transaction is more akin to a joint venture that increases the attractiveness of U.S. Healthcare's network while increasing Gary's sales, but, if it can be forced into a purchase/sale paradigm, U.S. Healthcare is a buyer and Gary's a seller.

At trial, however, BCI (and the district court) treated this reciprocity as a garden-variety tying arrangement. That approach was incorrect. Rather than being judged under the tests developed in tying cases, reciprocal-dealing arrangements should be condemned (if at all) only when they run afoul of the test this Court stated in *W.L. Gore & Assocs., Inc.* v. *Carlisle Corp.*, 529 F.2d 614, 624 (3d Cir. 1976):

> [T]he use of substantial purchasing power in one product market to coerce a supplier into a reciprocating purchase in another market *may be* an illegal restraint of trade *if* the user's purchasing power is sufficiently substantial *and* its use results in substantial foreclosure of competition in the other weaker product market. [Emphasis added.][3]

The distinction between tying and reciprocal dealing is not formalistic. As the leading treatise notes, "forced reciprocal exchanges are * * * legally distinct from ties and need not receive the same antitrust treatment." 10 P. AREEDA ET AL., ANTITRUST LAW ¶ 1750c, at 268 (1996). Although "an illegal tying arrangement requires that at least two products and/or services be purchased by the same individual," in a reciprocal exchange the "services [a]re moving in different directions." *Id.* at 267-268 (quoting *Waldo* v. *North Am. Van Lines*, 669 F. Supp. 722, 730-731 (W.D. Pa. 1987)). When the parties on the other side of a commercial transaction from an alleged "tying" defendant "are not buyers of an allegedly tied product at all, but are sellers," a different antitrust analysis is appropriate. *Id.* at 268 (quoting *49er Chevrolet* v. *General Motors Corp.*, 803 F.2d 1463, 1469 (9th Cir. 1986)).

If a reciprocal arrangement has any anticompetitive effects, those effects must arise in the second, "forced" market. See 10 AREEDA, *supra*, at ¶ 1776. "In tying, as in reciprocity, a defendant threatens competition primarily by foreclosing a substantial share of the relevant market — that is, the market in which the reciprocating defendant sells (analogous to the tied market)." *Id.* ¶ 1778c, at 466. Because the actual anticompetitive effects of a reciprocal-dealing arrangement often are implausible or attenuated, courts should subject reciprocal dealing

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[3] The test articulated in *W.L. Gore* for reciprocity is more deferential to business practice than is either the *per se* test or the rule-of-reason test that this Court applies to tying arrangements. Compare *W.L. Gore*, 529 F.2d at 624 (requiring both market power in defendant's purchasing market and substantial foreclosure in defendant's selling market to condemn reciprocal dealing), with *Town Sound*, 959 F.2d at 477 (requiring market power in tying market but only effect on a substantial amount of interstate commerce, not substantial foreclosure, in tied market under *per se* rule), and *id.* at 482-485, 493 n.35 (rejecting absolute requirement of market power in tying market, but requiring substantial foreclosure in tied market under rule of reason).

only to a rule-of-reason analysis. *Id.* ¶ 1778; *id.* ¶ 1778c, at 466. That inquiry should focus on "the defendant's ability to foreclose access to the market in which he sells," which is analogous to the tied-product market in a tying claim. *Id.* ¶ 1778b, at 464.

The Supreme Court has not mandated even modified *per se* treatment for reciprocal dealing. See 10 AREEDA, *supra*, ¶ 1778, at 461, 466. Rather, the Court has cautioned against the extension of *per se* treatment beyond the well-defined categories receiving that treatment now. See, *e.g.*, *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). By contrast to the handful of practices that have been condemned *per se*, there is neither broad judicial experience with reciprocal dealing nor a consensus that reciprocal dealing so frequently causes competitive harm and so rarely benefits consumers that it should be condemned out of hand. See Liebeler, *supra*, 44 St. John's L. Rev. at 545. The Federal Trade Commission, which once attacked reciprocal dealing with regularity, more recently has *terminated* consent decrees that prohibited reciprocity. 10 AREEDA, *supra*, ¶ 1775b, at 450 n.8 (collecting citations).

Many scholars have argued persuasively that "no attempt should be made to regulate reciprocity under the antitrust laws." Ferguson, *Tying Arrangements and Reciprocity: An Economic Analysis*, 30 Law & Contemp. Probs. 552, 553 (1965); see also Note, *Reciprocal Dealing*, 76 Yale L.J. 1020, 1029 (1967) ("[A] rule of per se legality, not illegality, should govern the practice of reciprocal dealing."). At the very least, there is no justification for finding this "natural and normal" business practice (*Morgan*, 118 F. Supp. at 633) to violate the antitrust laws unless market power has been demonstrated and competition has been actually and substantially impeded in a properly defined market for the "forced" product or service.

The court below erred by failing to recognize that the practice challenged in this case was reciprocal dealing rather than a tying arrangement. Even if tying law is applied to the facts of this case, however, BCI's antitrust claims must fail as a matter of law.

2. *U.S. Healthcare Did Not Have Market Power In Any Properly Defined Market*

A tie can be condemned *per se* only if the defendant has market power in the tying market. See *Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2 (1984). If a plaintiff makes no "showing that the defendant has power in an economically and legally relevant t[ying] product market," the defendant is entitled to judgment. *Town Sound*, 959 F.2d at 479 n.12.

The tying-product market definition that the district court allowed to go to the jury — "U.S. Healthcare members with prescription drug benefits in the areas surrounding * * * Gary's pharmacies in suburban Philadelphia" (JA 2398-2399) — is not a relevant market by any stretch of the imagination. U.S. Healthcare's subscribers — or U.S. Healthcare itself, as a single negotiator of prescription prices — cannot constitute a market. Single-brand markets have, on rare occasions, been held permissible in certain circumstances, but here the necessary circumstances are absent. Similarly, the contorted geographical market relied on is flawed.

The smallest possible relevant market in this case would be prescription drug sales in the greater Philadelphia area. In that market, even if the share to which BCI's expert testified were accepted, U.S. Healthcare's market share would be so low that it would preclude as a matter of law a finding of tying that is unlawful *per se*.

a. *U.S. Healthcare members with prescription drug benefits do not constitute a relevant product market*

According to BCI, the relevant product market consists of U.S. Healthcare members with prescription drug benefits. The only thing that can be said in favor of that product-market definition is that it makes computation of market share easy: it is, by definition, 100%. As this Court said in *Town Sound*, 959 F.2d at 479, "If the market were so defined, of course [U.S. Healthcare] would have market power, being the sole seller. But such a narrow definition makes no sense in terms of real world economics, and as a matter of law we cannot adopt it." Cf. *Blue Cross & Blue Shield United* v. *Marshfield Clinic*, 65 F.3d 1406, 1411 (7th Cir. 1995) (Posner, C.J.) (HMOs are not a separate market), cert. denied, 116 S. Ct. 1288 (1996). Product markets are to be determined by evaluating which products would be reasonably interchangeable by consumers for the same purposes. *Allen-Myland, Inc.* v. *IBM*, 33 F.3d 194, 201 n.8 (3d Cir. 1994). Application of that principle illustrates the folly in BCI's proposed market.

As the jury was properly instructed (JA 2398), all products that are reasonably interchangeable from the standpoint of the consumer belong in the same market. See *Allen-Myland*, 33 F.3d at 201 n.8. It is unclear who "consumes" U.S. Healthcare members who purchase prescription drugs — which highlights the ludicrous nature of both BCI's "product market" and the application of tying doctrine to reciprocity facts.[4] Nevertheless, it must be Gary's that is the "consumer" in this alleged "market." According to BCI, Gary's "buys" the U.S. Healthcare members to have those members purchase prescription drugs at Gary's stores.

The question, then, is whether any other product would be reasonably interchangeable from Gary's standpoint. Gary's would have no reason to prefer a U.S. Healthcare member who purchased $100 of prescription drugs in a year over a Blue Cross/Blue Shield member (or an uninsured person) who purchased an identical dollar volume of drugs. The "use" to which Gary's puts the "products" (*i.e.*, collecting the profit margin from sales of prescription drugs) is precisely the same. No evidence in the record indicates that Gary's did not consider members of other prescription plans, or uninsured persons, completely interchangeable with U.S. Healthcare members. At a minimum, then, the smallest possible product market that could comport with this Court's precedents would be "all purchasers of prescription drugs."

Naturally, Gary's would *like* to have an assured supply of business from U.S. Healthcare subscribers *and* maximize its sales to other buyers of prescription drugs simultaneously. By saying that other customers are interchangeable with U.S. Healthcare subscribers, we do not suggest that Gary's could make up its lost sales overnight if it lost U.S. Healthcare's business. But product-market definition turns on the existence of close substitutes for a particular "product" — not on the ability of any particular "consumer" to switch *effortlessly* to

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[4] "Participation in U.S. Healthcare's pharmacy program" is not a cognizable product or service. Not every economic benefit can form the basis of a tying claim. See *United Farmers Agents Ass'n* v. *Farmers Ins. Exch.*, 89 F.3d 233, 236 (5th Cir. 1996) (rejecting tying-product "market" consisting of electronic access to policy information about Farmers Insurance policyholders), petition for cert. filed, 65 U.S.L.W. 3467 (Dec. 4, 1996) (No. 96-981).

such substitutes.[5]

"All purchasers of prescription drugs" may be used for ease of analysis, but it is still too narrow to constitute a proper product market in a tying case, where power over the tying product is relevant only to the extent that the seller can *coerce* purchases of the tied product. Gary's derived 70% of its revenues from the non-prescription, retail side of its business, diluting any coercive power that was limited to the pharmacy business. JA 1899. Gary's would not have a marked preference for a customer from whom it earned $100 profit in a year on prescription sales over a purchaser of candy bars, detergent, or other goods from whom Gary's earned $100 profit in a year. Given the use for which Gary's employs them, these "products" are fungible. Thus, the most analytically sound market in this case would be "all consumers of products from retailers with in-store pharmacies" — the market defendants urged at trial. JA 2399.

The trial court erroneously permitted BCI to present the case to the jury as a single-brand market. Both before and after *Eastman Kodak Co.* v. *Image Technical Services, Inc.*, 504 U.S. 451 (1992), courts have been skeptical of single-brand markets because interbrand competition ensures that consumers will reasonably perceive the different brands to be interchangeable.[6]

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[5]Reflecting the fundamental unsoundness of BCI's attempt to apply tying concepts to this reciprocal-dealing case, it is analytically difficult even to apply the usual market-power concepts from tying cases to a *seller* such as Gary's. When a *buyer* of goods or services loses a source of supply and faces close substitutes, he simply negotiates a price with the substitute seller and proceeds. When a *seller* (such as Gary's) faces the loss of a large customer, by contrast, he must *compete* successfully for the business of other customers if he is to make up the lost sales. BCI's theory of this case is about relieving Gary's of the obligation to *compete* for business by assuring Gary's a source of customers from U.S. Healthcare without allowing U.S. Healthcare to demand benefits in return. That competition-avoiding approach is the antithesis of antitrust.

[6] See, *e.g.*, *Town Sound*, 959 F.2d at 480 ("Except in rare circumstances, courts reject market definitions consisting of one supplier's products where other brands compete."); *Edward J. Sweeney & Sons, Inc.* v. *Texaco, Inc.*, 637 F.2d 105, 117 (3d Cir. 1980) (Texaco gasoline does not constitute a relevant market); *Digital Equip. Corp.* v. *Uniq Digital Technologies, Inc.*, 73 F.3d 756, 762-763 (7th Cir. 1996); *Tarrant Serv. Agency, Inc.* v. *American Standard, Inc.*, 12 F.3d 609, 614 (6th Cir. 1993); *R.D. Imports Ryno Indus., Inc.* v. *Mazda Dist. (Gulf), Inc.*, 807 F.2d 1222, 1225 (5th Cir. 1987); *Coast Cities Truck Sales, Inc.* v. *Navistar Int'l Transp. Co.*, 912 F. Supp. 747, 769 (D.N.J. 1995).

For example, in *Town Sound* this Court rejected a market defined as "new Chrysler cars." Like that spurious market, the "market" of U.S. Healthcare subscribers "makes no sense in terms of real world economics" and is unsustainable as a matter of law. 959 F.2d at 479. On the contrary, a market must include "actual or potential competitors who may take business away from each other" (*id*. at 480), as several health coverage providers regularly take subscribers (potential prescription purchasers, from Gary's point of view) from U.S. Healthcare.

Kodak does not support BCI's case. That decision merely reflects an application of the interchangeability principle to a peculiar set of facts. Independent service organizations brought suit alleging that Kodak had tied replacement parts for its copiers to Kodak repair service. 504 U.S. at 459. Kodak argued that it was impossible for it to establish a tie in that situation, because interbrand competition in the copier market prevented it from obtaining market power in a derivative aftermarket such as copier parts. According to Kodak, any attempt to exercise market power over copier parts would raise the "life cycle" cost of owning a Kodak copier, and customers would buy fewer Kodak copiers, making the attempt unprofitable. *Id*. at 470.

Noting that the record contained evidence that Kodak had actually been able to maintain supracompetitive prices in the parts market, see 504 U.S. at 469, the majority declined to let Kodak's economic theory prevail on summary judgment over what it perceived as the contrary facts in the record. Once a customer had purchased a Kodak copier, that customer was effectively "locked in" to the Kodak parts aftermarket. *Id*. at 476. Because the "switching costs" (*i.e.*, the costs of purchasing another brand of copier) for these "locked-in" customers were so high, it became feasible for Kodak to acquire market power in this captive aftermarket. *Ibid*.

The Court disagreed with Kodak's sweeping argument that a single brand of a product or service could *never* be a relevant market, noting that "[t]he proper market definition" rested on an "inquiry into the commercial realities faced by consumers." 504 U.S. at 482 (quotation marks omitted). Emphasizing interchangeability, the Court stressed that "[t]he relevant market for antitrust purposes is determined by the choices available to Kodak equipment owners." *Id*. at 481-482. Because a legitimate class of consumers had no reasonable substitute for Kodak copier parts, the Court allowed a single-brand market consisting of Kodak parts. *Ibid*.

Thus, the *Kodak* case teaches that "lock-in" occasionally may cause an interchangeability analysis to dictate a single-brand market. That holding is fully consistent with this Court's relevant-product-market analyses in single-brand cases.[7]

BCI produced no evidence at trial that could bring this case within the "lock-in" doctrine. In its post-trial briefs, perhaps recognizing the glaring omission in its case at trial, BCI made a confused assertion that U.S. Healthcare members are "locked in." That contention, aside from being factually incorrect,[8] betrays a fundamental misunderstanding of *Kodak*. In *Kodak*, it was the buyers of Kodak copiers, the victims of the alleged tie, who had high switching costs and were therefore "locked in." But BCI made no effort to prove that *Gary's* was in some way locked in to "purchasing" its pharmaceutical customers from U.S. Healthcare.

BCI has also characterized this aspect of its case as demonstrating the "uniqueness" of U.S. Healthcare members. A tying plaintiff may demonstrate market power by showing uniqueness (see *Jefferson Parish*, 466 U.S. at 17), but BCI has not come close to making the required showing. "`[U]niqueness confers economic power only when other competitors are in some way prevented from offering the distinctive product themselves."' *Town Sound*, 959 F.2d at 480 (quoting *Fortner Enterprises* v. *United States Steel Corp.*, 394 U.S. 495, 505 n.2 (1969)). The record does not show that U.S. Healthcare members are unique in this sense. On the contrary,

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[7] See, *e.g.*, *Town Sound*, 959 F.2d at 480 ("The relevant product market includes Chrysler cars *and* cars that are reasonably interchangeable with Chrysler cars."); *Tunis Bros. Co. v. Ford Motor Co., 952 F.2d 715, 724 (3d Cir. 1992) ("Clearly, the plaintiffs had the burden of proving that Ford tractors constituted the entire relevant market and that other tractors available for sale were not `reasonably interchangeable.'"); Edward J. Sweeney & Sons, 637 F.2d at 117 ("To establish that Texaco gasoline alone constituted a relevant market or submarket, appellants had to prove that Texaco gasoline was not considered reasonably interchangeable with other brands of gasoline and non-branded gasoline by a significantly large number of consumers.").*

[8] U.S. Healthcare members are not "locked in" in any sense. Health benefit contracts between U.S. Healthcare and employers are short — usually one or two years, if not less — and the costs of switching health plans are low. The evidence at trial showed that, when Gary's was acquired by Drug Emporium and desired to terminate its contract with U.S. Healthcare, it did so without incident by providing a month's notice. JA 2986. BCI has also argued that U.S. Healthcare members are "locked in" to the pharmacy that they selected. Although U.S. Healthcare members are required to purchase their prescription drugs from a single pharmacy, JA 582-584, a member can very easily switch pharmacies within the system. JA 584.

there is vibrant interbrand competition in the health insurance market. U.S. Healthcare's rivals can and routinely do enroll people who were once U.S. Healthcare members — thereby enabling them to "offer" such persons to pharmacies as customers. Even more routinely, they "offer" other customers who are interchangeable with U.S. Healthcare members from Gary's standpoint.

The claim that BCI is making is entirely unknown to antitrust law. Essentially, BCI is arguing that, because profit margins in the pharmacy business are allegedly low, U.S. Healthcare is in some way *required* to allow U.S. Healthcare members to purchase prescription drugs at Gary's stores because Gary's needs them. That theory flagrantly violates the doctrine, established in *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919), that businesses have the cherished right to decide whether to do business with other firms. "[I]n the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal." *Id.* at 307.[9]

Consider, by analogy, a law firm heavily dependent on one client. The client makes a product that the law firm uses and insists, as a condition of using the law firm's services, that the firm purchase the client's products rather than those of its fierce competitors (Apple personal computers rather than rival brands, for example). BCI's theory necessarily would mean that the client violated the antitrust laws, for the law firm could not easily replace the client if it left (thus requiring that that single client be deemed a "relevant market" in which the client's 100% "share" necessarily gives it "market power"), and the firm would be "forced" to buy from the client products that it might prefer to buy elsewhere on better terms. The facially absurd nature of that result — which depends on the idea that the firm should not have to engage in price and non-price competition such as showing loyalty by buying the client's products — shows how fundamentally misguided and anticompetitive is BCI's theory of this case. See also note 5, *supra*.

In sum, the product market proposed by BCI — U.S. Healthcare members with prescription drug benefits

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[9] The district court rejected defendants' request to instruct the jury on the *Colgate* doctrine. JA 143. Instead, the court contradicted almost 80 years of Supreme Court precedent by informing the jury that Gary's had the right to participate "fully and freely" in U.S. Healthcare's network. JA 2395, 2404.

— cannot be sustained as a matter of law. The smallest relevant product market that could conceivably be proper is "all purchasers of prescription drugs."

b. *"The areas surrounding Gary's pharmacies in suburban Philadelphia" do not constitute a relevant geographic market*

To complement its indefensible product market, BCI also selected a contrived geographic market — "the areas surrounding I Got It At Gary's pharmacies in suburban Philadelphia."[10] Unfortunately for BCI, the only evidence of U.S. Healthcare's share of the health benefits market in greater Philadelphia — the narrowest logical geographic market — is only 16%. JA 1910-1911. Seeking to make U.S. Healthcare's share appear higher, BCI devised a non-contiguous "market" consisting of the geographic areas surrounding each Gary's location, but BCI neglected to enter sufficient evidence of U.S. Healthcare's market share even in those areas.

BCI did put forward a "survey" conducted by its "expert" — who is a pharmacist, not an economist. The survey, BCI's sole evidence on market share, consisted of students calling pharmacies selected out of a phone book and asking them a series of questions. JA 1493-1499. Although we discuss the systematic errors in the survey more thoroughly below (at 42-47), some of its more significant errors invalidate BCI's suggestion of market power. The survey was designed to produce data on 6-8 pharmacies in a region close to three Gary's locations arbitrarily selected (see JA 1494; pp. 44-45, *infra*) by BCI's expert. No evidence was submitted indicating that the three stores — all in the same county — around which data were collected were in any way representative of all six Gary's locations; to the contrary, BCI's expert cautioned that the nature of the survey was such that the results could not be extrapolated. JA 1497, 1501. Thus, BCI did not present a valid geographic market. "The mere delineation of a geographical area, without reference to a market as perceived by consumers and suppliers, fails to meet the legal standard necessary for the relevant geographic market." *Tunis Bros.*, 952 F.2d at 727.

BCI's "geographic market" was not even the relevant area for Gary's, and thus violated the fundamental

[10] BCI's request that its expert research U.S. Healthcare's share in a larger market indicates that BCI understood that its proposed product market definition was infirm. If the product market actually were "U.S. Healthcare members with prescription drug benefits," the geographic market would not matter — U.S. Healthcare would always have a 100% share.

principle that a geographic market should be defined by the area in which a potential buyer may rationally look for the products or services he seeks. *Pennsylvania Dental Ass'n* v. *Medical Serv. Ass'n*, 745 F.2d 248, 260 (3d Cir. 1984). The only evidence about the area in which Gary's sought potential customers was testimony indicating that Gary's had purchased broadcast television advertising time (JA 2011), indicating that Gary's rationally looked for customers throughout greater Philadelphia — not just in the area immediately surrounding three of the six stores. BCI therefore failed to meet its "evidentiary burden of proving the relevant geographic market." *Tunis Bros.*, 952 F.2d at 726. The only geographic market that can legally be inferred from the evidence is the greater Philadelphia area.

c. *U.S. Healthcare does not have market power in any properly defined market*

BCI's failure to allege or support legally sufficient product and geographic markets is fatal to its *per se* claim — BCI cannot change theories on appeal. See, *e.g.*, *Allen-Myland*, 33 F.3d at 204 n.14; *Edward J. Sweeney & Sons,* 637 F.2d at 117. But, even if BCI had designated valid product and geographic markets, defendants would be entitled to judgment on the *per se* claim as a matter of law because U.S. Healthcare did not have market power.

We showed above that the smallest possible relevant product market is "all purchasers of prescription drugs." BCI's own expert testified, based on his flawed surveys, that U.S. Healthcare members purchased only 20-25% of the prescriptions even within BCI's gerrymandered "geographic market." JA 1543. The Director of Pharmacy Operations at Gary's itself — with a more concrete basis for his assessment — insisted that only 10-12% of its pharmacy sales came from U.S. Healthcare members. JA 1900. Consulting financial reports, Gary's controller testified that U.S. Healthcare subscribers accounted for less than 2% of Gary's total business. JA 555-556. And the only evidence about the greater Philadelphia area was unrebutted — just 16% of residents belong to a U.S. Healthcare plan. JA 1910-1911.

U.S. Healthcare's maximum 20-25% share in the "geographic market" proposed by BCI, and its 16% share of the health benefits market in greater Philadelphia, conclusively indicate its lack of power in the inter-brand relevant product market at issue. A ***30%*** market share precludes a finding of market power in a tying

case, *Jefferson Parish*, 466 U.S. at 27, and even a 40% share may be too small, *Town Sound*, 959 F.2d at 481. See also *Ball Memorial Hosp.* v. *Mutual Hosp. Ins., Inc.*, 784 F.2d 1325, 1334-1336 (7th Cir. 1986) (market shares *overstate* power in fluid health care financing market). The jury was instructed according to this black-letter law, and its verdict indicates that it must have relied on the erroneous definition of a "U.S. Healthcare" market. JA 2400. Because U.S. Healthcare lacked market power in any relevant market, defendants are entitled to judgment on BCI's *per se* antitrust claim.

B. The Reciprocal-Dealing Arrangement Did Not Violate The Antitrust Laws Under The Rule Of Reason

U.S. Healthcare's conduct could fall afoul of the rule of reason only by causing an actual anticompetitive effect in the market for the provision and administration of health benefits — the "tied"-product market. *Jefferson Parish*, 466 U.S. at 29-31. But BCI did not approach such a showing. Even if BCI had "present[ed] some evidence that [U.S. Healthcare had] engaged in tying and some evidence that some injury" resulted to BCI, such evidence would not suffice to sustain a judgment of antitrust liability under the rule of reason. *Town Sound*, 959 F.2d at 486. What BCI failed — but needed — to show, was competitive harm to the *market* for providing and administering health benefits. At most, BCI showed that it lost a single account. But, even if Gary's — despite the unequivocal contrary testimony of its decisionmaker (JA 418) — in fact was "forced" to use U.S. Healthcare's TPA services, that solitary incident could not prove BCI's case. As the Supreme Court put it, "If only a single purchaser [is] `forced' with respect to the purchase of a tied item, the resultant impact on competition [is] not * * * sufficient to warrant the concern of antitrust law." *Jefferson Parish*, 466 U.S. at 16.[11] And, as the evidence in this case demonstrates, this lack of concern is well founded: BCI did not remotely demonstrate any

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[11] See also *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532, 539 (7th Cir. 1986) ("There is no anticompetitive effect when a buyer simply terminates an at-will contract with one supplier and enters into a similar contract with another supplier."); *Dunn & Mavis, Inc.* v. *Nu-Car Driveaway, Inc.*, 691 F.2d 241, 245 (6th Cir. 1982) ("Chrysler's substitution of one auto transport company for another at its Warren plant does not limit competition in any substantial sense. A contrary decision would limit without reason the normal principle that a buyer is entitled to choose among various sellers who offer competing products or services.").

harm to the broad competition among the numerous insurance companies, HMOs, and TPAs (both independent and affiliated with HMOs or insurers).

A practice may consign "a certain class of competitors * * * to competitive oblivion," but that is "no concern of the antitrust laws unless consumers [a]re also hurt because of diminished competition." *Town Sound*, 959 F.2d at 494. There was no sign of such harm to a *class* of consumers in the market. The one consumer that BCI contended had been harmed, Gary's, insisted to the contrary. JA 418-420.[12] BCI presented opinion testimony — which was disputed by Gary's — that BCI's TPA services offered a better bargain than U.S. Healthcare's. JA 1298, 418-420. But "the Sherman Act is neither a lowest-responsible-bidder statute nor a panacea for all business affronts which seem to fit nowhere else." *Orson, Inc.* v. *Miramax Film Corp.*, 79 F.3d 1358, 1370 (3d Cir. 1996) (internal quotation marks omitted).[13] Risler testified that she chose CHA in part because of its provider network and better medical management. JA 419. Gary's, the "victim" supposedly "forced" to buy CHA's TPA services, did not complain — a strange deficiency in a case that, under the *antitrust* laws, is supposed to be about harm to *consumers* like Gary's.

Thus, BCI has demonstrated neither that U.S. Healthcare has market power in the "tying" market nor that competition was affected in the "tied" market. Those deficiencies sound the death knell for any tying antitrust claim under the rule of reason.

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[12] Aside from testimony by Gary's personnel that they selected the superior TPA in hiring CHA, the record also indicates that Gary's benefited from the process of competitive bidding. For example, the competition from CHA forced BCI to offer to lower its commission — an action it had not taken during the renewal periods when it faced no competition. JA 327.

[13] That a price for one product may be higher than the price for a substitute does not support the conclusion that all sales of the higher priced product result from the exercise of market power or some other distortion of the competitive market — that some people buy BMWs rather than lower priced Toyotas hardly proves BMW's market power. If that view of the market were correct, all markets would be single brands, for the lowest priced brand would drive out all others. But that is not how markets work; there are preferences other than price.

1. *U.S. Healthcare Had No Power In The "Tying" Market*

We have demonstrated that U.S. Healthcare had no power in any legally relevant "tying" market. This showing conclusively precludes BCI's rule-of-reason claim for two reasons.

First, we have already explained that the facts of this case constitute reciprocal dealing rather than tying. This Court settled the test applicable to reciprocal-dealing arrangements in *W.L. Gore,* 529 F.2d at 624 (emphasis added):

> [T]he use of substantial purchasing power in one product market to coerce a supplier into a reciprocating purchase in another market may be an illegal restraint of trade *if the user's purchasing power is sufficiently substantial* and its use results in substantial foreclosure of competition in the other weaker product market.

Thus, this Court has made it clear in the reciprocal-dealing context that a finding of market power in the defendant's purchasing market is a prerequisite to a finding of liability. Lacking such market power, defendants deserve judgment on the rule-of-reason claim as a matter of law.

Second, this Court in *Town Sound* stressed that a rule-of-reason claim requires plaintiffs to "offer a plausible theory of how the defendant's tie-in is causing injury cognizable by the antitrust laws." 959 F.2d at 482. The theory must demonstrate substantial impact in the "tied" market. "[I]f the plaintiff cannot come up with evidence of injury to competition, not simply to the plaintiffs themselves, then [judgment as a matter of law] is appropriate." *Id*. at 486.

At trial, BCI articulated one theory only: U.S. Healthcare had tyrannical market power and imposed its will on Gary's. In *Town Sound*, this Court indicated that this theory, which it called "power leveraging," could be tried under the modified *per se* rule and the rule of reason. 959 F.2d at 486. Nevertheless, the Court recognized that an absence of market power compels judgment for the defendant under this theory of the rule of reason: "where a defendant indisputably proves that it lacks sufficient power in the tying product market, a plaintiff's power leveraging claim, whether packaged in `per se' or rule of reason terms, falls apart." *Ibid*.

For both of these reasons, U.S. Healthcare's indisputable lack of market power in any relevant market compels judgment as a matter of law against BCI on its rule-of-reason claim.

2. *U.S. Healthcare Did Not Foreclose A Substantial Portion Of The "Tied" Market*

Although BCI staked its entire rule-of-reason case on a power leveraging theory, out of an abundance of caution we address one other argument. BCI made references at trial to market foreclosure. This Court in *Town Sound* indicated that foreclosure of the *tied-product* market could constitute a legitimate theory under the rule of reason. 959 F.2d at 493.

BCI used the term "market foreclosure" to argue that U.S. Healthcare had the power to foreclose *Gary's* from a portion of the market for prescription drug customers — the *tying* market. This was nothing more than another way of attempting to demonstrate that U.S. Healthcare had market power in the tying market. To pursue the theory articulated in *Town Sound*, however, BCI would have needed to prove that *BCI* was foreclosed from a substantial volume of business in the TPA business — the *tied* market. The record contains no such showing, but indicates that BCI has more than doubled its business between 1992 and 1995. JA 1343-1345.

The sum total of BCI's evidence of the effect of U.S. Healthcare's actions in the tied market consisted of BCI's inability to renew one (rather small) contract.[14] That evidence falls far short of demonstrating harm to competition. This Court in *Town Sound* indicated that it was necessary to foreclose a "substantial portion" of the tied market to hurt competition. 959 F.2d at 493 & n.2; see also *Virtual Maintenance, Inc.* v. *Prime Computer, Inc.*, 957 F.2d 1318, 1330 (6th Cir.) ("[t]he foreclosure of 400 computer systems * * * is insignificant as a matter of law"), vacated, 506 U.S. 910 (1992), reinstated in pertinent part, 11 F.3d 660, 663-664 (6th Cir. 1993). The record in this case contains absolutely no evidence that competition in the tied market was damaged, and defendants should therefore receive judgment as a matter of law on the rule-of-reason claim. *Town Sound*, 959 F.2d at 493 & n.2; *W.L. Gore*, 529 F.2d at 624.

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[14] In late 1994, U.S. Healthcare established written policies requiring that pharmacies above a certain size offer a U.S. Healthcare HMO to their employees to secure access to U.S. Healthcare's provider network. This was called Criterion 25 in Pennsylvania. BCI submitted evidence that U.S. Healthcare applied this Criterion to several other pharmacies, in both Pennsylvania and New Jersey (where the requirement was called Criterion 19), but that evidence, and other evidence pertaining to other pharmacies, was "relevant only to [BCI]'s RICO claims." Add. A63.

3. ***The Standardless Rule-of-Reason Jury Instructions Warrant A New Trial***

Even if BCI's rule-of-reason claim had an articulable legal basis sufficient to sustain a verdict reached in an error-free trial, the flagrant error in the jury instruction on the rule of reason would compel a new trial. A new trial is required "if the instructions were capable of confusing and thereby misleading the jury." *Griffiths* v. *CIGNA Corp.*, 988 F.2d 457, 462 (3d Cir. 1993).

The theme of this Court's thorough rule-of-reason analysis in *Town Sound* was that "a plaintiff must offer a plausible theory of how the defendant's tie-in is causing injury cognizable by the antitrust laws." 959 F.2d at 482. The Court listed several theories that would enable a plaintiff to meet the required showing. *Id.* at 487-494. The common denominator of those theories was that, "if a plaintiff cannot come up with evidence of injury to competition, not simply to the plaintiffs themselves, then [judgment as a matter of law] is appropriate." *Id.* at 486.

That bedrock requirement of injury to competition was nowhere to be found in the instructions presented to the jury. To the contrary, the court provided no guidance and allowed the jurors to impose liability on their slightest whim (JA 2403 (emphasis added)):

> *[T]he law does not define which restraints of trade are reasonable and which are not. It's for you to decide* whether the evidence in this case shows an unreasonable restraint. And the plaintiff may not recover unless you find an unreasonable restraint by a preponderance of the evidence.
>
> And you may consider the following factors: First, the nature of the particular industry involved which in this case is the health benefits business.
>
> Secondly, factors which are peculiar to the health benefits business.
>
> Third, the nature of the restraints and its effect, actual and probable.
>
> Fourth, the history of the restraint and, fifth, the defendants' reasons for adopting the particular practice which is alleged to be a restraint.[[15]]
>
> If, based on these considerations, you find that the tying arrangement at issue in this case constitutes an unreasonable restraint of trade, then the plaintiff has established that the defendants have violated the antitrust law and you must go on to the questions of causation and damages.

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[15] The district court repeatedly precluded defendants from presenting evidence of the reasons they adopted the policy that pharmacies with 25 or more employees must offer U.S. Healthcare benefits in order to be included in the pharmacy program. Defendant Richard Wolfson would have testified that Criterion 25, as it was known in Pennsylvania, was motivated and inspired by the Federal HMO Act, 42 U.S.C. § 300(e), *et seq.*, which expresses a congressional policy that employers with 25 or more employees "shall include in any health benefits plan * * * offered to their employees * * * the option of membership in qualified [HMOs]." *Id.* § 300(e)(9); see also JA 801-803. Defendants' state of mind was also relevant to plaintiff's claims of criminal activity under RICO. See JA 2418. Thus, the district court's decision to exclude this important evidence was an abuse of discretion that, at minimum, compels a new trial.

Nowhere in the other instructions were the jurors ever informed of the legal requirements of a rule-of-reason tying claim. Rather, the instructions literally told them that there *are* no such requirements. A graver abdication of a court's duty to explain the law is difficult to imagine. Because that instruction was "capable of confusing and thereby misleading the jury," defendants are entitled to a new trial. *Griffiths*, 988 F.2d at 462.

II. BCI'S RICO CLAIMS FAIL AS A MATTER OF LAW

The jury found that the routine commercial practices at issue in this case violate RICO, 18 U.S.C. § 1961 *et seq.*, but BCI's RICO claims fail as a matter of law. BCI failed to show that it has standing to recover for any alleged crimes committed against Gary's. BCI also did not present a sustainable case that any of the defendants committed any of the alleged predicate acts. Finally, the errors committed below on the antitrust claims necessarily constituted error under the RICO instruction given to the jury. At a minimum, defendants are entitled to a new trial.

A. BCI Lacked Standing To Press Its RICO Claim

BCI was awarded damages as a result of predicate crimes allegedly directed at Gary's. As an indirect victim of the alleged predicate acts, however, BCI suffered no harm sufficiently proximate to the alleged RICO violation. BCI lacks standing to pursue the RICO remedy.

The Supreme Court held in *Holmes* v. *Securities Investor Protection Corp.*, 503 U.S. 258 (1992), that secondary victims of RICO violations are not proper plaintiffs because they fail to satisfy RICO's proximate-cause requirement. The Court began with the language of 18 U.S.C. § 1964(c), which provides that "[a]ny person injured in his business or property by reason of a violation of section 1962 * * * may sue therefor." The "very unlikelihood that Congress meant to allow all factually injured plaintiffs to recover" persuaded the Court that "RICO should not get such an expansive reading" as to require only "but for" causation. 503 U.S. at 265-266.

Instead, the Court determined that standing under RICO incorporates a requirement of proximate cause. 503 U.S. at 268. Under the common law conception of proximate cause, "a plaintiff who complained of harm flowing merely from the misfortunes visited on a third person by the defendant's acts was generally said to stand at too remote a distance to recover." *Id.* at 268-269. And there are sound reasons to reject the claims of indirectly

injured victims. "[R]ecognizing claims of the indirectly injured would force courts to adopt complicated rules apportioning damages among plaintiffs removed at different levels of injury from the violative acts, to obviate the risk of multiple recoveries." *Id.* at 269. Nor is there a compelling reason for courts to shoulder this burden: "the need to grapple with these problems is simply unjustified by the general interest in deterring injurious conduct, since directly injured victims can generally be counted on to vindicate the law as private attorneys general, without any of the problems attendant on suits by plaintiffs injured more remotely." *Id.* at 269-270.[16]

Under *Holmes*, BCI lacks standing in this case. BCI is alleging that Gary's has been the victim of mail fraud, wire fraud, and extortion — and that *BCI* should therefore receive damages. Truly, BCI exemplifies the "plaintiff who complain[s] of harm flowing merely from the misfortunes visited upon a third person." *Holmes*, 503 U.S. at 268. Allowing BCI to sue on these facts also would present complicated problems of damage apportionment in the event that Gary's attempted to bring a follow-on RICO action. If anyone was injured by the conduct that constitutes the focus of the RICO claims, it was Gary's. Gary's, the directly injured "victim," surely had enough incentive to bring this treble-damages RICO claim if it in fact had been subjected to criminal activity. Yet Gary's has made no such claim, and BCI seeks to collect a windfall from an indirect injury. *Holmes* prevents such gamesmanship. The judgment in BCI's favor on the RICO claims should be reversed because BCI lacked standing to bring them.

B. BCI's RICO Claim Relied On Predicate Acts That Were Not Crimes

BCI alleged that the defendants violated 18 U.S.C. § 1962(c) and (d). A violation of § 1962(c) requires conduct of an enterprise through a pattern of racketeering activity. *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 496 (1985). "Racketeering activity" is defined to consist of a variety of state and federal crimes, and a "pattern" must be at least two crimes. See 18 U.S.C. § 1961(1), (5). Section 1962(d) is violated by conspiring

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[16] After *Holmes*, this Court has denied RICO standing to plaintiffs with indirect injuries. See *McCarthy* v. *Recordex Serv., Inc.*, 80 F.3d 842, 855 (3d Cir. 1996). But cf. *Environmental Tectonics* v. *W.S. Kirkpatrick, Inc.*, 847 F.2d 1052 (3d Cir. 1988) (before *Holmes*, affording standing to an indirectly injured competitor), aff'd on other grounds, 493 U.S. 400 (1990).

to violate § 1962(c).

BCI accused U.S. Healthcare of five predicate crimes: violation of Pennsylvania's commercial bribery statute, 18 Pa. Cons. Stat. § 4108(b), extortion, 18 U.S.C. § 1951, mail fraud, 18 U.S.C. § 1341, wire fraud, 18 U.S.C. § 1343, and violation of the Travel Act, 18 U.S.C. § 1952. But, as we will demonstrate, BCI has not proved or even alleged conduct that would violate any of those laws. The theory under which BCI was allowed to proceed at trial rendered any use of economic pressure — an inevitable, legitimate ingredient of bargaining — a crime. Because they have committed no predicate crimes, and *a fortiori* no "pattern" of crimes, defendants should have received judgment on the RICO claims as a matter of law.

1. *Defendants' Conduct Was Not Commercial Bribery Under Pennsylvania Law*

The Pennsylvania commercial bribery statute proscribes both "commercial bribery" and "breach of duty to act disinterestedly," and imposes the following penalty on a "Corrupt disinterested person" (18 Pa. Cons. Stat. § 4108(b)):

> A person who holds himself out to the public as being engaged in the business of making disinterested selection, appraisal, or criticism of commodities or services commits a misdemeanor of the second degree if he solicits, accepts or agrees to accept any benefit to influence his selection, appraisal or criticism.

BCI failed to show (1) that U.S. Healthcare held itself out as in the business of making *disinterested* selection, appraisal, or criticism of commodities or services, or (2) that it solicited, accepted, or agreed to accept a benefit to influence its selection, appraisal, or criticism.

Section 4108(b) is identical to § 224.8(2) of the Model Penal Code. The statute is limited in application "to professional critics, commercial rating agencies, and the like." American Law Institute, Model Penal Code and Commentaries § 224.8, at 335 (1980). This provision "would be involved if an organization providing consumers with ratings of various products on the market were to accept money from a manufacturer to report distorted ratings." *Ibid*. Thus, the statute applies only to entities holding themselves out as disinterested.

But U.S. Healthcare does not provide a rating service; it operates HMOs. Provider quality is a necessary, but not always sufficient, criterion for inclusion in the network of providers to which U.S. Healthcare members have access. An HMO is designed to provide access to low-cost, high quality health care *and* to make a profit

for the HMO; there is nothing "disinterested" about the enterprise. Coan, *You Can't Get There From Here — Questioning the Erosion of ERISA Preemption in Medical Malpractice Actions Against HMOs*, 30 Ga. L. Rev. 1023, 1060 n.6 (1996). "[A]s a matter of simple semantics," *Orson*, 79 F.3d at 1374, U.S. Healthcare does not come within the bribery statute because it has no duty to act disinterestedly.

BCI's entire "proof" that U.S. Healthcare held itself out as providing disinterested selection services is this snippet from a U.S. Healthcare annual report: "[W]e have developed sophisticated quality assessment systems so the care received by our members continues to meet the highest standards. These systems begin with the certification of providers * * *." JA 1670-1671, 2741-2742. That passage simply does not show that U.S. Healthcare held itself out as "disinterested," or as "in the business of * * * selection, appraisal, or criticism." BCI made no showing under any "common and approved usage" of those statutory terms. *Orson*, 79 F.3d at 1374.

Pennsylvania law *does* impose on U.S. Healthcare the duty to allow *only* quality providers into its network. 28 Pa. Code § 9.71; *McClellan* v. *Health Maintenance Org.*, 604 A.2d 1053, 1059 (Pa. Super. 1992). But it does not follow that U.S. Healthcare has a duty to allow *all* qualified providers into its network. One of the public policy debates surrounding HMOs is whether HMOs should be compelled as a matter of law to allow all interested and minimally qualified providers into their networks. Many States have enacted so-called "Any Willing Provider" laws ("AWP laws") that require HMOs to allow all comers into their networks.[17] But Pennsylvania has turned back several proposed AWP laws, in part at the urging of the Federal Trade Commission, which consistently has opposed AWP laws as anticompetitive.[18] Pennsylvania has retained the traditional rule that HMOs may decide whom to admit into their networks, so U.S. Healthcare is permitted to pick and choose among

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[17] Recent Legislation, *Health Care Law, 109 Harv. L. Rev. 2122, 2124 (1996); Hellinger, Any-Willing-Provider and Freedom-of-Choice Laws: An Economic Assessment, Health Aff., Winter 1995, at 297, 298; Any Willing Provider Laws Proliferate at State Level, 3 Health L. Rep. (BNA) No. 46, at 1683 (Dec. 1, 1994).*

[18] *E.g.*, H.B. 571 (Pa. 1995); H.B. 630 (Pa. 1995); H.B. 2146 (Pa. 1995); S.B. 747 (Pa. 1995); S.B. 1525 (Pa. 1994); H.B. 2748 (Pa. 1994). See 3 Health L. Rep. (BNA) at 1683 (noting 1993 letter from FTC to Pennsylvania legislature); see also *FTC Finds Bill's Open Policy May Restrict Consumer Choice*, 59 Antitrust & Trade Reg. Rep. (BNA) 51 (1990) (1990 letter to Pennsylvania legislature).

qualified providers there. Thus, U.S. Healthcare's selection of the members of its provider network *cannot* be an objective and disinterested rating service. U.S. Healthcare retains the legal right — which its annual report certainly does not disclaim — to exclude qualified providers from the network.

Gary's decision to buy TPA services from a U.S. Healthcare subsidiary also cannot constitute a bribe as a matter of law. The suggestion that Gary's *"bribed"* U.S. Healthcare cannot co-exist with the burden of BCI's case in general — that U.S. Healthcare *coerced* Gary's — or with the alleged predicate act of extortion in particular. The jury instructions recognized that the same act could not constitute bribery and extortion. JA 2412, 2414. Extortion and bribery are "mutually exclusive crimes" in Pennsylvania. *Commonwealth* v. *Francis*, 191 A.2d 884, 889 (Pa. Super. Ct. 1963). Whereas extortion is accomplished by "coercion or threats," a bribe must be "volunteered." *Commonwealth* v. *Bellis*, 472 A.2d 194, 205 (Pa. Super. Ct. 1984), aff'd, 494 A.2d 1072 (Pa. 1985). But if Gary's ever "volunteered" to trade consideration for TPA services in exchange for expanded inclusion in the TPA network, that "bribe" annihilates BCI's antitrust, extortion, fraud, and tort theories, replacing them with a crime for which BCI has no conceivable standing to recover against U.S. Healthcare (or against Gary's, for that matter, given the at-will terminability of the BCI-Gary's contract).

Because BCI has failed to prove a violation of the Pennsylvania commercial bribery statute, that law cannot serve as a predicate crime in support of BCI's RICO claim.

2. *Defendants' Conduct Was Not Extortion Under The Hobbs Act*

Invoking a statute captioned "Interference with commerce by threats or violence," BCI has characterized the reciprocal dealing involved in this case as extortion, but federal law provides nothing of the kind. Extortion depends on a threat's being "wrongful" — an element not present in this case. BCI's extortion claim therefore fails as a matter of law.

The Hobbs Act imposes criminal penalties on "[w]hoever in any way or degree obstructs, delays, or affects commerce or the movement of any article or commodity in commerce, by robbery or extortion or at-

tempts or conspires so to do." 18 U.S.C. § 1951(a). "Extortion" is defined to mean "the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence, or fear." *Id.* § 1951(b)(2). This Court has held that a violation of the Hobbs Act requires the following elements: (1) the defendants induced or attempted to induce some other person to part with that person's property; (2) the defendants did so with the person's consent, but the consent was *coerced by the wrongful use or the wrongful threat of force, violence or fear*; (3) interstate commerce or an item moving in interstate commerce was delayed, obstructed, or affected in some way or degree; and (4) the defendant acted knowingly and willfully. *United States* v. *Traitz*, 871 F.2d 368, 380-381 (3d Cir. 1989).

Extortion under the Hobbs Act must "involve[ ] payment in return for something *to which the payer is already legally entitled*." *United States* v. *Addonizio*, 451 F.2d 49, 72 (3d Cir. 1972); see also *United States* v. *Inigo*, 925 F.2d 641, 650 n.8 (3d Cir. 1991). We explained above that the Pennsylvania legislature has rejected several AWP bills. Thus, Pennsylvania has affirmatively decided that providers have no "right" to inclusion in an HMO's network. Because Gary's had no entitlement to inclusion within the U.S. Healthcare network, any demand that defendants made in return for such inclusion could not constitute extortion as a matter of law.

The required "fear" can be an apprehension, concern, or anxiety about possible economic loss. What was also required, however, and what BCI completely failed to show, was that the defendants' alleged use of fear of economic loss was wrongful. *United States* v. *Capo*, 817 F.2d 947, 951 (2d Cir. 1987) (en banc). In the classic case of extortion (*e.g.*, a gangster demanding protection money on threat of violence), the defendant has no legal right to make such a demand and has no claim of right to the property requested. In business bargaining, however, businesses have a perfect legal right unilaterally to decide with whom they will deal, see *Colgate*, 250 U.S. at 307, and have a claim of right to enter into a reciprocal transaction.

The Supreme Court recognized the "claim of right" defense to a charge of extortion in *United States* v. *Enmons*, 410 U.S. 396 (1973). The defendants were charged with attempting to obtain higher wages and other

benefits for striking employees through the wrongful use of actual force and violence. The Court interpreted the statutory word "wrongful" to require that the alleged extortionist have no lawful claim to the property. *Id.* at 399-400. Despite the breadth of the holding in *Enmons*, this Court has limited its holding to the labor arena for fear of effectively repealing the Hobbs Act. See *United States* v. *Cerilli*, 603 F.2d 415, 419 (3d Cir. 1979).

The First Circuit has noted, however, that — although it may be appropriate not to recognize a "claim of right" defense in extortion cases based on the wrongful use of force or violence — different considerations apply in the context of "economic fear." *United States* v. *Sturm*, 870 F.2d 769, 772-773 (1st Cir. 1989). "Whereas the use of actual or threatened force or violence to obtain property is inherently wrongful, there is *nothing inherently wrongful* about the use of economic fear to obtain property." *Id.* at 773 (emphasis added) (citation omitted). Therefore, "for purposes of the Hobbs Act, the use of legitimate economic threats to obtain property is wrongful only if the defendant has no claim of right to that property." *Ibid.*

This Court has not yet considered the application of *Enmons* to economic fear, but the logic of *Sturm* is inescapable. If the holding in *Cerilli* was necessary to prevent effective repeal of the Hobbs Act, the holding in *Sturm* is necessary to prevent the Hobbs Act — freed from the requirements of *Enmons* — from swallowing all of modern commercial practice.[19]

One court has recently and persuasively analyzed the distinction between hard bargaining and extortion. In *Viacom Int'l, Inc.* v. *Icahn*, 747 F. Supp. 205 (S.D.N.Y. 1990), aff'd on other grounds, 946 F.2d 998 (2d Cir. 1991), the defendants were accused of purchasing substantial stock in the plaintiff company and then coercing the plaintiff to buy its stock back for cash, stock warrants, and free advertising — all allegedly under a threat of a corporate takeover. In return for the requested "greenmail," the defendants agreed not to buy the plaintiff's stock (or otherwise to seek control of the plaintiff) for a period of 11 years. *Id.* at 207-209.

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[19] The trial court refused to instruct the jury on a "claim of right" defense. JA 2261-2262. Thus, at a minimum, defendants are entitled to a new trial. *Griffiths*, 988 F.2d at 462.

Drawing the same distinction that this Court drew in *Addonizio*, 451 F.2d at 72, the *Viacom* court dismissed as a matter of law the allegation that the challenged practice constituted extortion (747 F. Supp. at 213 (citations omitted)):

> The difference between "hard bargaining" and extortion is as follows: In a "hard bargaining" scenario the alleged victim has no pre-existing right to pursue his business interests free of the fear he is quelling by receiving value in return for transferring property to the defendant, but in an extortion scenario the alleged victim has a pre-existing entitlement to pursue his business interests free of the fear he is quelling by receiving value in return for transferring property to the defendant.

The same analysis applies to the present case. BCI assumed — and convinced the district court — that Gary's somehow had a right "fully and freely" to participate in U.S. Healthcare's provider network. See, *e.g.*, JA 2395, 2404. But no such right exists. To the contrary, the *Colgate* doctrine has provided for more than 75 years that, in the absence of a monopoly, businesses have the perfect right to make unilateral decisions about those with whom they will deal. Because U.S. Healthcare had the right to deny Gary's access to its network for any reason or no reason at all, it necessarily had the right to condition access to the network on Gary's agreeing to do business with CHA. U.S. Healthcare simply never caused or threatened to cause the loss of anything to which Gary's was entitled. U.S. Healthcare's conduct was not "wrongful." As a matter of law, then, it cannot be classified as extortion.

Because BCI has not alleged or proved extortionate conduct that falls within the terms of the Hobbs Act, that Act cannot serve as a predicate crime in support of BCI's RICO claim.

3. *Defendants' Conduct Was Not Mail Fraud Or Wire Fraud*

BCI's allegation that U.S. Healthcare violated the federal mail fraud and wire fraud statutes can only be characterized as bizarre. The theory underlying BCI's claim is inescapably self-contradictory. Thus, BCI may not rely on either statute to support its RICO claim.

U.S. Healthcare violated the mail and wire fraud statutes only if it willfully and knowingly devised a scheme to defraud Gary's. See *Pereira* v. *United States*, 347 U.S. 1, 8-9 (1954) (mail fraud requires scheme to defraud); *Carpenter* v. *United States*, 484 U.S. 19, 25 n.6 (1987) (wire fraud requires scheme to defraud); 18 U.S.C. §§ 1341, 1343. "[D]efraud usually signifies the deprivation of something of value by trick, deceit, chicane or overreaching." *Kehr Packages, Inc.* v. *Fidelcor, Inc.*, 926 F.2d 1406, 1415 (3d Cir. 1991) (internal

quotation marks omitted).

BCI's contention supporting its mail/wire fraud theory is that U.S. Healthcare fraudulently misrepresented its actual motive throughout the generic-use audit of Gary's Eagleville store. According to BCI, whereas U.S. Healthcare actually and secretly intended to use the audit as pressure to extort TPA patronage from Gary's, it fraudulently misled Gary's into believing that the audit was a legitimate inquiry into generic utilization. That theory makes no sense. If U.S. Healthcare were trying to extort Gary's, it would have been self-defeating to disguise the reasons for the audit — a misrepresentation that could only hinder the desired extortion.

"Fraud is false speech in the purest sense, an intentional lie made to induce reliance." *In re Grand Jury Matter, Granowicz*, 764 F.2d 983, 988 (3d Cir. 1985) (en banc). There was no evidence that U.S. Healthcare ever misrepresented its reasons for the Eagleville audit — Gary's employees conceded that U.S. Healthcare's stated reason, Gary's excessive use of brand-name drugs, was accurate (JA 1850) — much less any evidence placing U.S. Healthcare under any duty to disclose its motivations for the audit to Gary's. A civil plaintiff must prove reliance to recover for mail and wire fraud violations. *E.g.*, *Andrews* v. *AT&T*, 95 F.3d 1014, 1024 (11th Cir. 1996); *Appletree Square I, Ltd. Partnership* v. *W.R. Grace & Co.*, 29 F.3d 1283, 1286 (8th Cir. 1994). The record in this case is devoid of any evidence that Gary's relied on the alleged misrepresentations. Indeed, Gary's could have demonstrated reliance only by rejecting U.S. Healthcare's TPA services and retaining BCI. BCI therefore cannot show that its alleged harm was a proximate result of the alleged misrepresentations. See *Holmes*, *supra*.

BCI has not demonstrated a violation of the mail fraud or wire fraud statutes, nor could it possibly demonstrate reliance or proximate cause. Thus, BCI may not rely on the mail fraud or wire fraud statute for predicate acts to uphold its RICO claim.

4. *Defendants' Conduct Did Not Violate The Travel Act*

To make out a violation of the Travel Act, 18 U.S.C. § 1952, BCI was required to prove interstate travel or use of an interstate facility with intent to promote an unlawful activity, and a subsequent overt act in furtherance of the unlawful activity. *United States* v. *Zolicoffer*, 869 F.2d 771, 774 (3d Cir. 1989). "Unlawful

activity" is "extortion, bribery, or arson in violation of the laws of the State in which committed or of the United States." 18 U.S.C. § 1952(b)(2).

BCI's Travel Act claim hinges on the Hobbs Act and commercial bribery claims. We showed above that those claims fail as a matter of law. With no "unlawful activity" left for U.S. Healthcare to "promote," BCI has no Travel Act claim, and cannot rely on the Travel Act as a predicate act. Without any proof of predicate acts, BCI's RICO claim fails as a matter of law.

C. RICO Does Not Permit "Aiding and Abetting" Liability

The trial court erroneously permitted the jury to consider "aiding and abetting" as a separate claim for liability under RICO (JA 2393, 2427), an especially prejudicial error for the individual defendants (such as Murphy) who had limited involvement in the events in suit. In light of *Central Bank* v. *First Interstate Bank*, 511 U.S. 164 (1994), holding that § 10 of the Securities Exchange Act of 1934 does not provide for "aiding and abetting" liability because the text of the statute does not proscribe such conduct, § 1962 of RICO should be similarly construed. See *United States* v. *Viola*, 35 F.3d 37, 40-41 (2d Cir. 1994), cert. denied, 115 S. Ct. 1270 (1995). This Court did not consider the effect of *Central Bank* in its decision on "aiding and abetting" in *Jaguar Cars, Inc.* v. *Royal Oaks Motor Car Co.*, 46 F.3d 258 (3d Cir. 1995).

D. The Errors On The Antitrust Claims Contaminated The RICO Instructions

In instructing the jury on the definition of extortion, the court below stated:

> [T]hus interfering with a person's right to freely make business decisions by wrongfully causing him to fear economic harm is extortion under the Hobbs Act.
> Further, putting a person in fear of economic harm is wrongful when the defendant causing the fear is not entitled to the property obtained or when the defendant uses fear of economic harm to achieve an unlawful objective *such as a violation of the Federal antitrust laws* * * *.

JA 2413 (emphasis added). The court's other instructions told the jury that BCI's legally erroneous antitrust market definitions provided a lawful basis to support its RICO claim, which further compounded the legal error. A jury applying the instructions could have concluded — as the jury actually did in this case — that U.S. Healthcare had violated the antitrust laws as a result of the reciprocal dealing alleged in this case. Once the jury arrived at that decision, the above instruction required the jury to find that extortion under the Hobbs Act had been committed. In other words, the error in the antitrust instructions permitted and almost guaranteed an erroneous

finding that RICO had been violated.

We have shown above that BCI's RICO claim, like its antitrust claim, fails as a matter of law. Even if the Court were to hold that BCI had somehow made its case under RICO, the instructional error nevertheless would require a new trial. *Griffiths*, 988 F.2d at 462.

III. THE TORTIOUS-INTERFERENCE AWARD SHOULD BE REVERSED

Competitors routinely tack a tort claim onto their antitrust suits against rivals who take business from them. Just as routinely, courts reject the tort claim that accompanies an invalid antitrust claim, because the same policies that favor hard competition under the antitrust laws also inform the common law of tortious interference. See, *e.g.*, *Los Angeles Land Co.* v. *Brunswick Corp.*, 6 F.3d 1422, 1429-1431 & n.9 (9th Cir. 1993); *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532, 542-543 (7th Cir. 1986); *Cernuto, Inc.* v. *United Cabinet Corp.*, 448 F. Supp. 1332, 1337 (W.D. Pa. 1978), rev'd on other grounds, 595 F.2d 164 (3d Cir. 1979).

BCI received damages on the theory that the reciprocal dealing at issue constituted tortious interference with its contractual relations (actually, *prospective* contractual relations) with Gary's. But the Pennsylvania law of tortious interference required BCI to prove that defendants used "wrongful means" in competing with BCI, and BCI made no legally sufficient showing of wrongfulness, so defendants are entitled to judgment as a matter of law on this claim.

Pennsylvania courts are guided by the Restatement (Second) of Torts in forming tortious-interference case law. *Adler, Barish, Daniels, Levin & Creskoff* v. *Epstein*, 393 A.2d 1175, 1184 (Pa. 1978). The Restatement distinguishes between the torts of interference with performance of a contract and interference with prospective contractual relations. Compare Restatement §§ 766, 766A with *id.* § 766B. If a contract is terminable at will, the Restatement characterizes it as prospective. *Id.* § 768 cmt. a ("Even an option to renew or extend a contract is prospective while not exercised."). Because the uncontradicted testimony at trial indicated that the contract between BCI and Gary's (JA 2814-2821) was terminable at will, JA 286-288, BCI's only claim can be for tortious interference with prospective contractual relations.

To state a claim for that tort, BCI needed to show (1) a prospective contractual relation; (2) the purpose or

intent to harm the plaintiff by preventing the relation from occurring; (3) the absence of privilege or justification on the part of the defendant; and (4) actual damage resulting from the defendant's conduct. *Thompson Coal Co.* v. *Pike Coal Co.*, 412 A.2d 466, 471 (Pa. 1979). Pennsylvania courts have taken these elements from § 766B of the Restatement, which provides that "[o]ne who intentionally and improperly interferes with another's prospective contractual relation" is liable "for the pecuniary harm resulting from loss of the benefits of the relation." This case turns on what constitutes "improper" interference.

Section 767 of the Restatement sets forth seven factors to be considered in determining whether interference is improper. As this Court has recognized, however, the "general rules" expressed in § 767 have been "refined in section 768(1) which deals specifically with competition as a proper or improper interference with existing or prospective contractual relations." *Franklin Music Co.* v. *American Broad. Cos.*, 616 F.2d 528, 543 (3d Cir. 1980).

Section 768 provides as follows:

> One who intentionally causes a third person * * * not to continue an existing contract terminable at will does not interfere improperly with the other's relation if
>
> (a) the relation concerns a matter involved in the competition between the actor and the other and
> (b) the actor does not employ wrongful means and
> (c) his action does not create or continue an unlawful restraint of trade and
> (d) his purpose is at least in part to advance his interest in competing with the other.

Restatement § 768(1) (quoted in *Franklin Music Co.*, 616 F.2d at 543; *Gilbert* v. *Otterson*, 550 A.2d 550, 554 (Pa. Super. Ct. 1988)). The key question — essentially the same question presented by the antitrust counts — is whether U.S. Healthcare "employ[ed] wrongful means."

A. Defendants' Conduct Did Not Constitute "Wrongful Means"

To argue that reciprocal dealing is wrongful, BCI relies on the same theme it used to argue that it constitutes an antitrust violation and several crimes: U.S. Healthcare coerced Gary's into buying TPA services. The only court that has decided whether a reciprocal-dealing arrangement is "wrongful" under the Restatement analysis determined that the defendant lacked market power and then ruled for the defendant as a matter of law on both

a Sherman Act count and a tort count. *Great Escape, Inc.* v. *Union City Body Co.*, 791 F.2d 532 (7th Cir. 1986).

Although Indiana law applied to the tortious-interference claim, Judge Cudahy's opinion for the court noted that the Restatement approach would produce the same result:

> The Restatement * * * suggests that the facts before us cannot support a claim of tortious interference with prospective business relations. First, interference with prospective relations requires that more blameworthy means be used than does the tort of interference with contractual relations. Thus, "when the means adopted is not innately wrongful . . . the interference is more likely to be found to be not improper." Restatement of Torts § 766B Comment e. The Restatement defines innately wrongful means as those that are tortious themselves. Second, the Restatement requires especially egregious means to be employed when a competitor is seeking to expand its business.

791 F.2d at 542 n.6. The court then discussed § 768 of the Restatement. *Ibid.* The court emphasized that it is appropriate to decide these types of claims as a matter of law (*id.* at 543):

> [T]hese limitations by the various authorities on the tort of interference with prospective business relations are appropriate. Competitors and their allies are not necessarily gentlemen — or even scholars. Competition may be rough and tumble and even — within reasonable bounds — involve economic factors extraneous to the main competition itself. We do not believe a searching analysis only of motive is in most instances enough to send these cases to the jury.

Pennsylvania courts also have not hesitated to decide tortious-interference cases as a matter of law. *E.g.*, *Gilbert* v. *Otterson*, 550 A.2d 550, 555 (Pa. Super. 1988).

The Seventh Circuit's approach has a great deal of merit. If a defendant lacks market power, there is no reason to believe that a reciprocal-dealing practice has the potential to injure competition. To the contrary, allowing sellers to use every competitive advantage furthers competition. Here, Gary's felt that it got the benefits of non-price competition by obtaining better services from CHA. JA 419. That BCI failed to have a contract renewed is not a tort; it is an inevitable consequence of a competitive marketplace. We showed above that U.S. Healthcare has no market power in any legally relevant market. Therefore, defendants are entitled to judgment on the tortious-interference claim as a matter of law.

BCI has devoted much effort to alleging that the conduct at issue in this case is inherently wrongful, but we showed above that its federal-law claims lack merit. BCI comes no closer to making its case under Pennsylvania law. Pennsylvania "is one of the few states without antitrust statutes of general application," and specifically does not proscribe tying arrangements. 14 J. VON KALINOWSKI, ANTITRUST LAWS AND TRADE REGULATION

§ 170.01, at 170-2, -5 (1996). Indeed, Pennsylvania approves of the type of conduct at issue here. New Jersey has adopted an AWP law, but Pennsylvania has not. JA 756.[20] Rather, Pennsylvania has rejected proposed AWP laws and thus has consciously retained the traditional rule that HMOs may decide whom to admit into their networks. See pp. 28-29, *supra*. Allowing juries to condemn that practice as inherently wrongful would violate the Commonwealth's public policy.

Furthermore, as the *Great Escape* court noted, to constitute "wrongful means" under the Restatement analysis, an action must be independently tortious. 791 F.2d at 542 n.6. Pennsylvania law has consistently reflected this principle. See, *e.g.*, *Franklin Music Co.*, 616 F.2d at 545 (encouraging a breach of fiduciary duty); *Pino* v. *Prudential Ins. Co.*, 689 F. Supp. 1358, 1362-1363 (E.D. Pa. 1988) (misrepresentations); *SI Handling Sys., Inc.* v. *Heisley*, 658 F. Supp. 362, 375 (E.D. Pa. 1986) (misappropriation of trade secrets); *Techno Corp.* v. *Dahl Assocs., Inc.*, 535 F. Supp. 303, 307 (W.D. Pa. 1982) (dissemination of confidential information). BCI adduced no proof at trial that would indicate that defendants' actions were independently tortious. For that reason, defendants are entitled to judgment under Pennsylvania law.

B. Instructional Errors Warrant A New Trial On The Tortious-Interference Claim

Even if BCI had presented a jury question on tortious interference, a new trial would be required. The trial court instructed the jury on "wrongful means" as follows (JA 2431):

> It is — wrongful means to take business away from a competitor by using economic power in matters that are unrelated to the business in which the competitors compete. Thus taking away a competitor's business by applying economic pressure in an area that's unrelated to the field in which the parties compete constitutes wrongful means.
>
> Wrongful means also include any unlawful conduct in violation of specific statutory provisions or of established public policy.

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[20] New Jersey's AWP law became a focal point at trial. In eliciting testimony regarding U.S. Healthcare's dealings with other pharmacies, relevant only to the RICO claims, BCI proffered evidence regarding the involvement of the New Jersey Department of Insurance. The court admitted that evidence, over objection. JA 1032-1033, 1052-1054. The evidence had no probative value and was extremely prejudicial in that suggested that U.S. Healthcare had contravened the public policy of the State of New Jersey. The court delivered no curative instruction that Pennsylvania had precisely the *opposite* public policy. The admission of the New Jersey evidence was therefore an abuse of discretion and mandates a new trial. *Advanced Med., Inc.* v. *Arden Med. Sys., Inc.*, 955 F.2d 188, 199 (3d Cir. 1992).

The court then listed the factors enumerated in § 767 of the Restatement. JA 2431-2432.

The court's first two sentences directed a verdict for the plaintiff on the facts of this case. That instruction, derived from Restatement § 768, cmt. e., declares that *all* reciprocal dealing is tortious. That notion is not and cannot be the law of Pennsylvania. As we have explained, the public policy of Pennsylvania supports the type of conduct at issue in this case. No Pennsylvania court has ever even cited the comment at issue, let alone adopted it as Pennsylvania law. The Supreme Court of Pennsylvania is "guided" by the Restatement in shaping Pennsylvania law in this area but does not necessarily accept every jot and tittle buried in the comments. *Adler, Barish, et al.*, 393 A.2d at 1184. Moreover, the proposed rule of law, if applied broadly enough to condemn *all* reciprocal dealing, would lead to absurd results by declaring that all reciprocal-dealing arrangements — most of which are procompetitive — are tortious. The one court to have confronted the issue soundly rejected the proposed rule. See *Great Escape,* 791 F.2d at 543 ("Competition may be rough and tumble and even — within reasonable bounds — involve economic factors extraneous to the main competition itself."). The comment, therefore, does not represent the law of Pennsylvania. Instructing the jury on this basis was clear error and dictated an erroneous result.

The second paragraph quoted above, although an accurate statement of the law, also necessitates a new trial. The problem here is the errors on the antitrust and RICO claims. Because the jury had already erroneously determined that the defendants had violated the antitrust laws and RICO, it was instructed that the conduct was also tortious. The errors in the antitrust and RICO analysis therefore inevitably infected the tortious-interference analysis.

Finally, there was no reason for the lower court to have instructed the jury on the § 767 factors. Those factors provide guidance on when interference is wrongful *when the defendant is not a competitor.* Where, as here, a competitive situation is involved, only § 768 should be used. See *Franklin Music*, 616 F.2d at 543. Pennsylvania juries are not given the liberty to decide on a case-by-case basis whether competition is a good thing; it is clearly privileged activity. See Restatement § 768; *Gilbert*, 550 A.2d at 555 ("The right to compete included the right to divert business from [the plaintiff].").

For all of these reasons, the lower court's instructions did not, as a whole, properly instruct the jury as to the Pennsylvania law of tortious interference with prospective contractual relations. At a minimum, defendants are entitled to a new trial. *Griffiths*, 988 F.2d at 462.

IV. THE COMPENSATORY AND PUNITIVE DAMAGES AWARDS CANNOT STAND

Two aspects of the damages awarded by the jury also require reversal as a matter of law. First, the uncontradicted evidence adduced at trial showed that Gary's merged with a larger chain of pharmacy/retailers during the time of trial. For this reason, BCI's damages cannot extend past the date of the merger. Second, the record is devoid of facts that would establish a legal basis for awarding punitive damages under Pennsylvania law. Thus, the punitive component of the damage award should also be reversed.

A. BCI Was Not Entitled To Be Compensated For The Period After May 31, 1996

During the course of the trial, Drug Emporium acquired the Gary's chain. JA 1860-1861. Upon acquiring Gary's, Drug Emporium canceled the TPA contract between Gary's and U.S. Healthcare effective May 31, 1996, because its employees would henceforth be covered by the Drug Emporium plan (JA 2986). Therefore, defendants cannot have proximately caused BCI any damages after May 1996. When the evidence of record is insufficient to demonstrate the injury allegedly being compensated, it is appropriate for a court to reverse a compensatory damages award. *Price* v. *City of Charlotte*, 93 F.3d 1241, 1255 (4th Cir. 1996), petition for cert. filed, 65 U.S.L.W. 3467 (Dec. 16, 1996) (No. 96-962).

Using the methodology that resolves any conceivable ambiguity in favor of BCI — the one used by BCI's damages expert Wayne Geisser — it is possible to calculate the maximum amount of compensatory damages supported by the record. That calculation indicates that, at most, BCI could have sustained $111,040 in compensatory damages during the period before May 31, 1996, and the remainder of the $200,000 compensatory award should be vacated.[21]

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[21] That number is calculated as follows: Geisser stated that BCI would have earned $49,150 in profits for the year ending June 30, 1995. JA 1414-1415. Geisser also estimated that BCI would have received $67,516 in profits during the second full year of damages. *Ibid.* The second year of damages, however, ended on June 30, 1996. To find the total damages as of May 31, 1996, it is necessary to prorate the

B. Punitive Damages Were Not Warranted

We have demonstrated above that BCI's tortious-interference claim is legally deficient and that, at a minimum, U.S. Healthcare is entitled to a new trial. Even if the finding of liability could be affirmed, however, the award of punitive damages cannot stand.

"[P]unitive damages will lie only in cases of outrageous behavior, where defendant's egregious conduct shows either an evil motive or reckless indifference to the rights of others." *Takes* v. *Metropolitan Edison Co.*, 655 A.2d 138, 146 (Pa. Super. 1995). They require actions "of such an outrageous nature as to demonstrate intentional, willful, wanton or reckless conduct." *Ibid.* (quoting *SHV Coal, Inc.* v. *Continental Grain Co.*, 587 A.2d 702, 704 (Pa. 1991)). "[A]n award of punitive damages must be supported by evidence of conduct * * * more serious than the mere commission of the underlying tort." *Franklin Music*, 616 F.2d at 542.

Defendants' conduct here was nothing more sinister than legitimate competition for business. Even if the Court were to hold that BCI presented a jury question on the somewhat murky intentional-interference tort, the record is devoid of any indication that defendants behaved with an evil motive or in a wanton manner. See, *e.g.*, *Tunis Bros.*, 952 F.2d at 740-741 (it is not outrageous conduct to induce a plaintiff to give up a franchise when defendant has the right to terminate the franchise). For its proof in this regard, BCI relied on the punctuation in one sentence in a handwritten memorandum from a departing CHA marketing executive (defendant Murphy) to his successor, noting that the Gary's business was in play, that CHA should be able to win the business, and that the "Group [is] currently w/[BCI president] Arnie Katz!" JA 2491, 2319. Confidence in the outcome of competition with a specific competitor bears not the slightest relation to punishable motives or conduct. Thus, the evidence does not support punitive damages against U.S. Healthcare. It is even clearer that the individual defendants are entitled to have the punitive damages reversed. If the evidence does not indicate outrageous conduct in the aggregate, it certainly does not support a finding of outrageousness on the part of the individual defendants, who were merely doing their jobs. It may not be surprising that a jury erroneously instructed that defendants' actions constituted extortion, which is a federal crime subject to severe punishment, found that the standard for

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second-year damage figure by 11/12. This leaves profits of $61,890 (rounding up) during the first eleven months of the second year of damages. Adding this number to the first year of damages yields $111,040 — the number used in the text. Geisser expressly approved this methodology at trial. *Ibid.*

punitive damages had been met. But there is no evidence to support that view. When "evidence of aggravated conduct involving bad motive or reckless indifference" is absent from the record, "judgment [as a matter of law] on the punitive damages verdict [i]s proper." *Franklin Music*, 616 F.2d at 542. In addition, if the compensatory damages are reduced, the punitive damages award should be remitted as unconstitutionally disproportionate under *BMW of North America, Inc.* v. *Gore*, 116 S. Ct. 1589 (1996).

V. EVIDENTIARY ERRORS REQUIRE JUDGMENT FOR DEFENDANTS AS A MATTER OF LAW OR A NEW TRIAL

In addition to the errors identified above, the district court also committed legal error and abused its discretion in making several evidentiary determinations. We address only three egregious examples. The district court erred by admitting into evidence (1) a survey by BCI's expert that did not at all adhere to professional norms; (2) hearsay evidence of "coercion," contrary to the trial testimony provided by the declarant, under the "state of mind" exception; and (3) opinion testimony that U.S. Healthcare's generic-use policy violated Pennsylvania law.

A. The Testimony Regarding The Knowlton Survey Was Inadmissible

BCI's sole evidence of market share derived from a survey designed by one of its experts, Dr. Calvin Knowlton, Associate Professor and Chair of the Department of Pharmacy Practice and Pharmacy Administration at the Philadelphia College of Pharmacy and Science. JA 1426-1427. Knowlton has no formal background in economics or in analysis of market power. JA 1549-1552. In his survey, undergraduate students armed with the Yellow Pages called up 6-8 pharmacies within varying distances of each of three arbitrarily selected Gary's store locations and asked them a series of questions. Using only the responses that listed U.S. Healthcare as their primary HMO customer, Knowlton formed the opinion that U.S. Healthcare possessed market power. Knowlton's survey, however, is riddled with methodological errors. In addition, the survey is rank hearsay, and

the gross errors in methodology prevent the survey results from having the indicia of reliability that might allow admission.

In *Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), the Supreme Court instructed courts to maintain a "gatekeeper" function over proffered scientific testimony. The court must "determine * * * whether the expert is proposing to testify to (1) scientific knowledge that (2) will assist the trier of fact to understand or determine a fact in issue." *Id.* at 592. That determination "entails a preliminary assessment" both "of whether the reasoning or methodology underlying the testimony is scientifically valid and of whether that reasoning or methodology properly can be applied to the facts in issue." *Id.* at 592-593. A study or survey that fails to satisfy professional norms is inadmissible. See, *e.g.*, *Khan* v. *State Oil Co.*, 93 F.3d 1358, 1365 (7th Cir. 1996), petition for cert. filed, 65 U.S.L.W. 3417 (Nov. 26, 1996) (No. 96-871).

Survey results being offered as proof of the matters asserted — as in this case — are also objectionable as hearsay. *Pittsburgh Press Club* v. *United States*, 579 F.2d 751, 755 (3d Cir. 1978). Such surveys are admissible only if they meet the requirements of Federal Rule of Evidence 803(24) by having "circumstantial guarantees of trustworthiness" — as would be the case if the survey is conducted in accordance with professional norms. *Id.* at 758. After reading the relevant portion of *Pittsburgh Press Club*, the district court correctly noted that Knowlton's survey "does not meet the standards that have been articulated by the Court of Appeals." JA 1442-1445. But the court reversed itself the next morning. JA 1461.

Knowlton's survey should have been excluded both as improper scientific testimony and as improper hearsay. We frame our analysis under the hearsay rule because this Court's analysis in *Pittsburgh Press Club* eerily anticipated the most fundamental errors in Knowlton's survey. The same factors also demonstrate the survey's lack of scientific validity under *Daubert*.[22]

In *Pittsburgh Press Club*, 579 F.2d at 758, the Court laid out the methodology necessary for a survey to

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[22] Although the general standard of review of evidentiary decisions is abuse of discretion, this Court conducts plenary review of the district court's *Daubert* analysis and interpretation of Fed. R. Evid. 702. *In re Paoli R.R. Yard PCB Litig.*, 35 F.3d 717, 749 (3d Cir. 1994).

comply with professional norms:

> [1] A proper universe must be examined and [2] a *representative* sample must be chosen; the persons conducting the survey must be experts; [3] the data must be properly gathered and accurately reported. [4] It is essential that the sample design, the questionnaires and the manner of interviewing meet the standards of objective surveying and statistical techniques.

To be admissible, a proposed survey must at least comply with these four requirements. Knowlton's survey complies with *none* of them.

1. *"A Proper Universe Must Be Examined."*

Knowlton explained the difference between primary and secondary trading areas. A primary trading area is the geographic area surrounding a pharmacy from which it draws 50% of its clientele. JA 1489. A secondary trading area is the geographic area surrounding a pharmacy from which it draws 90% of its clientele. *Ibid*. Knowlton's survey, mixing apples and oranges, consisted of the *primary* trading area for one of his "clusters" (Eagleville-Norristown-Trooper, see JA 1500) and the *secondary* trading area for the other two (Lansdale, JA 1500-1501, and Abington, JA 1501). In addition, Knowlton's survey used a universe that was skewed by the propensity to advertise in the Yellow Pages, from which survey targets were selected in preference to the more comprehensive list maintained by the Board of Pharmacy. Knowlton acknowledged at trial that this deficiency could skew his results. *Ibid*.

2. *"A Representative Sample Must Be Chosen."*

The touchstone of a legitimate survey is random selection — without it, there is no reason to believe that the sample is representative of any larger universe. Knowlton decided to collect data in the areas surrounding only three of the six Gary's stores, but he did not randomly select the three. Instead, he selected three locations in the same county (JA 1497), simply "because they appealed to" him (JA 1494). Once Knowlton did that, his survey lost any possible predictive value. Statisticians differentiate between descriptive statistics and inferential statistics. See, *e.g.*, W. WENTZ, MARKETING RESEARCH: MANAGEMENT AND METHODS 134-137, 149-150 (1972). Descriptive statistics merely tabulate whatever data are on hand (*e.g.*, "of my three friends, 66.7% prefer Coke over Pepsi"). Only the use of inferential statistics — which involve scientific data selection, thus enabling approximation of error — permits one to generalize about the population from which the sample was drawn. Knowlton recog-

nized these principles:

> [W]e didn't try to infer anything from this. We didn't say that because these three pharmacy clusters in Montgomery County said what they did that that means that's what all of Pennsylvania would be like. * * * [W]e couldn't * * * generalize from these three clusters into Pennsylvania, because that's not how the design was set up * * *.
>
> So, I therefore used descriptive statistics which is just simple percents and frequencies. This many said this, this many said that. This is a percent, that's a percent.
>
> If it were a situation where we were actually going to be inferring or generalizing to the state, because we had randomly selected throughout the state and that kind of stuff, then we would use a whole different type of statistics, which was much more complicated that we don't even need to get into. Inferential statistics which would be involved with confidence intervals and P values and all those things.

JA 1497-1498. Knowlton's "survey" was a description of the 20 data points that he bothered to take — and nothing more. There is thus not even a remote possibility that the "survey" was *representative* of any population relevant to this case.

3. *"The Data Must Be Properly Gathered And Accurately Reported."*

No one outside of a courtroom would take seriously a scientist who collected a set of data, retained and reported data from the responses that were consistent with his theory, and ignored and failed to report any data that were inconsistent with the hypothesis. Yet that is exactly what Knowlton did in this case. Knowlton's survey asked 20 pharmacists to name the HMO with which they did the plurality of their business, and to report the percentage of their prescription business for which that HMO was responsible.[23] Fourteen of the 20 pharmacies named U.S. Healthcare as their largest HMO customer. JA 1515-1517. Knowlton then generalized about the data supplied by those 14 pharmacies — *while ignoring the six pharmacies that reported that U.S. Healthcare was not their largest HMO customer.* JA 1533. These six data points wouldn't be nearly as helpful to BCI's case, *so Knowlton did not consider them in his empirical analysis. Ibid.* This type of selective analysis in and of itself renders the entire survey inadmissible.

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[23] Although the survey nominally asked for quantitative information, the respondents did not actually compile data to give a response. That the respondents were merely providing offhand guesses to the survey made the slanting in Knowlton's survey even more effective.

4. *"It Is Essential That The Sample Design * * * Meet The Standards Of Objective Surveying."*

Objective surveying is a bedrock principle of survey design. The use of suggestive questions renders void the data obtained as answers to the biased questions, because people responding to a survey tend to react to the framing of a question. See, *e.g.*, J.R. EISER, SOCIAL PSYCHOLOGY 219-220 (1986). For example, asking 100 people "What is your favorite soft drink?" will likely produce very different results from the question "Of all soft drinks, such as Coke or Pepsi, which is your favorite?" By providing examples within the question, the surveyor necessarily biases the response in favor of the examples.

Knowlton's *pilot* survey was *not* unduly suggestive — it merely asked respondents to name the customer providing the most pharmacy business. JA 2802-2804. In Knowlton's eyes, however, that survey resulted in "confusion," so he "improved" the question (JA 1654):

> You provide services for people with prescription cards, like PCS and PAID, et cetera.[24] You also provide services for people on specific HMO plans like Keystone, U.S. Healthcare, et cetera. What's the name of the HMO with which you did the most prescription business * * * ?

Of the 20 pharmacies surveyed, 14 responded "U.S. Healthcare" and 5 responded "Keystone." JA 1615, 1515-1517. Only one respondent did not conform to the careful slant in Knowlton's question. This one flaw alone should compel the exclusion of the survey.

* * * * *

As Knowlton testified, "[t]he way that this was done was not rocket science." JA 1501. The survey was inadmissible as unreliable hearsay and as improper scientific testimony. It had no probative value, but its trumped-up data easily could have had a prejudicial effect on the jury. Because BCI's *sole* evidence of market share in a legally relevant market should not have been admitted, defendants are entitled to judgment as a matter of law.

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[24] This first part of Knowlton's "improvement" was also a clever way of skewing his survey results in BCI's favor. PCS, PAID, and PACE are large, institutional, non-HMO purchasers of prescription drugs. In fact, PAID was Gary's largest purchaser of prescription drugs, and both PAID and PACE purchased more prescription drugs from Gary's than did U.S. Healthcare. JA 1840. By structuring his question such that survey respondents excluded those large, non-HMO purchasers, Knowlton effectively narrowed his product market from "purchases of prescription drugs" to "HMO purchases of prescription drugs."

At the very least, the plainly substantial prejudice resulting from this erroneously admitted evidence requires a new trial. *Advanced Med., Inc.* v. *Arden Med. Sys.*, 955 F.2d 188, 199 (3d Cir. 1992).

B. Prejudicial Hearsay Statements Were Erroneously Admitted Under The "State Of Mind" Exception To The Hearsay Rule

Robin Risler, the ultimate decisionmaker from Gary's on the question of which TPA to hire, unambiguously testified that she selected CHA because it presented an all-around better option. JA 418-420. The *only* evidence that BCI presented to contradict Risler's testimony — the *only* evidence in support of its claim that Gary's had been coerced into hiring U.S. Healthcare — was hearsay testimony. Three BCI employees testified that Risler had indicated to them that she was being forced to fire BCI. JA 260-264, 477-478, 481-487. One witness, Sandra Chen, testified that Gary Wolf had indicated to her that he was under pressure to entertain a bid for U.S. Healthcare's TPA services. JA 436-440. The district court allowed into evidence a full rendition of these hearsay conversations, over strenuous objections. JA 260-262, 435-436, 471-477, 483. The purported basis for admission was Federal Rule of Evidence 803(3), which provides an exception to the hearsay rule for a declarant's then-existing mental, emotional, or physical condition. The district court's decision to admit reams of hearsay under the "state of mind" exception was based on an erroneous view of the law and was an abuse of discretion. Because the erroneously admitted evidence constituted BCI's sole direct evidence of coercion, defendants are entitled to judgment as a matter of law.

Federal Rule of Evidence 803(3) provides as follows:

> *Then existing mental, emotional, or physical condition*. A statement of the declarant's then existing state of mind, emotion, sensation, or physical condition (such as intent, plan, motive, design, mental feeling, pain, and bodily health), but not including a statement of memory or belief to prove the fact remembered or believed unless it relates to the execution, revocation, identification, or terms of declarant's will.

The Advisory Committee Notes to Rule 803(3) explain the rationale for the exclusion from evidence of statements of "memory or belief to prove the fact remembered or believed":

> [t]he exclusion of "statements of memory or belief to prove the fact remembered or believed" is necessary to avoid the virtual destruction of the hearsay rule which would otherwise result from allowing state of mind, provable by a hearsay statement, to serve as the basis for an inference of the happening of the event which produced the state of mind.

When a declarant makes an out-of-court statement about her state of mind as a result of a factual condition, the statement may be admitted under Rule 803(3) to demonstrate the declarant's state of mind, but it is not admissible to prove the truth of the factual condition. See, *e.g.*, *Electroglas, Inc.* v. *Dynatex Corp.*, 497 F. Supp. 97, 102-103 (N.D. Cal. 1980) (in tying case, statement not admissible under Rule 803(3) to prove existence of the tie). Thus, if Robin Risler told someone that she was quitting Gary's because a co-worker had assaulted her, that statement would be admissible to prove that she was going to quit Gary's, *but not admissible to prove the assault.* This somewhat abstract distinction can be critical.

In fact, this very issue proved dispositive in a recent antitrust decision by this Court. In *Stelwagon Mfg. Co.* v. *Tarmac Roofing Sys., Inc.*, 63 F.3d 1267 (3d Cir. 1995), cert. denied, 116 S. Ct. 1264 (1996), the plaintiff alleged price discrimination in violation of the Robinson-Patman Act. The district court admitted, under Rule 803(3), conversations that the plaintiff's employees had had with plaintiff's customers to the effect that the customers had been able to make purchases from the defendant more cheaply than had the plaintiff. *Id.* at 1274. This Court noted that “[s]tatements that are considered under the exception to the hearsay rule found at Fed. R. Evid. 803(3), commonly referred to as the `state of mind' exception, cannot be offered to prove the truth of the underlying facts asserted.” *Ibid.* The Court observed that the district court, while claiming to admit the statements only to prove state of mind, had, in actuality, impermissibly relied on the statements to make out an element in the antitrust claim. *Id.* at 1274-1275. Because there was no other evidence in the record to establish this element, the Court vacated the tainted aspect of the judgment below. *Id.* at 1269.

The same analysis applies here. BCI presented its hearsay conversations as evidence, the district court admitted them for the limited purpose of demonstrating the state of mind of the declarant, but BCI was then permitted to rely on the *substance* of those statements — the sole evidence in the record on the factual question of coercion. Demonstrating coercion is a necessary element in each of BCI's theories for recovery. Thus, the absence of evidence in the record *that is actually admissible for the purpose of demonstrating coercion* mandates that defendants be granted judgment as a matter of law. See *Electroglas, supra*.

C. Lay Opinions About Pennsylvania Generic Drug Use Law Were Inadmissible

Under Pennsylvania law, pharmacy consumers have the right to demand that they receive brand-name rather than generic drugs. JA 1704. Pharmacies are required to post a sign informing consumers of this right. JA 1703. In the absence of such a request from a consumer or a notation by the prescribing doctor that the brand-name version is medically necessary (JA 928), however, it is perfectly acceptable for the pharmacist to substitute the chemically identical generic drug for a brand-name prescription. U.S. Healthcare requires its member pharmacies to substitute generic drugs whenever possible, because doing so is a necessary element in controlling the spiraling costs of health care. JA 926.

The district court permitted opinion testimony that U.S. Healthcare's generic-drug policy violated the Pennsylvania law on generic use. First, BCI's expert Knowlton testified that defendant Brownstein's explanation of U.S. Healthcare's generic-drug policy did not "square" with Knowlton's understanding of Pennsylvania's pharmacy regulations. JA 1567-1568. Admitting that testimony was error; expert witnesses should not be allowed to testify as to legal conclusions, and erroneous admission of those conclusions can be prejudicial. See, *e.g.*, *Marx & Co.* v. *Diners' Club Inc.*, 550 F.2d 505, 510 (2d Cir. 1977); *United States* v. *Scop*, 846 F.2d 135, 140 (2d Cir.), modified on other grounds, 856 F.2d 5 (2d Cir. 1988); see also *Zenith Radio Corp.* v. *Matsushita Elec. Indus. Co.*, 505 F. Supp. 1313, 1332 (E.D. Pa. 1981), aff'd in part, rev'd in part on other grounds, 723 F.2d 238 (3d Cir. 1983), rev'd, 475 U.S. 574 (1986).

The district court compounded its error by allowing Donald Burness, director of pharmacy operations at Gary's, to testify that, in his opinion, U.S. Healthcare's generic-drug policy was "stretching the limits" of Pennsylvania law. JA 1876-1878. The legality of U.S. Healthcare's generic-usage policy was not one of the issues at trial. The admitted opinions were therefore irrelevant even if allowing non-legal-experts to testify regarding their views of the law were legitimate. In addition, the prejudice from such erroneous admission was enormous. Both the RICO claim and the tortious-interference claim required the jury to evaluate defendants' conduct against a vague standard of wrongfulness. That BCI was allowed continually to elicit lay opinions that U.S. Healthcare was in some way operating illegally could very easily have prejudiced the jury in this regard.

Thus, the district court erred in admitting these opinions, and the resultant prejudice entitles defendants to a new trial. *Advanced Medical*, 955 F.2d at 199.

* * * * *

Under either 15 U.S.C. § 15 (antitrust) or 18 U.S.C. § 1964(c) (RICO), BCI is entitled to fees only to the extent that it is a prevailing plaintiff. Because the degree of success is "'the most critical factor' in determining the reasonableness of a fee award" (*Farrar* v. *Hobby*, 506 U.S. 103, 114 (1992) (quoting *Hensley* v. *Eckerhart*, 461 U.S. 424, 436 (1983))), reversal by this Court of any portion of the antitrust or RICO judgment would require the district court to reconsider the fees awarded. Accordingly, if this Court reverses the judgment in BCI's favor in whole or in part, the award of attorneys' fees should be reversed and remanded for such further consideration as is appropriate in light of this Court's ruling on the merits.

CONCLUSION

For the foregoing reasons, the judgment should be reversed with instructions to enter judgment for defendants on all counts. In the alternative, a new trial should be ordered.

Respectfully submitted,

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