

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION



In the Matter of
Schering-Plough Corporation,
a corporation,
Upsher-Smith Laboratories,
a corporation,
and
American Home Products Corporation,
a corporation.

Docket No. 9297

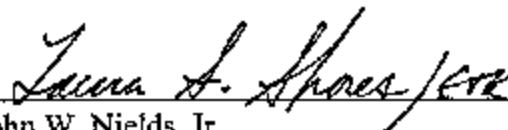
PUBLIC VERSION

**RESPONDENTS' MOTION TO STRIKE THE SUPPLEMENTAL EXPERT
REPORT OF PROFESSOR MAX H. BAZERMAN, AND RELATED
TESTIMONY, AND ACCOMPANYING MEMORANDUM OF LAW**

Respondents Schering-Plough Corporation and Upsher-Smith Laboratories, Inc. respectfully submit this motion to strike the supplemental expert report of Professor Max H. Bazerman (Exhibit A), and any testimony related thereto.

Professor Bazerman's supplemental report attempts to opine on a completely new topic – risk aversion – which was not in his initial report and which differs markedly from economic literature on the subject. Furthermore, Professor Bazerman's supplemental report is extremely late. It was submitted on January 14, 2002, two months after any such report was due. Consequently, respondents' cannot now depose Professor Bazerman on his new theory, nor can they provide any experts to refute it. Thus, given the obvious and substantial prejudice that will be imposed on the parties, respondents' respectfully request this Court to strike Professor Bazerman's supplemental report, and any testimony related thereto.

Respectfully submitted,



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Attorneys for Respondent
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January 23, 2002

CERTIFICATE OF SERVICE

I hereby certify that this 23rd day of January 2002, I caused an original, one paper copy and an electronic copy of Respondents' Motion to Strike the Supplemental Expert Report of Professor Max H. Bazerman, And Related Testimony, and accompanying memorandum of law, to be filed with the Secretary of the Commission, and that two paper copies were served by hand upon:

Honorable D. Michael Chappell
Administrative Law Judge
Federal Trade Commission
Room 104
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

and one paper copy was hand delivered upon:

David Pender
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Federal Trade Commission
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Erik T. Koons



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
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Bureau of Competition
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January 14, 2002

VIA COURIER

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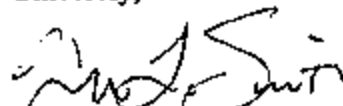
Re: Supplemental Rebuttal Expert Report of Professor Max Bazerman

Dear Laura:

Please find enclosed a copy of Supplemental Rebuttal Expert Report of Professor Max Bazerman. The report addresses topics on which Professor Bazerman testified at his deposition.

If you have any questions or concerns, please contact me at 202-326-2055.

Sincerely,



Clifton L. Smith

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

In the Matter of

SCHERING-PLOUGH CORPORATION,
a corporation

UPSHER-SMITH LABORATORIES, Inc.
a corporation; and

AMERICAN HOME PRODUCTS
CORPORATION,
a corporation

Docket No. 9297

**SUPPLEMENTAL REBUTTAL EXPERT REPORT OF
PROFESSOR MAX BAZERMAN**

In my report for the FTC, I noted that expert reports by Professor Willig, Professor Ordover, Dr. Kerr, and Dr. Addanki offered a number of technically correct analyses, but I questioned the applicability of these conclusions to Schering in its negotiations with Upsher or ESI. Perhaps the idea that has attracted the most attention is the concept of risk aversion. Willig, for example, shows how risk aversion by the branded firm could (theoretically) generate a net reverse payment. In my deposition, in response to questions from Mr. Gidley, I discussed why I questioned the likelihood that Schering would be risk averse in negotiating patent settlements. This supplemental report explains more fully the logic for why I would find it highly unlikely that Schering would have been risk averse.

It is important to first note that shareholders do not want extreme risk aversion by the firm that they invest in. Shareholders can better deal with risk through alternative investment strategies (i.e., by selecting the appropriate diversified portfolio). Shareholders should hold it against a firm that pays a premium in order to avoid risk. Similarly, executives of large corporations should not be paying a significant premium to reduce risk. Rather, their corporation can be expected to be more profitable in the long run if they act closer to risk neutrality. Thus, executives of large corporations should make decisions near risk neutrality.

Yet, there is a significant literature showing when executives *predictably* deviate from risk neutrality, toward risk averse or risk seeking behavior (one summary of this research is provided in Chapter 3 of my book, *Judgment in Managerial Decision Making*, 2002, Wiley). Individuals treat risks concerning perceived gains (a positive frame) differently from risks concerning perceived losses (a negative frame). Specifically, positively framed decision makers have a strong tendency toward risk aversion and negatively framed decision makers have a strong tendency toward risk seeking. In an attempt to explain these common and systematic deviations

from the standard economic model under uncertainty, Kahneman and Tversky (1979) developed Prospect Theory, which suggests that the way in which the problem is framed, or presented, can dramatically change the risk preference of the decision-maker. My book offers the following problem to exemplify Kahneman and Tversky's Prospect Theory:

A large car manufacturer has recently been hit with a number of economic difficulties, and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans:

Plan A: This plan will save one of the three plants and 2,000 jobs.

Plan B: This plan has a $1/3$ probability of saving all three plants and all 6,000 jobs, but has a $2/3$ probability of saving no plants and no jobs.

Which plan would you select?

Now, reconsider this problem, replacing the choices just provided with the following choices:

Plan C: This plan will result in the loss of two of the three plants and 4,000 jobs.

Plan D: This plan has a $2/3$ probability of resulting in the loss of all three plants and all 6,000 jobs, but has a $1/3$ probability of losing no plants and no jobs.

Which plan would you select?

The two sets of alternative plans are objectively the same. Saving one of the three plants and 2,000 of 6,000 jobs (Plan A) offers the same objective outcome as losing two of the three plants and 4,000 of 6,000 jobs (Plan C). Similarly, Plans B and D are objectively identical.

Notice that the two options in the first version of the problem are positively framed, while the two options in the second version are negatively framed. As a result of these two frames, empirical investigation demonstrates that most individuals (over 80 percent) choose Plan A in the first set and Plan D in the second set. While the two sets of choices are objectively identical, changing the description of the outcomes from jobs and plants saved to jobs and plants lost is sufficient to shift choice from risk-averse to risk-seeking behavior. This finding of risk aversion

in the domain of gains and risk seeking in the domain of losses has been replicated and generalized to many managerial contexts across hundreds of studies.

Bazerman, Magliozzi, and Neale (1995) was the first of many studies to show that this framing effect generalizes to the context of negotiation. This study found that positively framed negotiators tend to be risk averse and negatively framed negotiators tend to be risk seeking. This pattern has been replicated across multiple studies (Bottom & Studt 1993; De Dreu & McCusker 1997; Lim & Carnevale 1995; Olekalns 1997). Bazerman (2002) provides a review of this research, and offers the following example in Chapter 9:

To exemplify the importance of "framing" to negotiation, consider the following labor-management situation: The union claims it needs a raise to \$12 an hour and that anything less represents a loss given current inflation. Management argues that it cannot pay more than \$10 an hour and that anything more imposes an unacceptable expense. What if each side had the choice of settling for \$11 an hour (a certain settlement) or going to binding arbitration (a risky settlement)? Since each side is viewing the conflict in terms of what it has to lose, following Tversky and Kahneman's (1981) findings, each side is predicted to be risk seeking and unwilling to take the certain settlement. Changing the frame of the situation to a positive one, however, results in a very different predicted outcome. If the union views anything above \$10 an hour as a gain, and management views anything under \$12 an hour as a gain, then risk aversion will dominate, and a negotiated settlement will be likely.

In this case, the question is how to assess the likely frame of an executive in a market where his/her current firm has a monopoly, and a new entrant threatens to take away market share. Logic, experience with tens of thousands of managers, and research by Samuelson and Zeckhauser (1998) suggest that the status quo is an extremely common reference point. In the case of generic entry, the branded firm owns the market prior to the generic entry, and any resolution that allows generic entry is likely to be framed as a loss against the status quo. Thus, the literature on framing would predict that Schering is likely to act in a risk-seeking manner. Coupling the prescription toward risk neutrality with the psychological tendency for risk seeking

behavior in the domain of losses, I view it as extremely unlikely that the branded firm would be risk averse in the current case.

Dated: January 14, 2002

References

- Bazerman, M. H. 2002. Judgment in managerial decision making. New York: John Wiley & Sons, Inc., 5th edition.
- Bazerman, M.H., Magliozzi, T., & Neale, M.A. 1985. Integrative Bargaining in a Competitive Market, *Organization Behavior and Human Performance*, 34, 294-313.
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- Kahneman, D., & Tversky, A. 1979. Prospect Theory: An analysis of decision under risk. *Econometrica*, 47, 263-291.
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- Olekalns, M. 1997. Situational cues as moderators of the frame-outcome relationship. *British Journal of Social Psychology*, 36, 191-209.
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- Tversky, A., & Kahneman, D. 1981. The framing of decisions and the rationality of choice. *Science*, 211, 453-458.

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Docket No. 9297
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**RESPONDENTS' MEMORANDUM IN SUPPORT TO THEIR MOTION TO
STRIKE THE SUPPLEMENTAL EXPERT REPORT OF PROFESSOR MAX H.
BAZERMAN, AND ANY RELATED TESTIMONY**

The scheduling order in this case required complaint counsel to submit rebuttal expert reports on November 15, 2001. One such rebuttal report was filed by Professor Max Bazerman, complaint counsel's expert on negotiations. That report was filed timely.

On January 14, 2002, two months late and the week before trial is to begin, complaint counsel submitted an entirely new, additional report from Professor Max Bazerman. The new report is on the subject of risk aversion, a topic that was not the subject of any opinions by Professor Bazerman in his original report. The new report expresses opinions on the subject of risk aversion that differ markedly from the economic literature on that subject. The scheduling order in this case does not allow for such untimely expert reports under any circumstances. Nonetheless, complaint counsel did not seek the permission of this Court to submit its new report, or even seek the consent of Respondents. And it is too late for Respondents to depose Professor Bazerman on his new report, and too late for Respondents to provide experts of their own to refute it.

Complaint counsel provides no reason for this untimely report. This Court should strike complaint counsel's new expert report.

Professor Bazerman admitted that his first, timely, expert report did not contain even a *hint* of the new opinions he discloses in his new expert report. In fact, after offering a limited, vague discussion of this new opinion at his deposition,¹ Professor Bazerman admitted that this new thought occurred to him only recently:

Q. That's an interesting observation. Did you think about putting that in your report?

A. I didn't at the time, but as I read more and more, that's a thought that's come up.

Bazerman Tr. at 180.

Respondents have had no opportunity to respond to, or question Professor Bazerman about, his new "thought." This new thought was not in his report, and was raised by Professor Bazerman at his deposition out of the blue, unprompted by any question by respondents.² And respondents could not adequately respond to, or cross-examine Professor Bazerman about, his new thought because they had no advance notice of it.

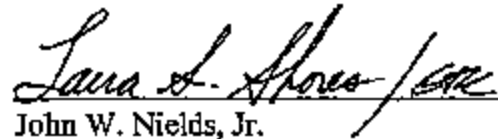
Complaint counsel has no right to proffer Professor Bazerman's new "thought" at this time, when respondents have not had an opportunity to cross examine him on this point or otherwise respond to it. Doing so would prejudice respondents, and should not be allowed. *See, e.g., Transclean Corp. v. Bridgewood Services, Inc.*, 101 F. Supp. 2d 788, 796 (D. Minn. 2001) (striking untimely expert report because inability to depose expert prejudicial); *In the Matter of Kellogg Co.*, 1978 FTC LEXIS 462, at *4 (March 29,

¹ Professor Bazerman's deposition was on December 18, 2001. Thus, even that limited mention of his new opinion was over a month too late.

² Respondents asked Professor Bazerman why, according to his report, he "carefully read" the report of complaint counsel's proposed expert Nelson Levy, but only "read" the reports of respondents' economic experts. Bazerman Tr. at 176. Professor Bazerman answered that question. After a series of different questions concerning Dr. Levy, Professor Bazerman offered his new opinion, explaining that he was going back to the earlier question about his review of respondents' economic expert reports. *Id.* at 178.

1978) (striking untimely requests for admissions because would interfere with trial preparations). Accordingly, respondents respectfully request that this Court strike Professor Bazerman's untimely expert report, and preclude him from offering any related testimony at trial.

Respectfully submitted,



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Dated: January 23, 2002

Attorneys for Respondent
Schering-Plough Corporation

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**ORDER GRANTING RESPONDENTS' MOTION TO STRIKE THE SUPPLEMENTAL
EXPERT REPORT OF PROFESSOR MAX H. BAZERMAN, AND RELATED
TESTIMONY**

IT IS HEREBY ORDERED that Respondents' Motion to Strike the Supplemental Expert Report of Professor Max H. Bazerman, And Related Testimony, is hereby GRANTED.

D. Michael Chappell
Administrative Law Judge

Date: _____, 2002