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REDACTED VERSION

VIA UPS OVERNIGHT DELIVERY

The Honorable Joel I. Klein
Assistant Attorney General
Main Justice Building
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001

Dear Assistant Attorney General Klein:

I am writing on behalf of Olympus America Inc. ("OAI") and C.R. Bard, Inc. ("Bard") to request a business review letter pursuant to the Department of Justice's Business Review Procedure, 28 CFR § 50.6. The parties seek a statement of the Department's present antitrust enforcement intentions with respect to a proposed dealer and sales agency agreement (the "Proposed Agreement").[1]

I. INTRODUCTION

Bard sells certain Bard-branded endoscopy accessory products ("EAPs") to end user customers such as hospitals, ambulatory surgicenters, and physicians ("end users"). OAI sells certain Olympus-branded EAPs to end users. The Proposed Agreement establishes a vertical relation between Bard and OAI and integrates their sales forces for EAPs. Under the Proposed Agreement, Bard will become the exclusive reseller of Olympus-branded EAPs. OAI will become a non-exclusive sales agent of Bard for Olympus-branded and Bard-branded EAPs. The commission structure will economically integrate the Bard and OAI sales forces. This

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[1] Exhibit 1 is the Term Sheet which the parties are prepared to sign upon a favorable statement from the Department. The parties also anticipate executing a definitive agreement to implement the Term Sheet, establish the transfer pricing, and address details not covered in the Term Sheet. The parties represent that the definitive agreement will implement the terms set forth in the Term Sheet and acknowledge that the Department's statement of enforcement intentions would not apply if the definitive agreement were to alter the terms set forth in the Term Sheet.

integration of sales and marketing will create a much broader line of EAPs than either party currently offers, and it will make the companies more competitive against the dominant seller of EAPs.

This broadened line of EAPs will benefit end users in a number of ways. First, end users will benefit from reduced transactions costs in purchasing EAPs. End users will enjoy one-stop shopping for reusable (Olympus-branded) and disposable (Bard-branded) EAPs. They will receive their EAPs in a single shipment for which they will receive a single invoice from Bard. (Term Sheet, Ex. 1, p. 2, § A-2-c.)

Second, armed with a much broader line of EAPs to sell, the OAI sales force will have a greater incentive to provide better customer service to end users of EAPs.

Third, OAI will be able to offer end users a new option in leasing. This option will be available for OAI's "cost per procedure" or "CPP" leases. This new CPP lease will involve OAI endoscopy equipment and Bard-branded EAPs. We will explain in section V-D why this new CPP lease will be superior to any CPP leases OAI currently offers.

These customer benefits, generated by a broadened product line, will make the Bard/OAI combination more competitive against the company which currently has the broadest product line and a dominant position in most EAP markets, Boston Scientific (Microvasive brand).

The integration of the two sales forces will make Bard/OAI a more formidable competitor in other ways as well. The two sales forces will function more effectively as a team. As explained in more detail herein, OAI's sales force can open doors for Bard's sales force due to OAI's reputation in endoscopes and other endoscopy equipment with which EAPs are used. Bard's sales force has skill in servicing customers with respect to many EAPs that OAI does not even sell. The complementary strengths of the two sales forces will greatly improve the chances of taking sales away from Boston Scientific.

The Proposed Agreement will also create efficiencies in delivering EAPs to the end user. OAI will be able to eliminate resources devoted to warehousing, picking orders, and shipping EAPs that are duplicative of Bard's. Either OAI's parent, Olympus Optical Co., Ltd., which manufactures EAPs for OAI, will ship directly from Japan to Bard's warehouse, or OAI will ship in bulk to Bard's warehouse. Bard will be responsible for breaking the bulk packages, inventorying the products, picking to fill orders, and shipping to customers, thereby eliminating the need for OAI to do so.

Finally, the Proposed Agreement will eliminate duplicative marketing costs, such as those associated with the production of two separate product notebooks. (Product Notebooks of Bard and OAI are enclosed herewith.)

II. THE PARTIES

A. Olympus America Inc.

Olympus America Inc. ("OAI") is a wholly-owned subsidiary of Olympus Optical Co., Ltd. ("Olympus Optical"), which is headquartered in Japan. Perhaps best known for its cameras, Olympus Optical designs and manufactures a wide range of products involving optics technology. Among these products are endoscopes and the video systems used with them (collectively "endoscopy equipment").[2] OAI markets and sells Olympus-branded endoscopy equipment in the United States. Physicians use endoscopy equipment to examine the upper and lower digestive tracks and the bronchial tree. One common procedure employing endoscopy equipment is an exam for colon cancer.

OAI also markets and sells various accessories used with endoscopes. These accessories, called "endoscopy accessory products" or "EAPs," are the subject of the Proposed Agreement.

There are many different EAPs, but each EAP is a medical instrument. It is inserted in and runs through a hollow channel in the endoscope, exiting directly into the patient through an opening at the end of the endoscope. An example of an EAP is a snare--a wire with a loop on one end. Snares are used to remove polyps in the colon. Pictures of many EAPs are contained in the Bard and OAI Product Notebooks enclosed herewith.

Since the same customers who buy endoscopy equipment also buy EAPs, OAI has a single sales force selling both product lines. OAI has been highly successful in selling endoscopy equipment, but that success has not translated into success in selling EAPs. Whereas OAI sells more than 50% of the endoscopes sold in the United States, an independent third party, Millennium Research Group, reports that OAI sells only **CONFIDENTIAL** of all EAPs sold in the U.S. in 1999 (Exhibit 2).

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[2] A folder containing brochures for Olympus endoscopy equipment is enclosed herewith. An endoscope consists of a control "handle" (held by the physician) which connects two flexible tubes that run in opposite directions from the handle. (An Olympus brochure is enclosed herewith). One tube, the insertion tube, is inserted in the patient in a minimally invasive way (through the esophagus or rectum). The other tube, the external tube, runs from the handle to a plug at the other end. The plug connects to the video system. Optic fibers originating at the plug end of the external tube run all the way to the far end of the insertion tube to carry light to illuminate the area under inspection inside the patient. A video chip located at the end of the insertion tube functions as a digital camera, sending images from inside the body to the video system. These images are displayed on a video monitor, allowing the physician to view the inside of the patient's digestive tract on the monitor.

This disparity exists because selling endoscopy equipment is very different than selling EAPs. Endoscopy equipment is a long-lived, big ticket item. The equipment for a single endoscopy system costs from $50,000 to $100,000 and lasts three to five years. Hospitals may order multiple endoscopy systems at a time, with the total price running hundreds of thousands of dollars. EAPs, in contrast, are short lived (as short as one procedure) and relatively inexpensive ($20-$150). Selling endoscopy equipment requires the sales person's time for months prior to the sale. Selling EAPs, in contrast, requires the sales person's time after the equipment sale is made. Servicing a customer's EAP needs may require visits as often as weekly. This servicing includes ongoing training, trouble shooting, inventorying, and restocking. Inventorying and restocking are particularly important if the customer is using disposable EAPs. Because OAI sells almost entirely reusable EAPs, the OAI sales force is relatively unskilled in this aspect of customer service. Bard, in contrast, sells almost entirely disposable EAPs and hence is relatively skilled in inventorying and restocking.

B. Bard

The Interventional Products Division of Bard manufactures, markets, and sells EAPs. Bard has a broader line of EAPs than does OAI, and Bard has been more successful than OAI in selling EAPs. Bard sold **CONFIDENTIAL** of all EAPs sold in the U.S. in 1999 (Exhibit 2).

Unlike Olympus, Bard does not manufacture, market, or sell endoscopy equipment--endoscopes and video systems. Under the Proposed Agreement, OAI will open the doors for Bard to OAI's endoscopy equipment customers. (Term Sheet, Ex. 1, p. 2, § A-1-4.) This access to customers who already trust OAI should enable Bard to increase its sales of Bard-branded EAPs. Since Bard-branded EAPs are almost entirely disposable, the parties anticipate that these increased sales will come at the expense of Boston Scientific, which sells exclusively disposable EAPs.

III. THE PROPOSED AGREEMENT

The Proposed Agreement establishes a vertical relation with an inherent and typical horizontal component, and it integrates the sales forces of the two companies as in a merger. The Proposed Agreement creates a vertical relation by requiring OAI to sell its EAPs exclusively to Bard for Bard to resell to end users. (Term Sheet, Ex. 1, p. 1, § A-1-a.) This exclusive reseller relation is vertical because OAI will sell to Bard in an arms-length transaction,[3]

[3] OAI and Bard will negotiate an arms-length transfer price for the sale from OAI to Bard. This transfer price will be subject to annual adjustment. (Term Sheet, Ex. 1, p. 1, § A-1-a.) Any upward adjustment, however, is limited to OAI's increased costs for buying (from its parent company in Japan) and selling EAPs; OAI may not raise prices to increase its profit margins.

and OAI will give up the difference between the retail price at which it currently sells EAPs and the wholesale price at which it will sell to Bard. Bard will unilaterally set the retail price for Bard-branded EAPs, and, subject to a maximum resale price provision, Bard will unilaterally set the price for Olympus-branded EAPs as well. (Id.) The horizontal component--OAI's commitment to stop selling to end users--is typical of any vertical relation in which a supplier chooses to sell through dealers instead of directly to end users.[4]

The Proposed Agreement also economically integrates the sales forces of two companies as in a merger. Bard will appoint OAI as its non-exclusive sales agent for EAPs. Thus, both the Bard and OAI commissioned sales employees will be selling both OAI and Bard-branded EAPs.[5] The parties anticipate that the two sales forces will work together to exploit their complementary strengths. The parties have created a commission structure that will incent the two sales forces to increase the sales of both Olympus-branded and Bard-branded EAPs. (Term Sheet, Ex. 1, p. 1, §§ A-1-a-2, 3; § A-1-b; p. 2, §§ A-3, 4.)

The desire to increase sales has motivated both parties to enter into the Proposed Agreement. That desire is manifested in numerous provisions of the Proposed Agreement, which are discussed herein: the maximum resale price imposed on Bard's resale of Olympus-branded EAPs; Bard's minimum annual purchase requirement of Olympus-branded EAPs; and special incentives for OAI and Bard to increase sales of each other's EAPs.

IV. ANALYSIS OF POTENTIAL ANTICOMPETITIVE EFFECTS

In this section, we demonstrate the absence of a risk of any anticompetitive effects. The Collaboration Guidelines dictate that the Proposed Agreement be analyzed under the Horizontal Merger Guidelines ("Merger Guidelines"). Nevertheless, we will first show that, if analyzed under the Collaboration Guidelines, the Proposed Agreement would be subject to the rule of reason, not the per se rule. Why? Because OAI's agreement to sell to Bard for resale instead of directly to end users is not the type of agreement that almost always leads to increased prices or decreased quantities. The maximum resale price provision prevents Bard from raising prices on Olympus-branded products.[6] Bard's minimum annual purchase requirement of

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[4] This arrangement is distinguishable from that in Example 9 in the Guidelines for Collaborations Among Competitors (the "Collaboration Guidelines). In that example, two widget manufacturers both continue to sell directly to their customers. Under the Proposed Agreement, OAI will no longer sell to its customers but will sell exclusively to Bard instead.

[5] OAI and Bard will each pay commissions to their own sales employees. (Term Sheet, Ex. 1, p.2, § A-3)

[6] Unless otherwise stated, we will use the term "price increase" to refer to an increase in price that occurs while costs remain constant.

Olympus-branded products prevents Bard from profitably decreasing the quantity of Olympus-branded EAPs available to end users. The Proposed Agreement does nothing to change Bard's unilateral control over prices and quantities of Bard-branded EAPs. Hence, the Proposed Agreement is not per se illegal.

We next analyze the Proposed Agreement under the Merger Guidelines. The issue is whether Bard's control over both the pricing of Bard-branded EAPs and, to a limited extent, of Olympus-branded EAPs, will enable Bard to charge prices higher than would be possible absent the "merger."

The Proposed Agreement does not create a risk of coordinated interaction in any relevant EAP market. The relevant markets are highly concentrated due to the existence of a dominant firm: Boston Scientific. The parties are combining their product lines and sales forces in order to compete against that firm. That is the antithesis of tacit collusion. Moreover, if the parties had wanted to tacitly collude, they would have given Bard complete control over the quantities of Olympus-branded EAPs that Bard purchases and the prices at which Bard resells them. Finally, a number of market factors make tacit collusion economically implausible.

The Proposed Agreement also does not create the risk of a unilateral price increase by Bard. The Proposed Agreement precludes such an increase with respect to Olympus-branded EAPs. The closest substitutes for the relevant Bard-branded EAPs are not OAI's but those of Boston Scientific. Like Bard's, Boston Scientific's relevant EAPs are disposable. The relevant Olympus-branded EAPs, in contrast, are reusable. The disposables are more convenient but also more expensive -- about $1000 more expensive when compared to the life cycle cost of a single reusable. End users willing to pay a $1000 premium for the convenience of disposables would simply switch over to Boston Scientific's product in response to an increase in the price of the Bard-branded product; the Olympus-branded product is a relatively poor substitute.

A. Collaboration Guidelines v. Merger Guidelines

Section 1.3 of the Collaboration Guidelines states that a collaboration will be treated as merger if four conditions are met. The first condition--that the parties be competitors in the relevant market(s)--may or may not be met if one looks solely at the demand side in defining markets. The parties probably are competitors, however, in that OAI is probably an uncommitted entrant across a broad range of EAPs that it currently does not sell but Bard does. As an uncommitted entrant, OAI is regarded as "participating in the relevant market if [its] inclusion would more accurately reflect probable supply responses" (Merger Guidelines § 1.32).

Assuming that the first condition is met, the second condition--that the formation of the collaboration involve an efficiency-enhancing integration of economic activity in the relevant market[s]--is easily met. The Proposed Agreement involves the economic integration of sales forces of the two parties, as explained above. The Proposed Agreement also entails financial risk taking by both parties. OAI will be giving up the spread between the retail price at

which it currently sells and the wholesale price at which it will sell to Bard. Bard, as will be discussed in more detail herein, is committing to purchase an aggressive annual minimum quantity of Olympus-branded EAPs from OAI, regardless of how much it resells. Finally, with OAI no longer selling direct, OAI will be able to eliminate retailing resources--the resources dedicated to the warehousing, inventorying, and handling of EAPs for shipment to end users.

The third condition--the elimination of all competition between the parties in the relevant market[s]--is met. The collaboration will eliminate whatever competition may exist between OAI and Bard in selling EAPs to end users.[7]

The fourth condition is that the collaboration not terminate within a sufficiently limited period by its own specific and express terms. The term of the Proposed Agreement is a minimum of three years, with automatic one-year renewals indefinitely, unless either party gives notice of termination. (Term Sheet, Ex. 1, p. 2, § 1-e.) Under Example 1 in the Collaboration Guidelines, this right to terminate does not constitute termination by the Proposed Agreement's "specific and express terms." Thus, the fourth condition is met.

We conclude, therefore, that the Proposed Agreement should be analyzed under the Merger Guidelines. We do not believe, however, that the Department would reach a different result under the Collaboration Guidelines. Under the Collaboration Guidelines, once the Department determines that the rule of reason rather than the per se rule applies, the analysis focuses on anticompetitive harms and procompetitive benefits in much the same way as do sections 2 and 4 of the Merger Guidelines. The analysis unique to the Collaboration Guidelines, therefore, is the threshold determination of whether the per se rule or rule of reason applies.

Accordingly, before turning to the Merger Guidelines, we will demonstrate that, under the Collaboration Guidelines, the rule of reason, not the per se rule, applies.

B. Collaboration Guidelines: Rule of Reason v. Per Se Rule

1. Definition of Per Se Illegality

The Collaboration Guidelines define a per se agreement as an agreement "of a type that always or almost always tends to raise price or reduce output." (Collaborative Guidelines, § 3.2) The Proposed Agreement does not meet this standard definition of per se illegality for two reasons. First, the Proposed Agreement involves an exclusive dealer arrangement and a sales agency, neither of which is a "type" that traditionally falls into the per se category.

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7 The collaboration does not eliminate Bard as a potential competitor of OAI in the creation of CPP leases with Bard-branded EAPs.

Second, the Proposed Agreement itself precludes increased prices or decreased quantities. The key provisions of the Proposed Agreement are as follows:

- The Proposed Agreement precludes Bard from profitably decreasing the quantity of Olympus-branded EAPs available to end users. Specifically, a minimum annual purchase requirement prevents Bard from profitably buying from OAI for resale to end users a lesser volume of Olympus-branded EAPs than OAI sold to end users before entering in to the Proposed Agreement. Under the Proposed Agreement, Bard must purchase annually a minimum quantity of Olympus-branded EAPs which is at least equal to OAI's sales for the 12 months preceding the effective date of the Proposed Agreement ("Base Year 0"). Moreover, the minimum ratchets upward to the extent Bard's sales in subsequent years exceed those of Base Year 0. (Exhibit 1, p. 1, § A-1-a-1.)[8] Because Bard must pay for the minimum quantity whether it sells the minimum or not, Bard cannot profitably decrease sales of Olympus-branded EAPs below current levels.

- The Proposed Agreement imposes no restraints whatsoever on Bard's sale of Bard-branded EAPs. Just as it does now, Bard will unilaterally set its prices and determine how much to produce and sell.

- The Proposed Agreement adds **CONFIDENTIAL** sales people--the OAI commissioned endoscopy sales force--with an incentive to sell Bard-branded EAPs. OAI as a company also has an incentive, explained more fully below, to increase sales of Bard-branded EAPs.

- A maximum resale price provision prevents Bard from raising prices on Olympus-branded EAPs. The initial maximum is OAI's current (2000) list price. This maximum is subject to adjustment in subsequent years only for changes in OAI's wholesale price to Bard. (Id.) Thus, if OAI's price to Bard goes down, the maximum resale price goes down as well. The maximum would go up if OAI's price to Bard increased, but OAI may increase prices only once a year, and then only for cost increases. (Id., third sentence) Bard is, of course, always free to resell below the maximum.

In sum, nothing in the Proposed Agreement changes the unilateral control Bard currently has over its pricing of Bard-branded EAPs. The Proposed Agreement does not give the parties, acting separately or together, the ability to raise prices on Olympus-branded EAPs. Finally, the Proposed Agreement does not create a mechanism for Bard to profitably cut its

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[8] Moreover, any Olympus-branded EAPs that OAI buys back from Bard for OAI's use in CPP leases do not count toward Bard's minimum annual purchase requirement. (Ex. 1, p. 3, § B-1-f.)

purchases, and hence its resales, of Olympus-branded EAPs. Therefore, the Proposed Agreement does not satisfy the criteria for being a per se agreement under the Collaborative Guidelines.

2. Reasonable Relation to Efficiency-Enhancing Integration

The Proposed Agreement is not per se for a second reason, independent of the definition of a per se agreement. The Collaborative Guidelines state that even an agreement that might otherwise be considered per se illegal will be evaluated under the rule of reason if the agreement is "reasonably related" to an "efficiency-enhancing integration of economic activity" and is "reasonably necessary to achieve its procompetitive benefits, the Agencies analyze the agreement under the rule of reason, even if it is of a type that might otherwise be considered per se illegal." (Collaboration Guidelines, § 3.2)

This provision of the Collaboration Guidelines applies to two elements of the Proposed Agreement that might otherwise be per se illegal. The first is OAI's agreement not to sell to end users--a customer allocation. This allocation is not a "naked" allocation between two competitors. Rather, this allocation is inherent in the creation of a vertical relation in which the supplier chooses to sell exclusively through one or more dealers rather than directly to end users. OAI will cease to compete with Bard, but OAI is giving up the difference between the wholesale and retail prices in order to do so.

Establishing this vertical relation is reasonably related to the efficiency-enhancing integration of the two sales forces, the elimination of duplicative retailing resources, and creation of a broadened product line consisting of both Olympus-branded and Bard-branded EAPs. This broadened product line, in turn, is "reasonably necessary to achieve" (indeed, it is the broadened product that will generate) the procompetitive benefits to end users of reduced transactions costs, improved service, and more choices in CPP leases.

The second element in the Proposed Agreement that might otherwise be per se illegal is the agreement of the OAI and Bard sales forces to cooperate rather than compete. This agreement necessarily follows from the facts that Bard will be the sole seller to the end user of both brands of EAPs and that OAI is merely Bard's sales agent. Competition between Bard and OAI sales people under the Proposed Agreement would be as senseless as competition between two Bard sales people would be now.

The appointment of OAI as Bard's non-exclusive sales agent, in turn, is "reasonably related" to efficiency-enhancing integration of giving the OAI sales force access to the broadened product line. This broadened product line will generate the procompetitive benefits discussed above. The cooperation between the OAI and Bard sales forces made possible by OAI's agency status will make the parties a more effective competitor against other firms, most notably the giant Boston Scientific/Microvasive. Consider an OAI sales person who sells a high volume of endoscopy equipment but a low volume of EAPs. That person's equipment

customers are probably heavy users of Microvasive-branded, disposable EAPs. A Bard sales person might not know about those OAI equipment customers or might not be able to get a foot in the door. Under the Proposed Agreement, however, the OAI sales person can provide the entree to the customer; the Bard sales person can provide the skill and experience to service the customer's EAP needs. The cooperation between sales forces makes for a more effective competitor against Boston Scientific/Microvasive.

C. Merger Guidelines

For the purpose of the discussion which follows, we will treat the Proposed Agreement as a merger between the endoscopy sales organizations of Bard and OAI.

1. Market Definition, Measurement and Concentration

a. Identifying the Stages in the Industry

In defining markets, it is necessary to identify which vertical stages in the industry are affected by the merger. (Merger Guidelines, § 1.11, footnote 11.) For EAPs, there are two categories of sellers, which correspond to the two vertical stages: (1) those who design and manufacture ("Manufacturers")[9]; and (2) those who market and sell to end users ("Dealers"). Dealers own the brand names under which they market and have sales forces that call directly on end users. In cases where vertical integration does not exist, there are two explicit prices in the supply chain: the wholesale price from the Manufacturer to the Dealer, and the retail price from the Dealer to the end user. In the case where a vertically integrated Manufacturer-Dealer sells to end users, only the retail price is explicit.[10]

Although OAI/Olympus Optical and Bard are each currently vertically integrated Manufacturer-Dealers, the Proposed Agreement has no affect at the design and manufacturing stage. Bard and Olympus Optical will each continue to independently design and manufacture their own EAPs.[11] Hence, innovation as a variable of competition, and innovation markets, if they exist, need not be considered.

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[9] Theoretically, this stage could be broken up into two components: design and manufacture. Someone could design a product and then hire a third party to manufacture it.

[10] In the case of Olympus Optical and OAI, Olympus Optical charges OAI an internal transfer price for EAPs, but this transfer price is not necessarily the same as the wholesale price Olympus Optical would charge an unaffiliated dealer in an arm's length transaction.

[11] If either party lags in the design and manufacture of competitively-featured and -constructed EAPs, the other party will have a strong incentive to exercise its option to terminate the Proposed Agreement. If Olympus Optical does not produce competitive Olympus-branded

The relevant stage is the dealer stage--the sale by Dealers of branded EAPs to end users, and the relevant price to consider is the retail price charged end users.

b. Product and Geographic Market Definition

The Millennium Research Report ("Millennium"), published by the Millennium Research Group, breaks EAPs sold in the in the United States in 1999 into nine major categories. The sales data for each of these nine categories is shown in Exhibits 3-11.

Although subcategories and multiple products exist within these major categories, the parties believe that these nine categories constitute appropriate product markets under demand-side methodology of the Guidelines with one exception.[12] As evidence that these nine categories are not too broad, they map into just six corresponding major categories in the Bard price list. The following chart shows this mapping:

EAPs, Bard will have problems selling its annual minimum purchase requirement. Failure to sell the minimum is very costly for Bard, since it must pay for the minimum even if it cannot sell them. Hence, if Bard is unable to sell the minimum, Bard will terminate. If Bard does not produce competitive Bard-branded EAPs, OAI has no reason to have its sales people waste their time trying to sell them.

12 As will be discussed in section C-2-b herein, it is debatable whether reusable forceps and disposable forceps are in the same product market.

EAP PRODUCT CATEGORIES AS REPORTED BY MILLENNIUM RESEARCH REPORT FOR 1999	CORRESPONDING EAP PRODUCT CATEGORIES CONTAINED IN BARD 8/1/99 PRICE LIST[13]
1. Biopsy & Retrieval Forceps	1. Biopsy Devices
2. Polypectomy Snares -Disposable	2. Polypectomy Devices
3. Hemostasis Devices	3. Hemostasis Devices
4. Dilatation Balloons	4. Dilatation Devices
5. Stents	5. Biliary Devices
6. ERCP Devices	[Included in Biliary Devices]
7. Biliary Stone Removal Devices	[Included in Biliary Devices]
8. Enternal Feeding Devices	6. Gastrostomy Devices
9. Low Profile Feeding Devices	[Included in Gastrostomy Devices]

Moreover, we seriously doubt that defining markets more narrowly would produce materially different results in market shares. For example, even if the cross-elasticity of demand between a large oval polypectomy snare and a medium hexagonal one were very low, we do not think that market shares in separate markets would change, given that all the sellers of snares sell multiple shapes and sizes.

Finally, we believe that the United States is the appropriate geographic market in which to analyze the Proposed Agreement. The Proposed Agreement applies only to the United States. (Term Sheet, Ex. 1, p. 1, § A-1-a.) Moreover, all Dealers in the United States sell EAPs nationwide.

c. Identification of Firms that Participate in the Relevant Market; Market Shares and Concentration

(1) Disposable and Reusable Biopsy and Retrieval Forceps

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13 See the Bard Product Notebook, behind the tab labeled "Ordering and Pricing Info."

As shown in Exhibits 3 - 11, OAI's name appears in only one of the nine Millennium Categories Biopsy & Retrieval Forceps (Ex. 3). Bard's name appears in all nine. HHIs for an assumed market of Biopsy and Retrieval Forceps are set forth in Appendix A.

Even if we were to add one or more uncommitted entrants and assign them market shares under section 1.32 of the Merger Guidelines, the post-merger HHI and increase thereof for this assumed market would be beyond the safe harbors in the Merger Guidelines.

But the high HHI for this market clearly results from the dominant position of Boston Scientific. The Proposed Agreement threatens Boston Scientific's dominant position and hence carries the potential to actually lower the HHI. As a result of the Proposed Agreement, the combined Bard and OAI sales forces will have a broader line of biopsy forceps (a line including both disposables and reusables) than the lines they separately have now. Carrying the broadest biopsy forceps line, the combined Bard and OAI sales forces will be able to compete more effectively against Boston Scientific than they are now able to do now separately. If Bard and OAI can take just three percentage points of market share away from Boston Scientific, the post-merger HHI will be lower than it is now.

(2) All Endoscopy Accessory Products

The assignment of market shares to uncommitted entrants under section 1.32 of the Merger Guidelines has implications for the remaining eight categories of EAPs reported by Millennium in which Bard's name appears but OAI's does not. We believe that OAI is an uncommitted entrant in each of these markets, thus creating a horizontal overlap.

More generally, we believe that every Dealer of EAPs is an uncommitted entrant in any major category in which it does not currently have sales. Any Dealer has the assets necessary to sell any EAP: a brand name and a sale force. In this regard, it is important to note that a Dealer does not have to integrate backward into manufacturing an EAP that it does not currently sell. Dozens of firms design and manufacture EAPs, even though they do not sell and market them to end users. (Olympus Optical has designed and manufactured its endoscopes to be "open" to third party EAPs, which is why so many EAP manufacturers exist.) Such non-integrated manufacturers sell products to Dealers with the Dealers' brand names on them. In fact, even vertically integrated Manufacturer-Dealers do not manufacture all the EAPs they sell; non-integrated manufacturers supply integrated Manufacturer-Dealers with some of their EAPs. For example, ACT Medical, Inc. manufactures many different EAPs for Boston Scientific, which Boston Scientific resells under its Microvasive brand name.

A reasonable approach to calculating market shares which takes into account uncommitted entrants is to look simply at each Dealer's share of total sales of EAPs.[14] Exhibit 2, which presents the sum of the data for the nine major categories set forth in Exhibits 3 -11, does just that.[15] Appendix B presents the HHI based on sales of all EAPs.

The assumed market is, of course, "highly concentrated" due to the dominant position of Boston Scientific. The increase in the HHI is less than 100 points, however, so no presumption of anticompetitive effect arises. And, if the Proposed Agreement is even slightly successful, enabling the combined OAI and Bard sales forces to take just one or two percentage points of market share from Boston Scientific, the post-merger HHI will be lower than it currently is.

2. Analysis of Potential Adverse Competitive Effects

We will analyze competitive effects on the assumption that any relevant EAP market will have post-acquisition HHIs and increases in HHIs in the ranges of the assumed markets shown above. The salient feature of any relevant EAP market is the approximately **CONFIDENTIAL** market share of Boston Scientific.

a. Coordinated Interaction

The Proposed Agreement does not increase the risk of coordinated interaction in any relevant EAP market. First, the motivation for and structure of the Proposed Agreement belies any desire of the parties to facilitate coordinated interaction. If either party wanted to tacitly collude with Boston Scientific, it would not enter into an agreement structured so as to make the parties a more effective competitor against Boston Scientific. For example, one way for OAI to tacitly collude with Boston Scientific would be to stay out of selling disposable EAPs. OAI sells primarily reusable EAPs. Boston Scientific, in contrast, touts the fact that it sells exclusively disposable EAPs. Under the Proposed Agreement, OAI's endoscopy sales force will have available to it, for the first time, a broad line of disposable EAPs, as well as an incentive to sell them. The Proposed Agreement is a plan for an attack on, not a plan for coordinated interaction with, Boston Scientific.

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[14] Another way to reach the same result is to define the market as "the sale of EAPs by Dealers" under footnote 14 of the Merger Guidelines, given that the same assets (primarily brand name and sales force) are used to sell all EAPs.

[15] The sales data in Exhibit 2 is simply the sum of the sales data for the nine major categories shown in Exhibits 3-11. Exhibit 2 understates OAI's actual sales by approximately **CONFIDENTIAL**. Some or all of those sales may be captured in "Other" in each of the nine categories from which Exhibit 2 is derived.

As another example, if Bard wanted to enter into an agreement with OAI that would enable Bard to tacitly collude with Boston Scientific, Bard certainly would not enter into an agreement that did not give it the ability to raise prices or decrease quantities sold of Olympus-branded EAPs.

Second, OAI has no interest in raising prices of EAPs, because OAI wants to sell endoscopy equipment. The higher the price of EAPs, the higher the "life cycle" cost of an endoscopy system. OAI has absolutely no incentive to make its endoscopy equipment--which generates revenues dwarfing OAI's EAP revenues--less attractive.

Section 2.11 of the Merger Guidelines recognizes that the incentive to sell a complementary product reduces the likelihood of coordinated interaction: "In addition, reaching terms of coordination may be limited or impeded by firm heterogeneity, for example, ... the production of another product [endoscopy equipment] that tends to be used together with [in fact, is always used together with] the relevant product[s, EAPs]." OAI's sales of endoscopy equipment distinguish it from all the other Dealers listed on Exhibit 2, most notably Boston Scientific, and take away any incentive OAI might otherwise have to tacitly collude on EAPs.

Third, even assuming that Boston Scientific and Bard/OAI, contrary to rationale economic behavior, engaged in tacit collusion to push prices up and quantities down, fringe firms in the market--essentially every other firm shown on Confidential Appendix B --could easily expand. These firms already have the critical assets for a Dealer: a brand name and a sales force. Some of them, such as Kimberly Clark and Novartis, though small sellers of EAPs, are large sellers in absolute terms, know how to market, and have the resources to do so. Having an increased supply of the product to sell is not an issue. These firms already manufacture the relevant products, or, to the extent they do not, they could buy them from among the dozens of third party manufacturers of EAPs.[16]

b. Unilateral Effects

Because unilateral effects depend on the degree of substitutability between products, the only assumed market for which it makes sense to analyze possible unilateral effects

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[16] Because the Proposed Agreement does not affect the manufacturing stage, we are not presenting a full blown analysis of ease of entry at the manufacturing stage. From a qualitative standpoint, Bard and OAI do not believe any significant barriers impede entry into the EAP manufacturing markets. No blocking patents cover any of the major product categories. Although FDA approval for a brand new product may take 2-3 years, the FDA approves successive generations of existing products within 90 days under the 510K process set forth in the Food, Drug and Cosmetic Act of 1936, as amended, 21 USC § 360(k)(1999).

is the one in which OAI and Bard currently sell in. This assumed market is for Biopsy and Retrieval Forceps.[17] According to the Millennium data, **CONFIDENTIAL** .

Because the forceps in this assumed market are differentiated (reusable and disposable), section 2.21 of the Merger Guidelines applies. The analysis required by section 2.21 demonstrates that the Proposed Agreement does not create any risk of a unilateral price increase.

First, Bard's and OAI's forceps are not the closest substitutes for each other. Bard sells disposable forceps; OAI sells reusable forceps. The tradeoff between reusables and disposables is a tradeoff between cost and convenience. Even taking into account cleaning costs, a reusable forceps will cost about $1000 less over its life span of 50 - 70 uses than would a comparable number of disposable forceps.[18] This $1000 life cycle cost difference dwarfs the initial purchase prices of reusables ($275) and disposables ($25) and renders reusables and disposables relatively poor substitutes for each other.

Suppose that after the Proposed Agreement went into affect, Bard raised its price on Bard-branded disposable forceps by 5%, while holding the price on Olympus-branded reusable forceps constant (as it would be required to do under the maximum resale price provision in the Proposed Agreement for Olympus-branded EAPs). Why would someone willing to pay an extra $1000 for disposables prior to the Proposed Agreement suddenly switch over to reusables in response to Bard's post-agreement unilateral price increase? Why wouldn't the end user just buy Microvasive disposables at unchanged prices instead?

OAI's and Bard's forceps are not the closest substitutes for each other. The closest substitutes for OAI's reusable forceps are Wilson-Cook's or Pentax's reusable forceps.

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[17] Our discussion herein of the relative closeness of OAI's reusable forceps and Bard's disposable forceps casts doubt on whether reusables and disposables should even be included in the same product market. We will assume they are in the same product market, however, because the Department's decision should not hinge on a market definition based on an assumption about the cross-elasticity of demand between reusables and disposables, when that cross-elasticity has not been measured.

[18] A disposable forceps, which is used one time, costs on average approximately $25. A reusable forceps costs less than $5.00 to clean after each use. Therefore, disposable forceps costs about $20 more per use than does a reusable forceps. A reusable forceps costs, on average, approximately $275, so it pays for itself after about 14 uses. But the reusable forceps has an average life expectancy of in the range of 50-70 uses. Therefore, over its life span, a reusable saves the customer about $1000 (50 uses (after the initial 14 to recover the cost of the reusable) x $20 per use).

The closest substitutes for Bard's disposable forceps are Boston Scientific's disposable forceps. Therefore, the Proposed Agreement does not create the risk of a unilateral price increase.

Second, the combined market shares of OAI and Bard in the assumed market fall well below the 35% threshold giving rise to a presumption of anticompetitive unilateral effects.

Third, the Proposed Agreement imposes a ceiling on Bard's resale price of Olympus-branded EAPs. (Term Sheet, Ex. 1, § A-1-a) Therefore, Bard may not unilaterally raise prices on Olympus-branded forceps.

c. The vertical customer restraints on Bard's resale of Olympus-branded EAPs

Under the Proposed Agreement, Bard may not resell Olympus-branded EAPs to any third party who intends to use them to create CPP leases competitive with OAI's. This customer restraint is not anticompetitive, because, absent the Proposed Agreement, OAI would not sell Olympus-branded products to such third parties in any event.

Bard remains free under the Proposed Agreement to sell Bard-branded EAPs to whomever it chooses.

V. PROCOMPETITIVE BENEFITS

A. Procompetitive Benefits Already Discussed

We have already discussed in detail several procompetitive benefits. Procompetitive benefits that flow from the broadened product line created by Proposed Agreement are reduced transaction costs for end users and the incentive for OAI sales people to provide better customer service with respect to EAPs after the equipment sale. Bard's access to OAI's endoscopy equipment customers and the cost savings resulting from the elimination of duplicative marketing efforts and retail warehousing operations will make Bard/OAI a more efficient competitor. These procompetitive benefits will lead to increased sales of OAI and Bard-branded EAPs.

In sections B. and C. which follow, we will discuss some additional incentives in the Proposed Agreement for the parties to increase sales.

B. Bard's Special Incentive to Increase Sales of Olympus-branded EAPs

Under the Proposed Agreement, Bard will have an opportunity to reduce its incremental (and hence average) cost of goods sold if Bard increases sales of Olympus-branded EAPs. For example, in the first year of the agreement, Bard will receive a 5% or 10% discount

off of OAI's sales price to Bard on incremental purchases from OAI that exceed 100% of OAI's sales in the year preceding the agreement. (Term Sheet, Ex. 1, p. 1, §§ A-1-a-2 and -3.)[19]

C. OAI's Special Incentive to Increase Sales of Bard-Branded EAPs

OAI has a procompetitive incentive to increase sales of Bard-branded EAPs. As the non-exclusive sales agent of Bard, OAI has the opportunity to earn a sales commission from Bard.[20] But OAI receives a sales commission from Bard only on Bard's increased sales of Bard-branded EAPs. (Id., p. 1, § A-1-b.) Not only does the absolute dollar amount of OAI's commission go up as sales of Bard-branded EAPs exceed 100% of Base Year 0's, but the commission rate itself also substantially increases as sales increase. (Id.)

D. Increased Customer Choice for CPP Leases from OAI

OAI not only sells but also leases endoscopy equipment. OAI offers leases with a variety of pricing terms. Some leases require monthly payments. Other leases require the lessee to pay a fixed amount per procedure performed with the endoscope. OAI refers to these leases as "Cost Per Procedure" or "CPP."

The broadened product line created under the Proposed Agreement will increase the options for EAPs available to OAI's CPP customers. In OAI'S current CPP leases, the customer has two choices with respect to EAPs. First, the customer may use EAPs supplied by OAI and have the cost of the EAPs rolled in to the cost per procedure. Given OAI's relatively limited EAP product line, this option is not realistic for many actual and potential CPP customers. Second, the customer may purchase EAPs from OAI or another supplier, in which case the CPP includes only the charge for endoscopy equipment, not the EAPs. Although this option broadens the EAP product line available, it undercuts the economic simplicity of a CPP lease. One of the advantages of a CPP lease is that it wraps all non-labor costs into a single price. Knowing this single price is useful to the end user because managed care insurers reimburse the end user on a cost per procedure basis. Thus, each type of CPP lease OAI is currently able to offer has drawbacks for the end user.

Under the Proposed Agreement, OAI's CPP customers will have a third option: Bard-branded EAPs included in the CPP lease. OAI's CPP customers will be able to use any combination of OAI and Bard-branded EAPs they desire under a CPP lease. CPP customers will

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19 In addition to Bard's special incentive, OAI also has every incentive to increase sales of Olympus-branded EAPs over current levels. Such increases necessarily increase the amount that Bard must take or pay for the following year.

20 This commission is distinct from the commissions that OAI pays its own sales force for selling Bard-branded EAPs.

be able to enjoy the convenience of receiving all EAPs in a single, periodic delivery and having the cost of all EAPs included in the CPP lease.[21]

Bard's favorable pricing to OAI on Bard-branded EAPs enables OAI to offer those EAPs in CPP leases. (Term Sheet, p. 3, § B-1-a) Absent the Proposed Agreement, Bard would have no incentive to give OAI this favorable pricing.

VI. CONCLUSION

The desire of both parties to increase the sales of their respective EAPs has motivated them to create the Proposed Agreement. The Proposed Agreement reflects that motivation, as it is full of procompetitive terms, including:

- Bard's obligation to purchase a minimum annual quantity of OAI-branded EAPs, a minimum which ratchets only upward
- The ceiling on Bard's resale price of OAI-branded EAPs
- The limit on OAI's right to raise the wholesale price to Bard
- The discount Bard receives based on the increase in sales of OAI-branded EAPs
- The commission OAI receives based on the increase in sales of Bard-branded EAPs

Indeed, the Proposed Agreement makes economic sense only if the parties do increase sales.

Why do the parties believe that the Proposed Agreement will enable them to increase sales? Because the Proposed Agreement will generate numerous benefits for end users, including:

- Reduced transactions costs in purchasing EAPs
- Improved customer service for OAI's endoscopy equipment customers

[21] In the term sheet, CPP refers to leases where the cost of EAPs rolled into the cost per procedure, i.e., leases where the customer wants OAI to supply both the equipment and the EAPs. The Proposed Agreement will have no effect on "equipment only" CPP leases. OAI's customers will remain free to purchase EAPs from any supplier rather than to have the cost of EAPs included in the CPP lease.

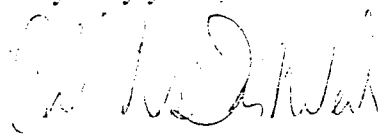
- Opportunity for lower prices due to lower costs resulting from the elimination of duplicative retailing and marketing functions

- A new option in the CPP lease, which is significantly more attractive than what OAI now offers, due to the broadened line of EAPs which may be included in the lease.

The proposed Agreement does not create the risk of any anticompetitive effects. The dominant firm in the market is Boston Scientific, and it is Bard's closest competitor. Therefore, Bard cannot unilaterally raise the price of Bard-branded EAPs. If Bard wanted to tacitly collude with Boston Scientific, it would not add the entire OAI endoscopy sales force to sell Bard-branded EAPs.

In sum, the Proposed Agreement will make Bard/OAI a more effective competitor against Boston Scientific. Therefore, Bard and OAI respectfully request that the Department state an intention not to challenge it.

Very truly yours,



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PVW/MEC
Attachments

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